

Effects of formal institutions on the performance of the tourism sector in the Philippines: The mediating role of entrepreneurial orientation

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HIGHLIGHTS

- ▶ The nature of Philippine formal institutions affects the entrepreneurial orientation of the Philippine tourism industry.
- ▶ Entrepreneurial orientation improves the performance of the tourism sector.
- ▶ Entrepreneurial orientation mediates the effects of institutions on firm performance.

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ABSTRACT

Although formal institutions and entrepreneurial orientation have both been found to contribute separately and positively to firm performance, the interplay between the two factors has not received much attention. This study draws from institutional theory and the entrepreneurship literature to argue that entrepreneurial orientation (EO) provides the mechanism through which the formal institutional environment influences the performance of firms in the tourism sector. Using structural equation modelling and data from a large-scale survey of firms in the tourism sector in the Philippines, it is shown that elements of the institutional environment, by themselves, only have limited influence on tourism firms' performance. EO is shown to partially enhance the effects of the institutional environment on firm performance. The strong mediating effect of entrepreneurial orientation on the relationship between the institutional environment and firm performance is a novel finding and highlights the important role of the government in ensuring that the formal institutional environment promotes entrepreneurship which, in turn, enhances the performance of the tourism sector.

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1. Background

The Philippines is one of the largest developing economies in Southeast Asia with a population of 103 million people (NSCB, 2012) and an annual per capita GDP of US\$4100. The services sector accounts for more than 50% of the country's GDP and the tourism sector contributes approximately 6% to GDP annually (NSCB, 2012). However, high unemployment (7.2% in 2011) and widespread poverty (more than 33% of the population live below the poverty threshold) make the Philippines one of the poorer performing economies of Southeast Asia. The tourism industry's growth lags behind that of Malaysia (10%) and Thailand (12.6%) (NSCB, 2012; WTO, 2011), and the country ranks as only the sixth most-visited country in the region (NSCB, 2012) despite having an

abundance of natural and cultural tourism attractions. The tourism sector creates employment for more than 3.3 million people, providing approximately 12% of the country's total employment (NSCB, 2011).

The information in Fig. 1 shows some salient features of the tourism sector in the Philippines over the 2000–2010 period. It is clear that the contribution of the tourism sector to the country's GDP, export revenues and employment have declined steadily during this period despite an upward trend in tourism arrivals. These trends suggest that the overall performance of firms in the tourism sector in the Philippines has deteriorated over the last decade, and raise several important questions regarding the overall international competitiveness of the sector. Given the significance of the tourism sector to the national economy, the sector has implemented numerous initiatives over the years, including continuous product and service innovation in order to remain competitive. Examples include medical tourism, which has been quite successful in countries such as Thailand, Mauritius, Malaysia and India; and eco-tourism and sports

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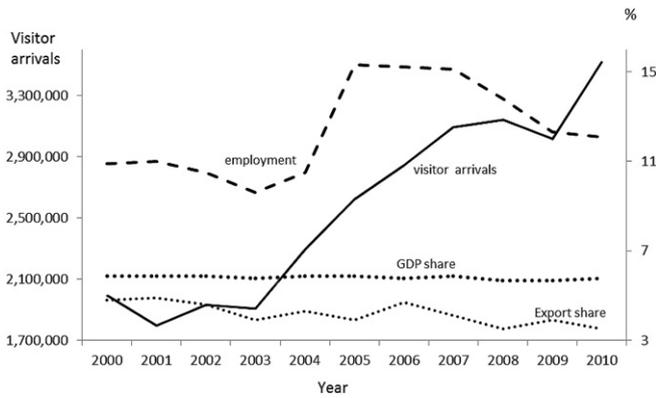


Fig. 1. Economic significance of tourism industry, 2000–2010. Sources: National Statistical Coordination Board, Manila (2011); Department of Tourism, Manila (2011); World Tourism Organization (2011).

tourism which have become integral growth strategies in the tourism sector in a number of countries, including New Zealand and Australia. New products and services not only attract new visitors but can also bring back those who have previously visited the country to experience something new.

The capacity of businesses to engage in innovative, proactive and risky initiatives, termed entrepreneurial orientation (Covin & Slevin, 1989; Lumpkin & Dess, 1996), has been found to have a strong link to the domestic institutional environment within which firms operate. The domestic institutional environment comprises a host of socio-economic and political factors as embodied in institutions. Institutions can be formal such as laws, government policies, legal or judicial systems and regulatory regimes, or informal, such as norms of behaviour, unwritten rules and conventions observed by a group of people or society (North, 1992; Peng, 2010). The government can use its monopolistic legislative and regulatory powers to enhance the performance of firms by ensuring that the domestic institutional environment for businesses is conducive to growth (Ahn & York, 2009; Peng, 2010; Peng, Wang, & Jiang, 2008). Thus, an important question which arises in relation to the performance of firms in the tourism sector in the Philippines is the extent to which the domestic environment, as embodied in formal institutions, is conducive to entrepreneurship and growth.

A limited amount of evidence has emerged in recent years which links the performance of the tourism sector in the Philippines to the state of the country's formal institutional environment. For example, Rodolfo (2009) has argued that some elements of the formal institutional environment in the Philippines undermine the ability of firms to attract domestic and international visitors. Similarly, Henderson (2011) points out that a combination of political instability, insurgency, civil unrest, corruption, red tape, inadequate government planning and program implementation, and underdeveloped tourism-related infrastructure, undermine the international competitiveness of the tourism sector in the Philippines. Further, it is also well-known that the absence of the rule of law in several parts of the country is a deterrent for travellers to those regions. Examples include the fragile peace and order situation associated with the rebel movement in the North, the separatist movement in the South, and political instability in the Central region of the country, which are all believed to hamper the development of the tourism sector in those regions. Reports of a number of international organisations such as the Global Competitiveness Report (IMD, 2011), Corruption Perception Index (Transparency International, 2010), Doing Business Report (World Bank, 2012), and Human Development Index (UNDP, 2010) have also noted the weaknesses of the formal institutional environment

in the Philippines. In particular, corruption, inefficient government bureaucracy, poor infrastructure, and regressive economic policies have been identified as impediments to economic growth and development. Despite such evidence, no empirical research exists to date on the extent to which the formal institutional environment influences the performance of firms in the tourism sector.

Traditionally, the performance of the tourism sector has been linked to natural endowments, tourism infrastructure (e.g., roads and ports), amenities, crime and safety, accessibility to transport, and marketing campaigns (Henderson, 2011; NSCB, 2011; Rodolfo, 2009). However, in recent years, it has become apparent that entrepreneurship and innovation have become critical elements of success in an increasingly competitive global tourism industry. A particular destination becomes a popular tourist destination because of the unique experiences offered by tourism entrepreneurs through the design of new tourism products (such as bungy jumping, wine tours, the V8 super car rally), and services (such as medical and health services, hosting of conventions), as opposed to traditional products such as sightseeing tours (Henderson, 2011; Wilks, Pendergast, & Leggat, 2005). What remains unclear is how firms in the tourism sector develop their entrepreneurial orientations (EO) and capabilities given the institutional voids that often exist in many developing countries (Avci, Madanoglu, & Okumus, 2011; Kraus, 2011; Peng et al., 2008). Research about entrepreneurship and entrepreneurial orientation of firms in the service and tourism industries, and the impact of elements of the wider institutional environment on the ability of firms to engage in entrepreneurship, remains under-developed (Hjalager, 2010; Kraus, 2011; Stokes, 2008; Thomas, Shaw, & Page, 2011). Significant research questions remain about the influence of EO on firm performance in the context of the tourism industry in a developing economy like the Philippines (Avci et al., 2011; Camison & Monfort-Mir, 2011; Hjalager, 2010; Kraus, 2011; Tajeddini, 2010; Thomas et al., 2011) where institutions are either under-developed or do not exist at all (Peng et al., 2008; Wu & Leung, 2005). Although a rich body of literature exists on how institutions affect business performance, there is a paucity of research in tourism about the effects of various elements of the formal institutional environment on the entrepreneurial orientation and behaviour of firms, particularly in developing economies (Kraus, 2011; Stokes, 2008).

The central contention of this research is that EO plays a critical role in explaining the effects of the formal institutional environment on firm performance. A particular gap in the literature relates to the interplay between institutions and EO, and the resulting effects on the performance of tourism firms in developing countries, where formal institutions are either under-developed or do not exist at all. This paper uses the tourism sector in the Philippines as a case study because the country's institutional environment remains fragile and highly unstable relative to other countries in the Southeast Asian region (Camison & Monfort-Mir, 2011; Hjalager, 2010). A volatile and weak political regime, corruption, insurgency, and bloated government bureaucracy marred by red tape and inefficiency, continue to undermine the country's industrial growth and cause severe fractures to the country's socio-economic development. Thus, the Philippines provides an ideal context to investigate the impacts of formal institutions on the performance of firms in the tourism sector.

The main aim of this study is to investigate the direct and indirect effects of different types of formal institutions on the performance of firms in the tourism sector in the Philippines. Four types of formal institutions are considered, including the rule of law, regulatory quality, government policies, and business support. The study posits that tourism firms are more likely to be entrepreneurial when the formal institutional environment is perceived to be supportive and conducive to growth (H1), and that EO

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