



Contents lists available at ScienceDirect

Journal of Business Venturing



## Exploration and exploitation in established small and medium-sized enterprises: The effect of CEOs' regulatory focus<sup>☆</sup>

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### ARTICLE INFO

#### Article history:

Received 13 March 2013  
Received in revised form 5 September 2014  
Accepted 22 September 2014  
Available online xxx

#### Keywords:

Regulatory focus  
SMEs  
Organizational ambidexterity  
Exploration  
Exploitation

### ABSTRACT

Based on theory of regulatory focus and organizational ambidexterity, we hypothesize that the level of engagement in exploration and exploitation in a small or medium-sized enterprise (SME) is affected by the respective CEO's chronic regulatory focus. In our analysis of survey responses from CEOs in Switzerland, we find that the CEO's level of promotion focus positively affects the firm's engagement in both, exploration and exploitation, while the CEO's prevention focus is negatively associated with the firm's exploration but not significantly related to its exploitation. The positive associations between a CEO's promotion focus and the firm's exploration/exploitation activities are enhanced under conditions of intense competition.

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### 1. Executive summary

Established businesses often excel in harvesting existing opportunities (exploitation). For instance, they improve the reliability of production processes, reduce material cost, or optimize the firm's internal routines. However, anecdotal evidence as well as scholarly studies have consistently shown that such exploitation is a required yet insufficient condition for long-term business success. In order to prevail across time, firms also need to be entrepreneurial and search for new business opportunities (exploration). Pursuing both sets of activities—exploitation and exploration—has been found to be challenging for firms, in particular for small- and medium-sized businesses (SMEs).

In this paper, we argue that the CEO's personality, in particular his/her (chronic) regulatory focus, affects whether the firm invests in exploration and/or exploitation, and analyze how those relationships are moderated by an important environmental determinant, namely competitive intensity. Regulatory focus is a quite stable disposition of individuals that develops in early childhood and that determines which types of goals an individual follows as well as how s/he tries to attain those goals. More specifically, regulatory focus consists of two independent dimensions: (1) promotion focus, which is associated with an individual's focus on gains and

<sup>☆</sup> We acknowledge helpful comments of Suresh Kotha and three anonymous reviewers. We thank Miriam Bird, Maw Der Foo, Melanie Ganter, Michael Gasda, Denis Grégoire, Andreas König, Pankaj Patel, Thilo Pfrang, Philipp Rauschnabel, Philipp Sieger, Marc van Essen, Thomas Zellweger, as well as participants of the Academy of Management Meeting 2013 in Orlando for their helpful comments on earlier versions of the manuscript. Moreover, we thank Mateja Andric and Franz Tschimben for research assistance and Tina Pedersen for editing support.

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advancements as well as the desire to maximize the number of achieved “hits,” and (2) prevention focus, which is associated with an individual's desire to avoid failure and to minimize the number of “losses.”

We theorize that a high level of promotion focus motivates CEOs to increase the respective firm's level of both, exploration and exploitation (H1a and H1b). The underlying rationale is that such CEOs require a steady stream of (small and large) accomplishments in order to avoid negative emotions. Moreover, we argue that a high level of prevention focus motivates CEOs to decrease efforts in exploration and to increase efforts in exploitation (H2a and H2b) as such CEOs aim to invest only in activities that fulfill their needs of safety. While exploitative efforts such as quality-enhancing activities serve to fulfill such needs, exploration is likely seen to conflict with such desires. Previous studies have drawn attention to the interplay of regulatory focus with the context and situational stimuli; thus we argue that competitive intensity strengthens the positive relations between promotion focus and exploration (H3a) as well as exploitation (H3b). Further, we hypothesize that the negative relationship between prevention focus and exploration is weakened (H4a) and that the positive relationship between prevention focus and exploitation is strengthened (H4b) under competitive intensity.

We test the hypotheses based on 153 survey responses of CEOs of Swiss SMEs collected in 2012. We find support for our hypotheses H1a, H1b, H2a, H3a, H3b, and tentative support for hypothesis H4b. Hypotheses H2b and H4a were rejected. Several robustness tests were conducted to increase the reliability of the analyses. Based on a recent typology of individuals with high/low promotion/prevention focus, we further empirically investigated the exploration and exploitation activities of “achievers,” “rationalists,” “conservatives,” and “indifferents.”

This paper intends to make three contributions to research, especially with regard to entrepreneurial firm behavior: First, the study contributes to entrepreneurship literature by revealing the CEO's promotion and prevention focus as important determinants of entrepreneurial activities in established firms. Second, the study advances research on organizational ambidexterity by drawing attention to CEO personality, in particular regulatory focus, as important yet so far neglected antecedent of organizational ambidexterity. Third, this study also contributes to research on regulatory focus by empirically studying different combinations of high/low promotion and prevention focus and by investigating the interplay of regulatory focus and competitive intensity.

## 2. Introduction

A major challenge for all established companies is the need to continually explore novel business activities and thereby remain entrepreneurial throughout the organizational life cycle (Bracker and Pearson, 1986; Hornsby et al., 2009; Zahra and Covin, 1995). An abundant body of extant research shows that, over time, incumbent firms tend to focus their attention on exploiting existing products and processes, thereby reducing their entrepreneurial activities, and, ultimately, becoming stagnant (e.g., Koberg et al., 1996; March, 1991; Rosenbusch et al., 2011). However, a critical determinant of long-term success is the firm's ability to pursue opportunities oriented toward the long-term (i.e., engage in exploratory activities) while at the same time harvesting short-term efficiency gains arising from the refinement of existing products and processes (i.e., engaging in exploitative activities) (Choi et al., 2008; Gedajlovic et al., 2012; Lavie et al., 2010).

As exploration and exploitation require different sets of capabilities, engaging in both sets of activities is generally challenging for firms (Lavie et al., 2010), especially for resource-constrained small and medium-sized enterprises (SMEs) (Rothaermel and Alexandre, 2009; Voss and Voss, 2013). Thus, scholars have recently identified several environment-, firm-, and top management team-level drivers of firms' concurrent engagement in exploration and exploitation (e.g., Gedajlovic et al., 2012; Hill and Birkinshaw, in press; Lavie et al., 2010). Despite these advancements, determinants that relate to the personality of the CEO are still poorly understood (Gibson and Birkinshaw, 2004; Raisch et al., 2009; Smith and Tushman, 2005). This is surprising in light of the strong influence of the CEO's personality on firm behavior in general (e.g., Hambrick and Mason, 1984; Nadkarni and Herrmann, 2010) and on innovation in particular (Gerstner et al., 2013). Given the authority structures and low levels of hierarchies common in SMEs, the influence of CEOs in SMEs is even stronger (Bierly and Daly, 2007; Man et al., 2002) than in larger organizations.

In this paper, we focus on one important yet understudied facet of the CEO's personality—his or her chronic regulatory focus (Brockner and Higgins, 2001). Chronic regulatory focus refers to an individual's motivational sets that determine his or her goals as well as how that person aims to accomplish those goals (Stam et al., 2010). As “one of the most comprehensive motivation theories” (Kark and Van Dijk, 2007: 503), regulatory focus theory has been applied to study various entrepreneurial phenomena (Brockner et al., 2004; Burmeister-Lamp et al., 2012; Wu et al., 2008), such as venture creation (McMullen and Shepherd, 2002), entrepreneurial opportunity recognition and decision making (Crowe and Higgins, 1997; Tumasjan and Braun, 2012), as well as venture and SME performance (Hmieleski and Baron, 2008; Wallace et al., 2010). Chronic regulatory focus, which refers to a relatively stable personality trait (Higgins, 1997; Higgins et al., 2001; Strauman, 1996),<sup>2</sup> is well suited for explaining decision making and actions among CEOs (Das and Kumar, 2011; Worthy et al., 2007), as individuals are inclined to “direct their attention toward issues consistent with their regulatory preferences” (Chiaburu, 2010: 462). More specifically, a CEO's chronic regulatory focus orientation affects his/her attention to specific issues, his/her preferred strategies for achieving goals, and his/her resource-allocation patterns (Wallace et al., 2010). As such, it is likely to also affect the firm's exploration and exploitation activities. This influence of chronic regulatory focus depends on the environmental context (Lanaj et al., 2012) since the environment, in particular the competition in the firm's market,

<sup>2</sup> Besides the chronic element of regulatory focus, there is also a more malleable, situational element of regulatory focus that can, for instance, be affected by framings of task specifics (van Dijk and Kluger, 2011), by leadership style of supervisors, or by work climate (Wallace et al., 2009)—elements, which are often manipulated in laboratory settings. Following previous entrepreneurship research (e.g., Bryant, 2009), the focus of this paper is on the more stable, chronic regulatory focus.

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