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Linking entrepreneurial orientation to firm performance: the role of differentiation strategy and innovation performance

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Abstract

In the strategy literature, the effect of entrepreneurial orientation (EO) on firm performance has been investigated in many studies. The latest researches investigate the relationship between them by considering the effects of third variables which can be internal and external factors. Within this framework, our study focuses on the mediating role of innovation performance and differentiation strategy on the relationship between entrepreneurial orientation and firm performance. The survey of this study is conducted on 991 middle and senior managers of 331 middle and large scale firms operating in manufacturing industry in Turkey, in 2014. The data gathered from questionnaires are analyzed with SPSS statistical package program at firm level. The results of analyses showed that both differentiation strategy and innovation performance mediate the relationship between EO and firm performance. Also, analyses results revealed another mediating effect in which differentiation strategy mediates the relationship between EO and innovation performance.

Keywords: Entrepreneurial orientation, Differentiation strategy, Innovation performance, Firm performance

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1. Introduction

In the strategy literature many researchers (eg: Miller, 1983; Lumpkin and Dess, 2001; Zahra and Covin, 1995; Wiklund and Shephard, 2005) have studied the importance of EO on firm performance. Entrepreneurial orientation is a firm level concept and it is closely related to strategic management and strategic decision making processes (Covin and Slevin, 1991; Lumpkin and Dess, 1996; Birkinshaw, 1997). Globalization, global competition, focusing on firm performance for profitability, and inadequacy of traditional managerial techniques due to the changing market conditions can be the reasons for the increase in the importance of corporate entrepreneurship (Morris and Kuratko, 2002).

The concept of “entrepreneur” goes back to 1755 and Cantillon (Hamilton and Harper, 1994). Cantillon defined entrepreneurs as risk takers and they buy at certain prices today and sell at uncertain prices in the future. In the 19th and early 20th centuries entrepreneurs were generally considered in an economic perspective. According to Schumpeter ([1942] 1994, p.132) “The function of the entrepreneur is to reform or revolutionize the pattern of production by exploiting an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry and so on.” According to Lumpkin and Dess (1996), the concept of

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entrepreneurship is mainly related to “new entry” and it is applicable to different levels such as individuals, groups and organizations. With the development of the strategic management literature, a new concept “entrepreneurial orientation” (EO) is emerged. They define EO at firm level, as the reflection of strategic orientation of a firm by affecting processes, practices, and decision-making activities that lead to new entry. Thus, new entry describes what entrepreneurship consists of and EO describes how new entry is carried out (Lumpkin and Dess, 1996).

Today, due to the globalization all sectors, companies, institutions and people are facing intense global competition. Under this pressure, for businesses it is being more difficult to exceed their rivals and outperform. In order to perform better than rivals firms should gain competitive advantage which is one of the most important subjects of management area. Porter has created two basic competitive advantages: low cost and differentiation. Cost leadership is related to producing products and services with lower costs than competitors and reaching a broader customer segment. Differentiation strategy is related to being unique in the market with the unique or different products and services companies offer (Porter, 1980, 1985). According to Barney (1991), in order to have a competitive advantage a firm needs to implement a value creating strategy that is not simultaneously implemented by any other potential competitors. Eisenhardt and Martin (2000) classified cost leadership strategy as temporary and long term sustainability of performance is not possible. Also, Murray (1988) stated that in the cost advantage strategy imitation is inevitable. On the other hand, differentiation strategy creates more sustainable competitive advantage with the unique products and services offered into the market and imitation is very difficult or very costly. (Grant, 1991; Carter and Ruefli, 2006). Also the recent study of Banker, Mashruwala and Tripathy (2014) showed that differentiation strategy creates sustainable higher financial performance in the long run. On the other hand another important subject is innovation or innovativeness which is one of the most important dimensions of EO, critical for differentiation strategy and again crucial for higher performance (e.g. Porter, 1990; Miller, 1983; Hull and Rothenberg, 2008). In the literature, some studies showed that there are relationships between EO, innovation and differentiation strategy (e.g. Prajogo et al., 2007). In this study we will exclude cost leadership strategy because of the higher sustainability of differentiation strategy and higher relationships with other variables (EO, innovation performance and financial performance) we investigate in this study.

In this study we investigate the relationships between EO, differentiation strategy, innovation performance and financial performance. More precisely, we want to analyze the role of differentiation strategy and innovation performance within the EO-financial performance relationship. Our expectation is that differentiation strategy and innovation performance will play a mediating role in the EO-financial performance relationship. In the rest of the paper we give literature review about our variables, we create our hypotheses, draw our research model and methodology, give empirical results from our analysis and present our conclusions.

2. Literature Review And Hypotheses

2.1. Entrepreneurial Orientation

Entrepreneurial orientation is defined as an organizational willingness to find and accept new opportunities and taking responsibility to affect change (Morris et al., 1996). According to Rauch and Frese (2009), EO describes firm level strategic processes that businesses use to gain competitive advantage. Thus, EO is not related to individual level variables as in the previous entrepreneurship theories, it is related to firm level processes (Rauch and Frese, 2009). Especially newly established firms should be very careful in pursuing strategic orientations because they have limited financial and managerial resources (Eisenhardt and Schoonhoven, 1990).

When the importance of EO on firm performance is considered, the EO can be a good measure to explore opportunities in the market and to utilize from them (Barringer and Bluedorn, 1999; Zahra and Garvis, 2000; Ireland et al. 2003). If a firm offers new products and services above averages and enter new markets it can be said that this firm is an entrepreneurial firm (Jennings ve Lumpkin, 1989). According to Lumpkin and Dess (1996), EO consists of independent variables and in the recent researches it is studied as a multidimensional concept (Lumpkin and Dess, 1996; Kreiser et al., 2002; Rauch et al., 2009). Miller (1983) defined entrepreneurial orientation in three dimensions: innovativeness, risk taking and proactiveness. Then Lumpkin and Dess, (1996) added aggressive competitiveness and autonomy to Miller’s 3 dimensions. In this study, depending on different models of corporate entrepreneurship we use