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RESEARCH ARTICLE

Why does entrepreneurial orientation affect company performance?

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Entrepreneurial Orientation (EO)

EO Dimensions	Definition
Innovativeness	Willingness to innovate, to introduce novelties through creativity and experiments focused on the development of new products and services, as well as new processes.
Proactivity	Seeking opportunities, advancing by introducing new products and services and to act anticipating future demands to create change and shape the environment
Risk-taking	Tendency to act boldly. Venturing into new and unfamiliar markets, relying on a large portion of resources to risk with uncertain results, get loans heavily.

Source: Adapted from Miller (1983).

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Entrepreneurial Orientation (EO)

Amongst the most validated and widely used constructs in the strategic entrepreneurship literature.

Most studies find that EO positively contributes to performance (e.g., Saeed et al., 2014; Rauch et al., 2009).

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Research Gap

- Surprisingly little is known about how the dimensions of EO combine and interact with each other in determining performance.

- Wales et al. (2013, p.375) highlight this as an area for future research, stating "…researchers could examine the relationships between the EO dimensions to explore whether some dimensions influence others when investigating EO as a multidimensional phenomenon."

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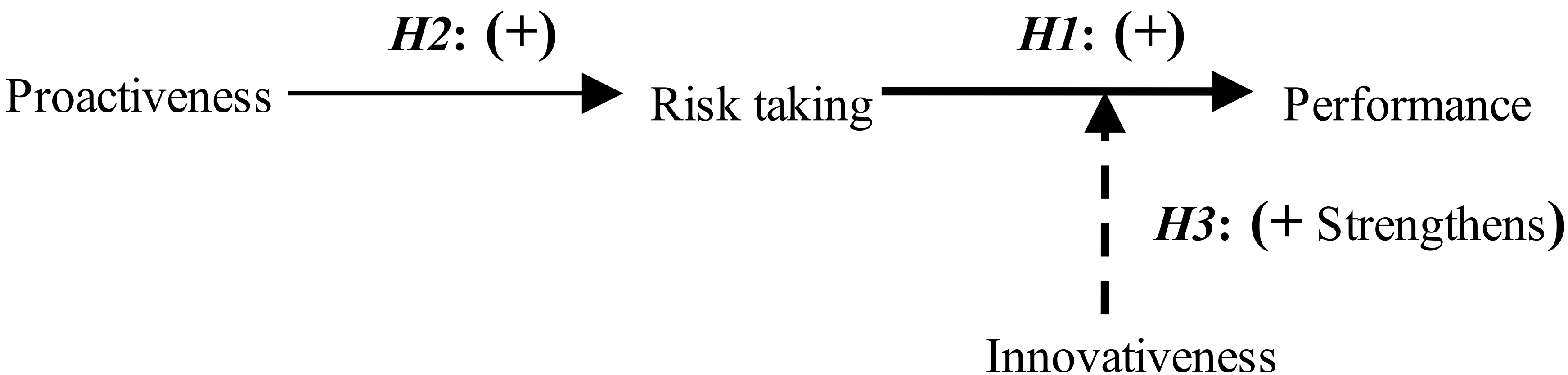
Contribution: new conceptual model



Key findings

We show that constructive risk taking is the central driver of company performance, mirroring the principle of risk and return in financial investment settings.

Risk taking that is associated with innovation has a particularly strong positive relationship with performance, consistent with innovation being a driver of growth and profitability.

More proactive firms tend to take on more risk and thus also perform better than less proactive firms.

Conceptual framework

- **Risk vs Uncertainty**
- "CAPM" (that builds on Markowitz's portfolio theory) → Subsequent asset pricing theories relax the assumption that the probability distributions of outcomes are known, thereby accounting for both risk and uncertainty/ambiguity.
- These theories are motivated by the observations of Knight (1921) and Keynes (1921) that uncertainty better characterizes situations of economic decision making including decisions of entrepreneurs and investors.
- The asset pricing theories in financial economics are not only widely used in academia but also within companies to mak investment decisions.

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Conceptual framework

- **Not all types of risk taking are expected to increase performance.** This is the case in financial economics theories of asset pricing such as the CAPM (Sharpe, 1964; Lintner, 1965), and it is also likely to be the case in corporate decision making and entrepreneurship.
  - There are many risks that a company could take that are not expected to increase performance.
  - We refer to the two types of risks **as *non-constructive* and *constructive* risks**, respectively. The defining feature of constructive risks is that they are expected to increase performance on average.

Indirect effects of innovativeness, proactiveness, and risk taking on performance

- **The risks associated with innovative strategies are likely to be constructive.**
  - Innovativeness involves creating new products and/or technological leadership (Covin and Slevin, 1991), which requires large upfront expenditure on R&D (Hornsby et al., 2009; Rosenbusch et al., 2011).
  - This strategy involves risk because R&D expenditure increases the chance of not being able to meet short-term financial obligations and new products/technologies can fail to bring in revenue despite the costs of development having already been incurred.
  - Innovation is considered by many entrepreneurship scholars as an important factor in driving growth and creating products or services with high profit potential (Cho and Pucik, 2005; Wiklund et al., 2009) and thus it is not surprising that several studies find a positive link between innovativeness and performance (Terziovski, 2010; Rosenbusch et al., 2011).

Implications

- First, our conceptualization implies that **any aspect of orientation/strategy that is related to performance obtains this association with performance via its relationship with risk taking.**
  - While we find empirical support for this notion within the dimensions of EO, many other aspects of orientation/strategy could be used to examine the generality of this notion.
- Second, our empirical results imply that **innovativeness positively influences the *type* of risks taken on by entrepreneurs, whereas proactiveness tends to influence the *level* of risk taking.**
  - It would be valuable to further explore how this tendency comes about, for example, do innovative firms deliberately take actions to offset the risks in being innovative?

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Implications

- Third, **there is considerable scope to increase understanding of the types of risk that are and are not associated with increasing performance**, i.e., characterize what constitutes constructive and non-constructive ("hazardous") risk taking.
  - Our results suggest innovativeness is one of the factors associated with constructive risk taking. This line of research might look for other factors that moderate the relationship between risk taking and performance, or might explore the concept of systematic versus idiosyncratic risk in the entrepreneurship context.
- Fourth, it would be useful to examine if/how our conceptualization of how the components of EO combine to drive performance depends on contextual factors, in particular the degree of competition and the degree of information about opportunities.

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