

**NETWORKING, THE MISSING LINK IN FIRM BASED
ENTREPRENEURIAL ORIENTATION (EO) PERFORMANCE
MODELS**

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Abstract

This paper examines the challenges of utilising Covin and Slevin's (1991) entrepreneurial postures of *risk taking*, *proactiveness* and *innovation* in terms of enhancing firm performance. The need for a configuration model that incorporates both internal and external environmental factors is outlined. A new model for Entrepreneurial Orientation (EO) which incorporates networking as a means to facilitate the link between EO and the firm's environment to enhance performance is proposed. The construct of networking is defined as incorporating the variables of *communication*, *trust* and *environmental scanning*.

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INTRODUCTION

The Need for Entrepreneurship

According to Morris and Kuratko (2002) entrepreneurship represents a unifying framework to cope with the immense transformation organisations require to deal with competitive, changing environments. Therefore it is essential that organisations understand the systems and processes that facilitate entrepreneurial behaviour (Knight 1997; Hitt et al 1999). In fact, even if these were not turbulent, fast-changing times, it appears entrepreneurship would still be important to organisations seeking to survive (Lyon, Lumpkin & Dess 2000) let alone thrive and gain a competitive advantage.

Entrepreneurial Opportunities

Entrepreneurship is situational dependent in that you must first have entrepreneurial opportunities. Entrepreneurial opportunities are those situations in which new goods, services, raw materials, and organising methods can be introduced and sold at greater than their cost of production (Casson 1982). According to Schumpeter (1934) there are three different categories of opportunities: (1) the creation of new information, as occurs with the invention of new technologies; (2) the exploitation of market inefficiencies that result from information asymmetry, as occurs across time and geography; and (3) the reaction to shifts in the relative costs and benefits of alternative uses of resources, as occurs with political, regulatory, or demographic changes.

It is clear that at any point in time only a subset of the population will discover a given opportunity (Kirzner 1973). The reason why some people and not others discover particular entrepreneurial opportunities appears due to two things: (1) the possession of the prior *environmental information* necessary to identify an opportunity, and (2) the *cognitive skills* necessary to value it (Shane & Venkataraman 2000). Human beings whether within an organisation or not, all possess different stocks of *environmental information*, and these stocks of information influence their ability to recognise opportunities (Shane & Venkataraman 2000). The source of information that enables opportunities to be recognised comes from the environment. To recognise an opportunity an entrepreneur has to have prior information that is complementary with new information, which triggers an entrepreneurial conjecture (Kaish & Gilad 1991). The information necessary to recognise any opportunity is not widely distributed across the population because people specialise in certain information due to their workplace requirements or interests (Becker & Murphy 1992). As a result, no two people share all the same information at the same time. Therefore information providing entrepreneurial opportunities is distributed according to idiosyncratic life circumstances (Venkataraman 1997).

In order to discover an entrepreneurial opportunity in the environment, people must have the *cognitive skills* necessary to identify new means-ends relationships that are generated by a given change (Shane & Venkataraman 2000). Even with the right information, individuals might not recognise new means-end relationships, as visualising these relationships is difficult. Rosenberg (1994) points out that history is rife with examples in which investors failed to see commercial opportunities. Successful entrepreneurs see opportunities in situations in which other people tend to see risks, and they act to ensure the opportunity is not lost whilst others suffer from inaction inertia (Baron 2000).

The decision on whether to act on an entrepreneurial opportunity appears to be a function of the joint characteristics of the opportunity and the nature of the individual (Venkataraman 1997). Evans and Leighton (1989) showed that exploitation of opportunities is more common when people have greater financial capital, strong social ties to the resource providers (Aldrich & Zimmer 1986)

and have useful information on opportunities developed from their employment background (Cooper, Woo & Dunkelberg 1989). Cooper et al (1989) found transferability of information from prior experience to the opportunity, as well as entrepreneurial experience (Carroll & Mosakowski 1987) increases the probability of exploitation of entrepreneurial opportunity because learning reduces its cost.

THE CURRENT RESEARCH PROBLEM

For a firm to take advantage of an entrepreneurial opportunity it needs to:

1. Operate in a changing environment that provides opportunities
2. Be entrepreneurially orientated – i.e. looking for opportunities to gain a sustainable competitive advantage and improve firm performance
3. Have in place a process to identify and exploit opportunities (research problem)

The influence of internal and external environmental factors on EO and firm performance has been shown using both contingency models (e.g. Dess, Lumpkin & Covin 1997; Zahra 1993) and configurational models (e.g. Wiklund & Shepherd 2005). Yet the process linking EO to both its internal and external environments to exploit opportunities to enhance performance is not well understood. One potential process that may provide this missing link is networking.

This paper examines the effect networking may have on firms identifying and exploiting opportunities, which might lead to improved performance. This process is explored through an investigation of the relationships among EO dimensions, factors in the firms' internal and external environments, the networking construct and firm performance. The main outcome expected from this investigation is the development of a more comprehensive EO model.

DEVELOPING A NEW EO – FIRM PERFORMANCE MODEL

Step One: Defining EO

According to Miller (1983:770): “what is most important is not who is the critical actor, but the *process* of entrepreneurship and the organizational factors which foster and impede it”. This concept of considering entrepreneurship at the firm level is the starting point for this study. Miller (1983:780) noted “entrepreneurship is a multidimensional concept comprising three dimensions: *innovation, proactiveness, and risk taking*”. These dimensions were further defined by Covin and Slevin (1991) and now form the basis of many EO studies.

Innovation

Covin and Miles (1999) suggested that entrepreneurship would not exist without innovation. They defined innovation as the firm's tendency to support new ideas, experimentation and creative processes earlier than competitors. Peters (1990) said that innovation requires creativity, and an obsession to see it through. Neely and Hii (1998) considered research and development (R&D) an important source of innovation. These authors said R&D included the ability of the firm to improve existing products, develop new products, and develop new production methods or equipment and product quality.

A number of authors have linked innovation to business performance. Bradmore (1996) said that innovation enhances business performance through the successful implementation of new ideas. Neely and Hii (1998) suggested two views on how innovation affects business performance. The first view stated that the production of new products or processes strengthens a firm's competitive position in relation to its rivals. The second view argued that the process of innovation transforms

a firm fundamentally by enhancing its internal capabilities, making it more flexible and adaptable to market pressures than non-innovating firms.

Proactiveness

Venkatraman (1989) claimed proactiveness was an important ingredient of entrepreneurship. This author defined proactiveness as seeking new opportunities, which may or may not be related to the present line of operations. Venkatraman also suggested firms can be proactive by: shaping the environment; introducing new products and brands ahead of competition; strategically eliminating operations which are in the mature or declining stages of product life cycle; participating in emerging markets; and by anticipating and pursuing new opportunities.

A number of authors have identified another component of proactiveness, which they describe as the intensity of a firm's efforts to outperform industry rivals and taking them head on at every opportunity. This has been defined as competitive aggressiveness. It is characterised by a strong offensive posture, which is directed at overcoming competitors (Lumpkin & Dess 1997). These authors define proactiveness as "a response to opportunities whereas competitive aggressiveness is a response to threats". Venkatraman (1989) suggested that competitive aggressiveness is accomplished by setting ambitious market share goals and taking bold steps to achieve them, such as cutting prices and sacrificing profitability.

Risk-Taking

Lumpkin and Dess (1996) defined risk taking as venturing into the unknown. This is because, in addition to monetary risk, it typically entails psychological and social risk (Gasse 1982; Lumpkin & Dess 1996). Recent research indicates that entrepreneurs score higher on risk-taking than do non-entrepreneurs (Falbe & Larwood 1995). Entrepreneurs are generally believed to take more risks than non-entrepreneurs do because the entrepreneur faces a less structured and a more uncertain set of possibilities (Bearse 1982). Moreover, Morris (1998) found that entrepreneurs tended to be moderate or calculated risk-takers. Calculated risk-taking is explained by Morris (1998) as an attempt on the part of the entrepreneur to find ways to mitigate, shift or share risk. The research overall suggests entrepreneurs are calculated risk takers.

Step Two: Defining the Link between EO and Firm Performance

The research to date indicates there is general agreement that EO does influence firm performance (Lyon, Lumpkin & Dess 2000). Typically this research suggests that increasing entrepreneurship is associated positively with company financial performance (e.g. Miller 1983; Zahra 1993). However, there has been some contention as to what the appropriate intensity of entrepreneurial behaviour is and what the implications of entrepreneurial activities, such as risk taking, will have on firm performance (Zahra 1993). Miller and Friesen (1982) have cautioned that increasing entrepreneurship beyond a particular threshold can harm a company's financial performance.

Some empirical research on the relationship between entrepreneurial behaviour (as measured by EO) and firm performance indicates that *contingent* rather than *direct* relationships may provide more accurate explanations of performance outcomes (Lyon, Lumpkin & Dess 2000). For example, Dess, Lumpkin, and Covin (1997) in a study of 32 firms competing in a variety of industries, linked entrepreneurial strategy making processes to firm strategy, the environment and performance. Further, Zahra (1993), using data from 102 companies in six industries, found that entrepreneurship had a positive influence on firm performance in dynamic growth environments, whereas this relationship was largely negative among firms in static and impoverished environments.

Zahra and Covin (1995) and Wiklund (1999) add that many variables could influence performance or moderate the relationship between EO and performance. As more contiguous variables have been tested, so our understanding of the relationship between entrepreneurship and performance has improved. For instance, Ensley et al (2006) linked environmental dynamism with

entrepreneurial leadership and new venture performance; Richard et al (2004) linked cultural diversity in management to EO and firm performance; and Dess, Lumpkin, and Covin (1997) linked strategy making processes to firm strategy, the environment, and performance. Wiklund and Shepherd (2005) go a step further in the debate about what internal and external environmental factors are important *contingencies* in moderating EO and firm performance. These authors identified that EO can assist in achieving high firm performance when the internal and external environmental factors are *configured* so they align appropriately and the firm is part of a growth market.

From the above it can be seen that there is a link between EO and performance. Therefore any new EO-Performance model needs to not only identify important environmental variables that might need careful configuration, but also how the firm can interact with its environment to ensure entrepreneurial opportunities are identified and exploited. Networking appears a proactive process that might assist in this interaction between a firm and its environment.

Step Three: Defining the Networking Construct

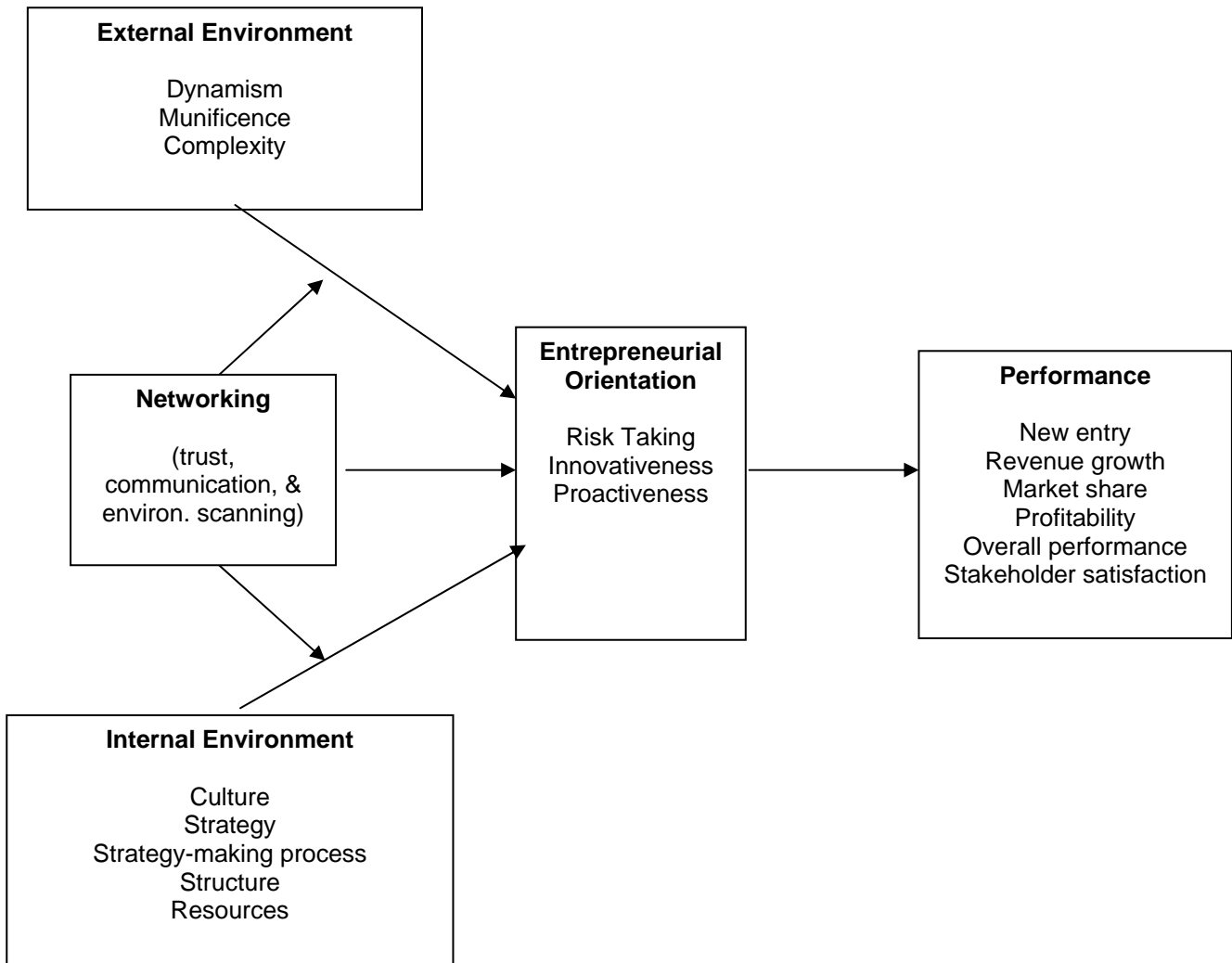
The process of networking has various definitions in the literature. Carson et al (1995) described networking in a small business context as “an activity in which the entrepreneurially orientated SME owners build and manage personal relationships with particular individuals in their surrounding (Carson et al 1995). This description highlights the EO link to networking as an interface with the environment. In general, networking includes the exchange of affect (liking, friendship), information, benefits and influence (Kaplan 1984; Liden & Mitchell 1988). Iacobucci (1996) suggests that entrepreneurial firms might use networking to exploit opportunities and states “the process of networking is a verb to describe the initiation and sustenance of interpersonal connections for the rather Machiavellian purpose of tapping those relationships later for commercial gain” (Iacobucci 1996: 13).

Most of the literature emphasises the positive aspects of networking behaviour and show that interpersonal networking plays an important role in the process of enterprise creation and growth (Aldrich et al 1989; Johannisson & Nilsson 1989; Birley, Cromie, & Myers 1991). In this regard, networking is seen primarily a means of raising required resources and can include: capital raising, identifying market opportunities, obtaining personnel, identifying and developing technology, identifying suppliers, obtaining ideas and ensuring future support for these ideas (Ramachandran & Ramnarayan 1993).

Ramachandran and Ramnarayan, (1993) in a qualitative study looked at 67 cases of small scale entrepreneurs in India found that entrepreneurs networking activities were driven by business considerations and were aimed at minimising the uncertainty and risk associated with the kinds of businesses that these entrepreneurs take up. They found that pioneering innovative (PI) entrepreneurs resort to greater networking to achieve effective environmental scanning, develop collaborative partnerships with customers and consultants (alliances built on trust and effective communication), and create organisational culture and practices orientated to professionalism. These authors also found that entrepreneurial firms developed distinct identities, focused on organisational capabilities and used networking to enhance their leadership position within their industry and community. What this study highlighted was that the nature of networking could be defined as comprising two components, one internal and the other external.

In this paper the authors have extended the work of Ramachandran and Ramnarayan (1993) and show how these internal and external networking behaviours might act as links between entrepreneurial individuals within a firm and their internal and external environments with resultant effect on firm performance. This link is illustrated in the model below and it highlights how networking might have a moderating effect on firm performance.

Figure One: A conceptual EO – Performance model showing the role of networking



This paper focuses on the networking component of the above model. It does not provide a detailed analysis of the components within the internal and external environments of the firm but does highlight how networking might influence these environments in an entrepreneurial firm.

Internal networking

The above model shows how networking as defined by Ramachandran and Ramnarayan (1993) i.e. developing effective trust and communication within the organisation, plus encouraging environmental scanning can influence the firm operational alignment necessary take advantage of external opportunities. In summary the model shows how internal networking links entrepreneurship to a range of components within the organisation. These components are utilised in the proposed model because they have been identified as important, either directly or indirectly, in previous EO-Performance studies: Culture (Burgelman & Sayles 1986; Kanter 1983); strategy (Venkatraman 1989; Woo & Cooper 1981); decision-making process (Dess, Lumpkin & Covin 1997; Miller & Friessen 1982); structure (Jennings & Lumpkin 1989; Slevin & Covin 1990; Naman & Slevin 1993); and resources (Ostgaard & Birley 1994; Ramachandran & Ramnarayan 1993).

External networking

The proposed model shows how the relationships between key decision-makers in a firm and those involved with the supply chain e.g. suppliers, customers, alliance partners plus other potential or existing interested parties (industry associations, family and friends, business

associates, researchers and consultants, competitors, government) and how these relationships are affected by dynamism (amount and speed of change, environmental hostility - Tan & Litschert 1994), munificence (scarcity or abundance of critical resources needed to operate – Castrogiovanni 1991), and complexity (regulations, competition, international, technological – Tan & Litschert 1994). The model shows how networking act as a conduit to influence the interaction between the firm and its external environment and suggests that developing effective trust and communication with external stakeholders, plus utilising environmental scanning can help the firm identify and exploit opportunities.

Summary of the Proposed Components of Networking

Trust

In the proposed new EO – Firm performance model trust is defined as the willingness to rely on an exchange partner in whom one has confidence (Moorman et al 1993). Morgan and Hunt (1994) more specifically define trust as a situation when one party has confidence in an exchange partner's reliability and integrity.

In the proposed model trust is identified as being an important link between the firm's EO and its internal and external environment. Wood, McDermott and Swan (2002) have identified several qualities from the literature associated with the term trust, including integrity, honesty, truthfulness, reliability, dependability, openness, and respect for the other's autonomy and fairness. Mayer et al (1995) advise that for effective inter-organisational relating, trust is an essential component. Kingsley and Malecki (2004) go further explaining that firms will only rely on an information source if there is a level of trust in the relationship. Ring (1997) suggests that trust can be fragile or resilient. This author suggests resilient trust facilitates networks through increasing the predictability of the goodwill of others.

Trust is important both within the firm and external to the firm. Research on trust external to the firm shows it is essential in building information sources (Kingsley & Malecki 2004; Wood, McDermott & Swan 2002). Trust has been shown to lead to collective learning over time (Lorenz 1988), the building of strategic networks (Butler & Hansen 1991) and strategic collaborations (Dodgson 1993). Trust can lead to information being gathered from formal networks such as subcontractors (Lorenz 1988), trade associations (Lane & Bachmann 1996) and suppliers (O'Donnell 2004). However, trust developed via informal networks also appears an important source for gathering information. These networks appear to be more associated with personal friendships (Carson et al 1995) and meetings with recognised experts in their chosen field, potential and valued customers and business friends and colleagues considered to be on the same "wavelength" (O'Donnell 2004).

Internal trust revolves around the relationships within the firm. According to O'Donnell (2004) most owner-managers network extensively with their employees for marketing purposes. This researcher found that most owner-managers, who are extensive and proactive networkers, maintain strong ties with their employees. This type of networker displays the characteristics often defined as entrepreneurial and highlights the importance for the entrepreneurial firm to develop an internal culture of trust.

Communication

For the purpose of the proposed model, communication undertaken by the entrepreneurial firm, whether done internally or externally, is focused on information gathering to identify and exploit opportunities. This definition is in line with that utilised by past researchers looking at the role of networking in firms (Kingsley & Malecki 2004; O'Donnell 2004).

In the proposed new EO- Firm performance model, internal communication is identified as being an important component in helping employees understand the firm's mission and objectives and getting them involved in implementing it. Having employees at all levels support the company's mission, impacts all the business outcomes. It also aids greatly in fostering consistency through

complex organisations (Sinickas 2006). Chernatony, Cottam and Segal-Horn (2006) further identify communication as an increasingly important and changing role in organisations, providing the interface for communicating values between the firm (internal) and its numerous diverse stakeholders (external). In the proposed model the overall the role of communication in an entrepreneurial firm, is about ensuring understanding of external opportunities and making internal changes to take advantage of them, provided they are in line with utilisation of the firm's core competencies (Hamel & Prahalad 1993).

In terms of the importance of different sources for external information, customers are the leading information source, (Glasmeier et al 1998; Karakaya & Kobu 1994) whereas information sources such as competitors and contacts made at local business meetings and social gathering are among the least important external sources of information (Malecki & Veldhoen 1993). Other external sources found to be important in past studies include trade associations and trade shows and impersonal forms of communication via written documents and the internet (Kingsley & Malecki 2004). These authors found that the more active a firm was in cultivating and using informal networks for information, the more likely they were to have both informal and formal patterns of communication with suppliers and customers. Kingsley and Malecki (2004) also highlight the link between communication and trust. They suggest that trust is important to secure information, however they identified it is the effectiveness of communication channels that is as important if not more important than trust. This makes sense as without information no decision can be made in terms of opportunity recognition and exploitation.

Environmental Scanning

In the proposed new EO-Firm performance model, environmental scanning is defined as a process of reviewing both the internal and external environment. When undertaken externally, it is a method for identifying, collecting and translating information about external influences into useful plans and decisions (Albright 2004). It involves defining the organisation's opportunities and threats (Huffman 2004). According to Dess, Lumpkin and Eisner (2007) successful environmental scanning alerts the organisation to critical trends before the changes have developed a discernable pattern and before competitors recognise them otherwise the firm may be forced into a reactive mode rather than being proactive. Thompson, Strickland and Gamble (2007) note that environmental scanning involves studying and interpreting the sweep of social, political, economic, ecological and technological events in an effort to spot budding trends and conditions that could become driving forces. These authors suggest that although environmental scanning is highly qualitative and subjective, it can be useful when undertaken in a systematic way using such analytical approaches as constructing scenarios and answering key questions.

In summary it can be seen that external environmental scanning can be undertaken in a systematic way. It allows the firm to scan for opportunities and threats to construct key scenarios or answer key questions necessary to improve firm performance. To achieve this in an effective manner, an entrepreneurial firm may consider utilising its network including suppliers, customers, industry associations, competitors, alliance partners and other interested parties. In fact, according to Albright (2004) most (useful) external sources of information are not published, rather most managers get much of their information from word-of-mouth through their personal network of contacts.

Internal environmental scanning involves identifying the firm's strengths and weaknesses so that it can maximise organisational responsiveness to take advantage of external opportunities (Albright 2004). This author suggests the firm must develop internal responses that assist in adjusting organisational structure and strategic plans to be more effective and flexible to changing market forces. Thus the successful firm is focused on learning as well as flexibility and responsiveness. Huffman (2004) suggests that firms are often too slow to respond to external events that give rise to opportunities. Huffman further suggests this is because senior managers are usually so invested in the status quo that they cannot deal with the need to change.

Overall it appears that internal environmental scanning should be used to assess how best to align the firm to take advantage of external opportunities. It appears that entrepreneurial orientated firms are well placed to take advantage of external opportunities as they are change orientated (Lumpkin, Dess & Eisner 2007).

In summary, networking appears to provide organisations methods to deal with both internal environmental issues (strengths and weaknesses) and external environmental issues (opportunities and threats). Watkins and Bazerman (2003) recommend that knowledgeable and creative people internal and external to the firm should be brought together to try to construct a plausible set of scenarios for potential surprises that could emerge over the coming years. Though somewhat appealing, this approach does not go far enough as it does not encompass the on-going benefits of networking to provide environmental monitoring and feedback necessary to ensure chosen scenarios can be implemented and modified as and when required.

Step Four: Testing the New EO-Performance Model

The next step will be to test the proposed model to see what enhancement it might provide in terms of explaining the EO-Performance link. To-date the role of EO has been tested against a number of individual variables. However, more comprehensive testing of EO against a number of internal and external variables is required. This will enable researchers to identify not only *what* variables are significant in firm performance but *how* by using the networking construct they might exploit opportunities to gain a competitive advantage.

CONCLUSION

This proposed new EO – Firm Performance model opens up a range of potential research areas and has practical benefits to firms wishing to utilise EO as a strategic approach to increase their performance. In terms of current EO theory, this proposed model brings together research on entrepreneurship from the marketing and strategic planning perspectives and shows how these research areas interact within the strategic framework of EO-firm performance in a meaningful way i.e. networking may be a process that provides the means to enable opportunity recognition and new entry.

There are a number of potential practical benefits from utilising the proposed new EO model. It opens up the opportunity for firms to gain a clearer understanding of what internal and external environmental factors they need to consider in order to improve performance. Also by proposing a configurational model for EO it may be possible may clarify what components of the external and internal environments really are important to achieve improvements in firm performance.

Networking may be a useful tool which firms can use to operationalise EO i.e. to align the firm's internal and external environments with its own EO in a manner to maximise firm performance. Also as networking can be taught and implemented within a firm it provides the potential to allow firms to take advantage of opportunities to gain a competitive advantage.

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