European Economic Letters
ISSN 2323-5233
Vol 14, Issue 4 (2024)
http://eelet.org.uk

# Impact of Entrepreneurial Orientation on SME Performance: The Mediating Role of Innovation

**[1]Radha Thangarajan**
[1]Research Scholar, Department of Business Administration, Kalasalingam Business School, Kalasalingam Academy of Research and Education, Krishnankoil, Tamilnadu, India. / Assistant professor, Department of Commerce, St. Claret College Autonomous, Bengaluru, Karnataka, India

**[2]Dr. Prabhakaran J**
[2]Associate Professor, Department of Business Administration, Kalasalingam Business School, Kalasalingam Academy of Research and Education, Krishnankoil, Tamilnadu, India

**[3]Dr. Hemanth Kumar S**
[3]Professor, Faculty of Management Studies-CMS Business School-JAIN (Deemed-to-be University), Karnataka, India

**[4]Dr. Sasmita Panda**
[4]Assistant Professor, PG Department of Management, St. Claret College Autonomous, Bengaluru, Karnataka, India

**[5]Rathish G**
[5]Assistant Professor, Department of Commerce, St. Claret College Autonomous, Bengaluru, Karnataka, India

**ABSTRACT**

Small and Medium Enterprises places very important role in developing an economy. Businesses that are more inventive will be better able to adapt to changing surroundings and create new capabilities that will improve their performance. In order to address such issues, the paper is structured to examine the theoretical background and, based upon extant literature, proposed a theoretical model where firm performance is seen as an outcome. Various factors have been used to determine the relationship between entrepreneurial orientation and firm performance by past studies. The entrepreneurial factors include Innovativeness, Risk taking and Proactiveness. In this research, a contribution to the literatureis made on entrepreneurial orientation and company performance. And in the study a mediating variable Innovation is introduced between entrepreneurial orientation and firm performance and to assess their relationship.
**Keyword**: Innovation, Entrepreneurial Orientation, Business Performance

**INTRODUCTION**

Small and Medium Enterprises are considered as the backbone of the economic development.SMEs have a tendency to use entrepreneurship principles to focus on the exploitation of opportunities and adopt innovative approaches to attract customers and increase profitability. (Omar et al., 2016). SMEs are facing stiff competition to withstand in the economy. Innovation and entrepreneurship have emerged as crucial ideas for long-termeconomic growth in today's complicated and volatile commercial environment.

More than 11 crore people are employed by the MSME sector, which currently contributes 29% to India's GDP and 48.1% of the country's total exports in 2022–23. According to the MSME Annual Report 2022–23, Kerala has the twelfth-largest number of MSMEs in India, with about 23.79 lakh units, 23.58 of which are microenterprises, and 44.64 lakh people employed as a result. Kerala has already made a name for itself as a centre for the coir, khadi,handloom, and tourism sectors.

SMEs are more creative due to higher flexibility and adaptability to the changes in the market.Moreover, they mostly contribute to employment growth although both the rate of establishment and failure of SMEs are high (Tambunan, 2007). SMEs foster economic development as well as encourage the flow of trade and investment between different countries (Nasir et al., 2017). Innovation in products and process regarded as an essential prerequisite for the organizational survival and success, attention to entrepreneurship orientation and change to an entrepreneur organization attracted the much attention of academic researchers and organizational members (Wang and Ahmed, 2004).

Entrepreneurial and innovative skills are the most important skills that can create a positive effect on the performance of MSMEs. (Kraus et al., 2012). Any business cannot be innovative if it does not take risks and act proactively. As a result, the current study's goal is to concentrateon the mediating function of innovation between taking risks, being proactive, and theperformance of MSMEs. Entrepreneurial orientation has positive impact on the business performance (Tajeddini et al., 2020). The challenging task of helping MSMEs compete in the global economy motivates study on strategic management frameworks and concepts as tools for enhancing organisational performance. The study mainly focuses on understanding relationship between entrepreneurial orientation and the business performances of SME and toknow the mediating effect of innovation and its influence on the relationship.

## OBJECTIVE OF THE STUDY

The main objective of the study is to know the mediating effect of innovation on entrepreneurialorientation and business performance. The study mainly focused on the existing literatures to assess the importance of innovation on the relationship between entrepreneurial orientation andbusiness performance.

### Strategic Orientation

Strategic orientation is a well-regarded and much-used concept in business literature concerned with firm performance (Kumar, Boesso, Favotto, & Menini, 2012). Strategic orientation is thestrategic direction implemented by a firm to create the proper behaviors for the continuous superior performance of the business(Nasir et al., 2017). Researchers and academics have nowpaid their attention in exploring these elements of the strategic orientation and its relationship with innovation and business performance among SMEs (Sahi et al., 2020). Some studies confirm the report by Swamidass and Newell (1987), who asserted that company performanceis influenced by business strategy and that companies with high work performance have clearstrategies. Badri et al. (2000) also found out that different strategies can result in different company performances. Strategy development also plays a vital role in increasing the company’s competitiveness (Singh et al., 2010). Strategic orientation can be explained in various ways as strategic choice, strategic trust, strategic fit, strategic predisposition, and strategic design (Chaffee, 1985).

### Entrepreneurial Orientation

Entrepreneurial orientation relates to behaviours, practices, the decision-making styles and processes that affect the organizations to entry into markets with new or existing products or services (Wiklund and Shepherd, 2003; Walter et al., 2006). Entrepreneurial orientation (EO) plays a critical role in exploring potential market opportunities, developing new business, andenhancing competitive advantage, all of which promote the rapid growth of enterprise(Zhai etal., 2018). Entrepreneurial orientation refers to the actions, procedures, policies, methods, decision-making strategies and practices within an organization, and supports entrepreneurial decisions in SMEs (Wiklund, J.; Shepherd, D.2003). Moreover, past studies have examined entrepreneurial orientation’s effects on innovation performance of SMEs( Musawa, M.S.,Ahmad, K ,2018) Usually entrepreneurial orientation is considered as the combination ofinnovation, risk taking, and pro-activeness (Aloulou & Fayolle, 2005).

### Measures

The study adopted entrepreneurial orientation’s three dimensions, namely risk-taking,innovativeness and proactiveness.

### Innovativeness:

The first entrepreneurial orientation dimension of innovativeness is about practicing and providing support to innovation, creative processes and the improvement of new ideas throughexperimentation (Lumpkin and Dess, 1996). Innovativeness refers to the tendency for enterprises to adopt and support creative processes, which may bring new products, new technologies, new services, new inventions, new tests, and soon. Innovativeness motivates enterprises to increase investment to carry out technology innovation activities such as new technology acquisition, new product development, and so on; thus, it can improve enterprise technological innovation ability (Lumpkin, G.T.; Dess, G.G. 1996**)**.

### Proactiveness

Proactiveness refers to the tendency for enterprises to take the positive marketing strategy, proactive action, and leading strategy to introduce new products, new processes, new technologies, and new services in order to transcend the competitors. In order to gain the competitive advantage, proactive enterprises tend to take advantage of the market opportunitiesahead of competitors, and take the lead in introducing new products and services. In the competitive industry and market, proactiveness plays a vital role in obtaining and maintainingthe competitive advantage of the enterprise (Jia, J.; Zhao, X.; Yu, X.;Wang, G.Will 2013) . A firm with a high proactiveness orientation may be particularly adept at forging new ties becausesuch a firm seeks out resources that would add value to the firm both in the present and in thefuture. The ability to read and anticipate changes in their environments is an eminent trait of entrepreneurial firms(Gunawan et al., 2013)

**Risk taking**

Risk-taking refers to the tendency for enterprises to take bold action in order to pursue high reward (Miller, D 1987). Risk-taking helps an enterprise form an organizational atmosphere oftolerance and risk; it is also a way to encourage the experiment (Slocum, J.W.; McGill, M.; Lei, D.T. 1994). Risk taking refers to a firm's tendency to engage in high-risk projects and managerial preferences for bold versus cautious actions in order to achieve firm objectives (Miller, 1983). Therefore, riskiness is important in resource allocation situations and can act asa key parameter in determining the decision processes involved in competitive strategy (Dickson and Giglierano, 1986). The riskiness trait is intuitive rather than analytical requiringrisk-oriented decision making and a significant financial and human resource investment (Miller, 1989).

**Business Performance**

Firm performance seems like a self-evident and self-explanatory term, but actually needs to be carefully deconstructed to understand its tangible content. Firm performance is a multidimensional construct consisting of revenue and cost-based financial performance, customer-related performance, innovation- related performance, and employee-relatedperformance. The performance of MSMEs has become the main priority in all countries in theworld as a result of global perspectives that acknowledge MSMEs as the economic growth engine in both developed and developing countries (Agwu, 2014; Naala et al., 2017).

The conventional approach to business performance assessment has been to emphasize profitability, most frequently measured by return on investment, which is widely regarded as the ultimate ‘‘bottom line’’ (Reese and Cool,1978, p. 28) test of success.

In the context of Small and Medium Enterprises (SMEs), Camison (1997) used three measuresof performance: profitability, productivity, and market share; Camison found that ‘‘the most profitable and productive organizations, whatever the index chosen, are those with more proactive strategic behaviors integrated into groups oriented towards innovation and quality, and towards customer satisfaction, in that order’’ (Camison, 1997, p. 413). Another important issue that needs to be considered when investigating the relationship between strategic orientation and firm performance is the existence of some contingencies such as business practices, economic conditions, business culture and politics (Punnett & Shenkar, 1994).

Enterprise performance has been measured using various indicators. Financial performance measures include: profit, revenue, earning per share, dividends per share, return on equity, return on asset, among others (Kaplan & Norton, 1996).

**Innovation**

Innovation is the key source for enterprises to gain competitive advantage and can provide lasting impetus to improve firm performance in the competitive market (Kim et al., 2012).Innovation can provide related services for the organization, its suppliers, and its consumers through new technologies, new processes, new methods, new services, and new business development methods, and can obtain a certain value.(Zhai et al., 2018). Innovation is a crucial factor in firm performance because of the evolution of the competitive environment(Bueno and Ordoñez, 2004). Innovation performance is considered to have a direct effect on firm performance (West and Iansiti, 2003; Brockman and Morgan, 2003). Innovation is alwayscorrelated with decision making out of unexpected opportunities, exceptions, new relations and uncertainty of result, and it is at high risk of failure (Davila et al., 2009).

**Conceptual Model**

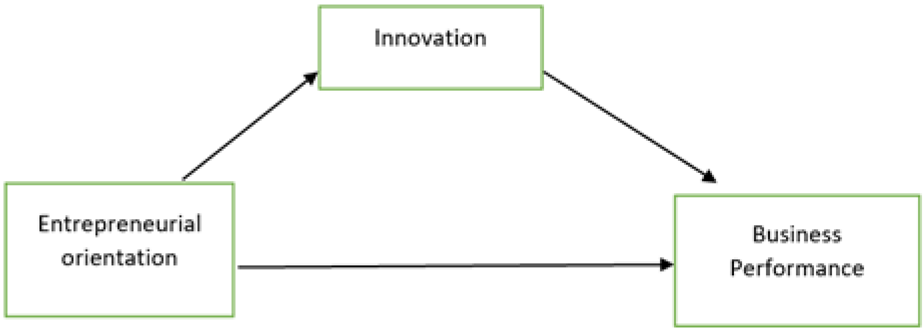

Figure 1: Research Framework

**Entrepreneurial Orientation, Innovation and Business Performance**

The relationship between entrepreneurship and firm performance has received considerable attention in the organizational and entrepreneurial literature over the last two decades (Vij, S.,& Bedi, H. S. 2012). Most previous studies investigating the independent effect of entrepreneurial orientation on firm's performance and ignore the factors that may mediate thestrength of the entrepreneurial orientation and firm's innovation performance. (Madhoushi et al., 2015)

Firms with innovativeness have a tendency to support new ideas and novelty, and further increase the engagement in developing new products or processes (Lumpkin and Dess, 1996; Li et al., 2009). The research conducted by Woodside et al. (1999) provided a view into the relationship between orientation strategy, innovation capability and performance. Some empirical studies have proven that strategic orientation will influence organizational innovationand organizational performance (Widya-Hasuti et al., 2018; Obeidat, 2016; Reulink, 2012).

Certain conditions in the study provide compelling evidence for the full mediating effect of Process innovation effectiveness on the relationship between EO and firm performance (Rochdi D., Khatijah O., Muhammad A.S.A.H. 2017).According to Zahra et al. (1999), EO increases proactiveness and inclination towards risk taking and innovation within a specific
firm. Consequently, EO may be deemed to be among the innovation performance antecedents(Baker and Sinkula, 2009; Renko et al., 2009)

**LIMITATION OF THE STUDY**

The study only focused on one of the strategic orientation i.e. entrepreneurial orientation and not focusing on various other strategic orientations like market orientation, learning orientation,technology orientation. The study mainly focused on entrepreneurial orientation and business performances and mediating effect of innovation. Despite decades of research conducted in thedifferent streams of orientation literature, little is known about the relationships between market orientation, technology orientation, learning orientation and entrepreneurial orientation(Grinstein 2008).

**CONCLUSION**

SMEs have significantly contributed to the creation of jobs, the eradication of poverty, and theadvancement of economic growth worldwide. SMEs are an integral part of the economic infrastructure of emerging nations and are essential for fostering growth, innovation, and prosperity. Although the SME sector is rapidly expanding and a significant contributor to India's GDP, the sector nevertheless confronts numerous obstacles. In order to secure a company's viability and performance, strategic orientations are viewed as guiding concepts thataffect how the company operates. From the various literature it can be understood that the entrepreneurial orientation places vital role in the performances of the business. The firm requires strategies focusing on entrepreneurial orientation with the effect of innovation to withstand in the competitive environment.

**REFERENCE**

1. Gunawan, T., Jacob, J., & Duysters, G. (2013). Working Paper No . 2013 / 28Entrepreneurial Orientation and Network Ties : Innovative Performance of SMEs in anEmerging- Economy Manufacturing Cluster. 1–27.
2. Kraus, S., Rigtering, J. P. C., Hughes, M., & Hosman, V. (2012). Entrepreneurial orientation and the business performance of SMEs: A quantitative study from the Netherlands. Review of Managerial Science, 6(2), 161–182. https://doi.org/10.1007/s11846-011-0062-9

3. Madhoushi, M., Sadati, A., & Delavari, H. (2015). Entrepreneurial Orientation and Innovation Performance : The Mediating Role of Knowledge Management Entrepreneurial Orientation and Innovation Performance : The Mediating Role of Knowledge Management. November 2011.
4. Nasir, W. M. N. bin W. M., Al Mamun, A., & Breen, J. (2017). Strategic Orientation and Performance of SMEs in Malaysia. SAGE Open, 7(2). https://doi.org/10.1177/2158244017712768
5. Omar, N. A., Md Aris, H., & Nazri, M. A. (2016). The effect of entrepreneurial orientation, innovation capability and knowledge creation on firm performance: A perspective on small scale entrepreneurs. Jurnal Pengurusan, 48, 187–200. https://doi.org/10.17576/pengurusan-2016-48-15
6. Vij, S., & Bedi, H. S. (2012). Relationship between entrepreneurial orientation and business performance: A review of literature. The IUP Journal of Business Strategy, 9(3), 17-31.
7. Zhai, Y., Sun, W., & Tsai, S. (2018). An Empirical Study on Entrepreneurial Orientation , Absorptive Capacity , and SMEs ' Innovation Performance : A Sustainable Perspective. https://doi.org/10.3390/su10020314
8. Kaplan, R. S. & Norton, D.P. (1996). Using the balanced scorecard as a strategic management system, Harvard Business Review (January-February), 75-85.
9. Jia, J.; Zhao, X.; Yu, X.;Wang, G.Will (2013) entrepreneurial orientation help to improve corporate performance:A study based on the mediating effects of competencyof top managers in entrepreneurial-oriented companies.Nankai Bus. Rev., 16, 47–56.
10. Slocum, J.W.; McGill, M.; Lei, D.T.(1994) The new learning strategy: Anytime, anything, anywhere. Organ. Dyn., 23, 33–47.
11. Zhai, Y., Sun, W., & Tsai, S. (2018). An Empirical Study on Entrepreneurial Orientation , Absorptive Capacity , and SMEs ' Innovation Performance : A Sustainable Perspective. https://doi.org/10.3390/su10020314
12. Miller, D. (1987) The structural and environmental correlates of business strategy. Strategy. Manag. J., 8, 55–76.
13. https://www.investindia.gov.in/team-india-blogs/understanding-msme-sector-kerala
14. Wiklund, J.; Shepherd, D. (2003). Knowledge-based resources, entrepreneurialorientation, and the performance of small and medium sized businesses. Strat. Manag. J., 24, 1307–1314.
15. Musawa, M.S.; Ahmad, K(2018). A Conceptual Framework for the Influence of Entrepreneurial Orientation and Environmental Dynamism on Marketing Innovation Performance in SMEs. Bus. Econ. J., 9, 1–8.
16. Baker W.E., Sinkula J.M., 2009, The complementary effects of market orientation andentrepreneurial orientation on profitability in small business, “Journal of Small Business Management”, 47(4).
17. RADHA, T. & Viji, R. (2021) “SHG- A dynamic tool for socio-economic up gradation of semi-urban women” International Journal of Research in Commerce, IT and Management, Vol.11,Issue.2,pp.1-5. Retrieved from https://ijrcm.org.in/article_info.php?article_id=9541
18. Radha T. (2024). Volatility in Sustainable Financial Growth through Predictive Analytics for Women Entrepreneurs in Tamilnadu. International Journal of Intelligent Systems and Applications in Engineering, 12(21s), 3774 –. Retrieved from https://www.ijisae.org/index.php/IJISAE/article/view/6127
19. Rypestøl, J.O.; Aarstad,(2018). J. Entrepreneurial innovativeness and growth ambitionsin thick vs. thin regional innovation systems. Entrep. Reg. Dev., 30, 639–661
20. Sahi, G. K., Gupta, M. C., & Cheng, T. C. E. (2020). The effects of strategic orientation on operational ambidexterity: A study of indian SMEs in the industry 4.0era. International Journal of Production Economics, 220, 107395.
21. Swamidass, P. M., & Newell, W. T. (1987). Manufacturing strategy, environmental uncertainty and performance: a path analytic model. Management science, 33(4), 509-524.
22. Badri, M. A., Davis, D., & Davis, D. (2000). Operations strategy, environmental uncertainty and performance: a path analytic model of industries in developing countries. Omega, 28(2), 155-173.
23. Naala, M., Nordin, N., & Omar, W. A. B. W. (2017). Innovation capability and firm performance relationship: A study of pls-structural equation modeling (Pls- Sem). International Journal of Organization & Business Excellence, 2(1), 39-50.
24. Bueno, E., Ordonez de Pablos, P., & Salmador Sanchez, M. P. (2004). Towards an integrative model of business, knowledge and organisational learning processes. International Journal of Technology Management, 27(6-7), 562-574.
25. Kim, C., Song, J. and Nerkar, A. (2012), “Learning and innovation: exploitation and exploration tradeoffs”, Journal of Business Research, Vol. 65 No. 8, pp. 1189-1194.
26. Rochdi, D., Khatijah, O., & Muhammad, A. S. A. H. (2017). Mediating role of the innovation effectiveness on the

relationship between entrepreneurial orientation and the SMEs performance in Algeria. Polish Journal of Management Studies, 15.

27. Davila, A., Foster, G., & Oyon, D. (2009). Accounting and control, entrepreneurship and innovation: Venturing into new research opportunities. European Accounting Review, 18(2), 281-311.
28. Grinstein, A. (2008). The relationships between market orientation and alternative strategic orientations: a meta-analysis. European Journal of Marketing, **42**, pp. 115– 134.