Linking entrepreneurial orientation and small service firm performance through marketing resources and marketing capability: A moderated mediation model

**Abstract**

Mixed findings documented in the literature suggest that the entrepreneurial orientation (EO)–performance relationship is more complex than a simple main-effects-only relationship. The literature offers two approaches in advancing this complex relationship: (1) examining the contingency effect and (2) examining the mediating effect on EO–performance. Through a moderated mediation framework we reconcile these distinct approaches by examining the underlying process through which EO contributes to performance and the specific condition under which this process is facilitated. Data from 469 small service firms indicate that marketing capability mediates the EO–performance relationship; this mediation effect is strongest when marketing resources are abundant.

**Keywords:** Entrepreneurial orientation, marketing capability, marketing resources

**Track:** Marketing strategy

1. **Introduction**

The literature has established a complex relationship between entrepreneurial orientation (EO) and performance. Some studies have found a positive relationship, some negative, while some report an insignificant relationship between EO and performance (Rauch et al., 2009). These conflicting findings suggest that the EO-performance relationship is more complex than a simple main-effects-only relationship (Kollmann & Stöckmann, 2014). The literature offers two distinct approaches in advancing the EO-performance relationship.

First, Covin and Lumpkin (2011) argue that while prior studies that have adopted a contingent approach in exploring the effect of different environmental contexts on the EO-performance relationship hold merit, further studies along this path are unlikely to advance theory. They suggest that studies looking beyond the environmental impact offer more potential in advancing the EO-performance relationship. Numerous studies have subsequently examined the effect of different moderators on the EO-performance relationship, such as the internal social exchange process (De Clercq et al., 2010) and transformational leadership behaviors (Engelen et al., 2015). The other approach (Baker & Sinkula, 2009) calls for future research to investigate the mediators that link EO and performance. Subsequent studies have examined the mediating effects on EO-performance relationship, including organizational learning and innovation (Alegre & Chiva, 2013) and exploratory and exploitative innovations (Kollmann & Stöckmann, 2014).

While these studies make important contributions, no study has incorporated both approaches to unpack the EO-performance relationship. This is a critical oversight that warrants academic inquiry because adopting the moderating approach may only explain the conditions under which EO affects performance, while adopting the mediating approach may only explain the process through which EO affects performance. In this sense, a more complete understanding of *how* and *when* EO contributes to performance is lacking. Our study aims to extend current knowledge by examining through the theoretical lens of the resource-based view (RBV) the underlying process through which EO contributes to performance and the specific conditions under which this process is facilitated.

Drawing on previous research highlighting an orientation–behavior gap as deduced by the RBV, we examine the role played by important organizational capabilities and resources within the EO-performance relationship. We propose marketing capability (MC) as an intervening mechanism and marketing resources (MR) as a facilitating condition in the EO-performance relationship, proffering that such mediating and moderating components are critical to achieving a more complete understanding of the EO-performance relationship. We focus on MR and MC because our understanding of the role of the marketing function in facilitating the EO-performance relationship is limited. It is surprising given the critical role marketing has in driving small firm success (Sok et al., 2015).

We contribute to the emerging field of strategic entrepreneurship and marketing strategy by integrating two key concepts: EO and the RBV. This approach addresses the call by Miller (2011) to link the EO construct to theory by embedding MR and MC in the EO-performance relationship. Further, by accounting for both mediation and moderation effects we provide a more complete picture of the EO-performance relationship. This approach helps to reconcile the critical but separate directions proposed by prior studies (Baker & Sinkula, 2009; Covin & Lumpkin, 2011; Kollmann & Stöckmann, 2014) in advancing the EO-performance relationship. In addition, we extend the contingency models that have dominated entrepreneurship research (Short et al., 2008) by examining under what circumstances the moderating effect of MR on the EO-MC-performance relationship is strongest. Finally, we provide an empirical contribution by placing the research in the context of small firms which have fewer hierarchical levels and shorter chains of command, compared to large organizations whose EO benefits may be hindered by organizational impediments such as hierarchical administrative structures (De Clercq et al., 2013).

1. **Theory and hypotheses development**

*2.1 Entrepreneurial orientation and performance*

EO is characterized by innovativeness, risk-taking, proactiveness, competitive aggressiveness and autonomy – all of which facilitate the pursuit of new opportunities (Lumpkin et al., 2009). EO is said to lead to superior performance (Covin & Lumpkin, 2011) because efforts to anticipate demand and aggressively position new product and service offerings often result in strong performance (Ireland et al., 2003). Although findings from a meta-analysis of 51 studies conducted by Rauch et al. (2009) found support for a positive relationship between EO and performance, findings from other studies did not replicate this positive relationship (Baker & Sinkula, 2009). Consequently, Baker and Sinkular (2009) suggest that resolving this confounding issue requires a deeper inquiry into the mechanisms (mediators) and conditions (moderators) that help to translate EO into superior performance. Because EO is the firm’s strategic orientation, EO represents how a firm operates rather than what it does (Lumpkin & Dess, 1996). Some suggest that EO does not automatically develop into entrepreneurial activities and that performance benefits of EO are low when there are no corresponding entrepreneurial behaviors taking place. Consequently, it is reasonable to conclude that the explanatory power of the EO-performance relationship may be hindered if EO is not converted into appropriate actions (Kollman & Stöckmann, 2014).

*2.2 The mediating role of marketing capability*

Some scholars suggest that resources are static and possess no real value in isolation and instead, it is the firm’s ability to deploy resources that better explain performance differentials between firms (Teece et al., 1997). In line with the RBV, it can be expected that EO by itself may not be sufficient for the realization of superior performance given it only reflects a firm’s disposition towards, rather than actual involvement in, entrepreneurial activity and as such the key to reaping the performance benefits of EO lies in the extent to which entrepreneurial activities are developed and the corresponding entrepreneurial behavior takes place (Wiklund & Shepherd, 2005). EO is therefore provides the basis that facilitates the enactment of entrepreneurial actions (Kollmann & Stöckmann, 2014).

Entrepreneurial firms adopt an entrepreneurial posture to identify new business opportunities with potentially large returns and strive to obtain first-mover advantages (Lumpkin & Dess, 1996). Given their propensity to accept risks, entrepreneurial firms strive to enter new or established markets with either new or existing goods or services (Kollmann & Stockmann, 2014). In doing so, entrepreneurial firms require the capabilities to not only develop and introduce new products or services to the market but also ensure that such products or services are delivered to customers in ways that align with their needs and are better than competing offerings. In this sense the role of MC is critical given it facilitates the enactment of customer-linking actions through which the entrepreneurial firm identifies and serves customers’ needs (Ngo & O’Cass, 2012). MC represents a firm’s capacity to undertake marketing activities such as promoting the business and establishing position in the markets. Through these marketing-centric activities entrepreneurial firms are in a better position to obtain first-mover advantages by shaping the rules of competition in ways that rivals find difficult to imitate, thus leading to superior performance (Kollmann & Stöckmann, 2014).

*H1:**MC mediates the relationship between EO and performance.*

*2.3 The moderating role of marketing resources*

Given entrepreneurial firms’ propensity to innovate frequently and take risks they are often faced with uncertain returns and high failure costs. Kollmann and Stöckmann (2014) argue that the full potential of EO may not be realized if resources are lacking because such conditions inhibit the actual implementation of the firm’s entrepreneurial spirit. Substantial resource commitments are therefore required to support the entrepreneurial firm’s innovative, risk-taking and proactive endeavors. Thus, when firms are endowed with MR it creates the necessary conditions that facilitate MC development. MR is conceptualized as the substantial amount of resources (e.g., people, time and money) that are invested in marketing-related activities such as promotion, pricing, and distribution. With the endowment of MR the value of EO increases because it provides firms with the necessary condition under which they have the backing needed to develop the required marketing actions to link with customers and introduce market offerings that help to obtain first-mover advantages. Conversely, when firms are deprived of MR they lack the fundamental factors needed to develop MC. Accordingly, they may be deterred from achieving superior firm performance given they are restricted in engaging in entrepreneurial activities and lack the critical resources to deliver unique offerings to customers that put them ahead of their competition.

*H2: The indirect effect of EO on firm performance through MC is moderated by MR, such that the indirect effect is stronger when MR is high than when it are low.*

1. **Research method**

To test our hypotheses we chose small service firms in Australia. In Australia approximately 84% of the total small business sector is attributable to service-based businesses. Therefore, promoting the competitive position of small service businesses is important for developing national economies and achieving future growth. The key informants were either chief executive officers or founders of small service firms where the total number of employees is less than 20. An email with personalized log-in data to access the online survey was sent to the key informants. 469 responses were obtained through an online survey. The *t*-test results revealed no significant differences between early and late respondents in terms of the means for items, suggesting that non-response bias was not a problem in the data. MR was measured using the eight-item scale adapted and refined from Coviello et al. (2006). Sample item is a ‘Substantial amount of our marketing resources (e.g., people, time, money) are invested in promotion-related’. MC was measured using a six-item scale adapted and refined from Chen et al., (1998) and Vorhies and Morgan (2005). Sample item is ‘At this point in time (i.e. right now), how certain are you that your business can establish position in the market’. EO was measured using the 18-item scale adapted and refined from Lumpkin et al. (2009). Sample item is ‘We actively introduce improvements and innovations in our business’. Performance was measured using the five-item scale adapted and refined from Gupta and Batra (2015). It captures the multifaceted aspects of performance including: sales growth, profit margin, return-on-investment, customer satisfaction and customer retention/loyalty. We controlled for firm age, firm size and industry type.

The model fits the data reasonably well (χ2 (1048) = 1496, p<.01; CFI=.95; TLI=.96; RMSEA=.04). The factor loading of all items was relatively high and the average variance extracted (AVE) of all constructs exceeded .50, providing support for convergent validity. The composite reliability of all constructs exceeded .70. Discriminant validity was established by comparing the square roots of the AVE against the off-diagonal correlations. The square roots of the AVE were consistently greater than the off-diagonal correlations, providing support for discriminant validity. To mitigate common method concerns, we first separated the measures of performance from those of the independent variables such that they appeared unrelated in the survey (Podsakoff et al., 2003). Second, the results from Harman’s (1976) single-factor test indicated that items did not load on a single factor. We followed Lindell and Whitney (2001) in selecting ‘personal happiness’, a variable unrelated to the dependent variable (r = 0.04, ns), as the marker variable for common method bias analysis. These results provide evidence confirming that common method bias was not a serious threat to this study.

 H1 proposes that MC mediates the relationship between EO and performance. We adopted the procedure recommended by Baron and Kenny (1986) to test this mediation hypothesis in which four conditions need to be met.: (1) the effect of the independent variable (IV) on the dependent variable (DV) must be significant, (2) the effect of the IV on the mediating variable (MeV) must be significant, (3) the effect of the MeV on the DV must be significant, and (4) when the MeV is included in the model the effect of the IV on the DV must be insignificant for full mediation or reduce in size for partial mediation. The effect of EO on performance (β =.47, p < .001) and MC (β = .54, p < .001) is significant, thus satisfying the first and second conditions for mediation. MC is also found to have a significant effect on performance (β = .34, p < .001), thus satisfying the third condition. The results also show that when MC is included in the model the effect of EO on performance becomes weaker (β = .47 vs β = .28), thus satisfying the fourth condition for partial mediation. Consequently, H1 is supported. H2 proposes that the indirect effect of EO on performance through MC is moderated by MR. We adopted the procedure recommended by Preacher et al. (2007) to test this moderated mediation hypothesis in which four conditions must be met: (1) the effect of the IV on the DV is significant, (2) the effect of the interaction between the IV and the moderating variable (MoV) on the MeV is significant, (3) the effect of the MeV on the DV is significant, and (4) there is a different conditional indirect effect of the IV on the DV via the MeV at different levels of the MoV. The results show that the effect of EO on performance is significant (β =.47, p < .001), thus satisfying the first condition. In addition, the interaction between EO and MR has a significant effect on MC (β = .11, p < .001), thus satisfying the second condition. MC was also found to have a significant effect on performance (β = .34, p < .001), thus satisfying the third condition. The statistical significance test recommended by Preacher et al. (2007) was adopted to examine the fourth condition. A statistically significant indirect effect is evident when the 95% upper and lower bound confidence intervals do not contain zero (Preacher et al., 2007). The results indicate that the indirect effect of EO on performance via MC is strongest at high levels of MR (LLCI = .096, ULCI = .223), thus satisfying the fourth condition. Consequently, H2 is supported.

1. **Discussion**

 Our model examining the underlying process through which EO contributes to performance and the specific condition under which this process is facilitated advances the idea that the EO-performance relationship is more complex than a simple main-effects-only relationship. By embedding the relationship between EO and performance into the RBV we address the call by Miller (2011) to connect the EO construct more closely to theoretical perspectives. Our theoretically-derived and empirically-validated model underscores the role of marketing in EO implementation. In addition, the support for the mediation effect advances current knowledge by suggesting that to achieve superior performance firms need to implement EO through MC, which represents an important behavioral manifestation of the firm’s EO and the key to achieving superior performance. The finding also supports the suggestion that EO reflects how a firm operates rather than what it does and therefore it should not be confused with actual entrepreneurial behavior (Lumpkin & Dess, 1996). Moreover, the support for the moderating effect of MR on the indirect effect of EO on performance via MC contributes to the literature by providing empirical evidence supporting the conditional nature of the EO-performance relationship. We identify the circumstances where the moderating effect of MR on the EO-MC-performance is strongest. This finding addresses the call by Miller (2011) to clarify the role of the firm’s internal resources in leveraging the effects of EO on performance. In particular, the finding that the indirect effect of EO on performance via MC is strongest at a high level of MR, compared to a medium and low level of MR, is in line with the RBV tenet that the concurrent pursuit of individually valuable resources increases causal ambiguity and resource interconnectedness – both of which make it extremely hard for competitors to imitate.

 In addition, the findings supporting both the mediation and moderation effects of MC and MR on the EO-performance relationship is in line with Wiklund and Shepherd’s (2005: 72) suggestion that greater insight into how EO influences performance can be achieved ‘through investigating the orchestrating themes and integrative mechanisms that ensure complementarity among a firm’s various aspects’. It also explains Messersmith and Wales’ (2011) view that EO effects need to be considered in combination with other firm-level constructs (MC and MR in this study) to better understand firm performance. Therefore, it appears that implementing EO and actualizing its full potential cannot be achieved through ad hoc manipulations of any single factor (Kollmann & Stöckmann, 2014). Rather, it is important that various internal levers (such as MC and MR) are holistically aligned with EO.

1. ***Managerial implications***

 In light of our findings some meaningful managerial implications can be drawn. First, the results of our study suggest that preserving the entrepreneurial spirit (being entrepreneurially-oriented) is critical to progress in organizational development. Yet, having an EO in itself is not sufficient to achieve superior performance outcomes. Firms must ensure that existing EO develops into actual entrepreneurial behavior, which is MC. Our study informs small business managers about the importance of harnessing MC to fully realize the potential contribution of EO on performance. This could be achieved by seeking assistance from professional business coaches. Second, the important role of MR cannot be overlooked. To remain competitive small businesses must be able to anticipate and respond to market changes. Small firm managers must ensure that there are available resources (e.g., time, money and people) that can be invested in marketing-related activities, such as establishing and building personal relationships with customers through a combination of online and offline marketing.

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