Entrepreneurial Orientation and Firm Performance in the Context of Upper Echelon Theory

Abstract
Entrepreneurial Orientation (EO) is a firm-level phenomenon, which involves the firm’s prospects to take risks, be proactive, and be innovative. The first phase of EO (late 1970’s-early 1990’s) was characterized by a conceptual development of EO, while the second phase (mid 1990’s-2009) involved studying the relationship between EO and firm performance. The emphasis of research then shifted towards studying the ‘black box of EO’ in the third phase (2010-2015). However, most of the research assumes a positive EO-performance relationship without providing enough theoretical foundations of the way EO enhances performance. This is true regardless of the undercurrent of studies that persist to reveal mixed or insignificant results. This paper provides insights into the origins of EO and shows that EO is subject to factors at the managerial level. Through the theoretical lens of upper echelon theory, we argue for the importance of studying the managerial characteristics such as CEO greed and overconfidence in relationship to the EO-performance relationship. Only then, can the taken-for granted positive EO-firm performance relationship be challenged. We hypothesize that the relationship between each dimension of EO and firm performance is curvilinear and that board power and CEO characteristics (CEO greed and overconfidence) significantly moderate this relationship.

Keywords: EO; firm performance; CEO greed; CEO overconfidence; upper echelon theory
1. Introduction

Many researchers have questioned the nature of the construct entrepreneurial orientation (EO). EO has predominantly been conceptualized as a firm-level behavior. Furthermore, EO is grounded in upper echelon theory in which it is a reflection of top management team (Covin & Miller, 2014). Authors such as Mintzberg (1973) and Khandwalla (1976) have reiterated the grounding of EO at the upper echelon theory. Thus, this indicates that the ‘upper echelon’ perspective is dominant in the literature on EO (Covin & Miller, 2014) and draws from Hambrick and Mason’s (1984) observations that over time organizations become reflections of their top managers. The importance of the top manager in EO is evident in Lumpkin and Dess’s (1996, p. 136) definition that EO is “the methods, practices, and decision-making styles managers use to act entrepreneurially”. In accordance with this conceptualization, some researchers have begun questioning an organization’s top management as a reflection of a firm’s behavior in order to identify EO (Zhu & Chen, 2015). However, when studying the EO-performance relationship, there is an ignorance of top managers in EO research despite its upper echelons heritage. Thus, perhaps ironically, the literature mostly disregards the human agency at play. This is important to pursue since there is a gap in the literature regarding exploring the role of managerial characteristics in the EO-firm performance relationship. Thus, it is important to investigate the complex phenomenon or the ‘black box’ of EO keeping in mind the human agency at play. It is of novelty to do so since EO has been decontextualized as Zahra and Wright (2011) have indicated and it is important to raise the importance of the human agency context back into the EO literature.

Building on the works of Mintzberg (1973), Khandwalla (1976), and Miller and Friesen (1982), EO was defined by Miller (1983) (even though Miller (1983) did not frame it as EO) as the joint exhibition of risk taking, proactiveness, and innovativeness. In other words, Miller (1983) conceptualized EO as a single construct composed of these three dimensions. Risk taking involves taking bold decisions and actions by venturing into new or emerging markets or by borrowing heavily and being willing to tolerate the uncertainty that comes with such entrepreneurial actions (Rauch et al., 2009). Proactiveness has been defined as an opportunity-seeking component of EO, which involves anticipating future demand (Rauch et al., 2009). Innovativeness, which is believed to be a central component of EO because of its emphasis on novelty and exploring opportunities (Lumpkin & Dess, 1996), involves engaging in experimentation and creativity.

Miller (1983) stated that the variables of risk taking, proactiveness, and innovativeness covaried significantly with EO. In doing so, Miller (1983, p. 770) indicated that an entrepreneurial firm is one that “engages in product market innovation, undertakes somewhat risky ventures, and is first to come up with proactive innovations, beating competitors to the punch”. The Miller (1983) definition and characterization of EO as risk-
taking, proactiveness, and innovativeness became the dominant characterization and definition adopted in the literature. Thus, investigators following Miller’s conceptualization of EO consider an entrepreneurially-oriented firm to be one that exhibits risk taking, proactiveness, and innovativeness as a sum total whereby the higher the exhibition of these three dimensions (driven by the actions of top managers), the higher the EO of the firm. However, Wales et al. (2011) indicated that EO is a much more complex ‘multifaceted phenomenon’ that pervades heterogeneously across organizational hierarchal levels. Wales et al. (2011) indicated that firm-level EO, as an organizational phenomenon, varies within a firm, and by extension may vary across levels of analysis within the firm.

Contrastingly, Lumpkin and Dess (1996) explicitly emphasized that EO is not characterized by a joint or single exhibition of all its dimensions, but rather that a firm can be considered entrepreneurial if it exhibits one or more of the dimensions of EO. For instance, an organization can be considered entrepreneurially-oriented when it engages in new venture creation whilst avoiding risks. Thus, in contrast to Miller (1983) and studies in his tradition, Lumpkin and Dess (1996) conceptualized EO as a multidimensional construct wherein each of the dimensions of EO have varying effects and should be studied independently and interdependently.

There is a wide variation in the literature with regards to defining and conceptualizing EO, a problem echoed by Covin and Wales (2012). There has been quite a thorough exploration of the concept of EO with researchers providing multiple definitions. However, there is a general consensus in the literature that EO is a complex construct in which an entrepreneurially oriented firm is likely to be more inclined to take risks, exhibit proactiveness, and be more innovative.

An issue that has received far less treatment is Lumpkin and Dess’ (1996) belief that the dimensions that make up EO might vary independently and interdependently such that their performance effects might not be uniform (Hughes & Morgan, 2007). Interestingly, at the time of their work, Lumpkin and Dess (1996) argued that there existed an untested biased assumption in the literature that higher EO leads to higher firm performance levels. This sparked a wealth of research that sought to find empirical support for the relationship between EO and business performance, largely implicating a positive EO-performance relationship (Rauch et al., 2009). The reason is that EO dimensions have been collapsed into one EO construct. However, when taking each EO dimension’s effect on firm performance interesting findings might be revealed. Thus, we hypothesize that each of the EO dimensions has an inverted U shaped relationship with firm performance.

Even though the EO research initially focused on the managerial aspects (Khandwalla, 1976; Mintzberg, 1973) later research has taken a toll on focusing on EO as a firm-level disposition with disregard to the human agency. In that context, it is of relevance to
Entrepreneurial Orientation and Firm Performance: In the Context of Upper Echelon Theory

examine the effect of CEO characteristics (particularly dark CEO characteristics such as greed and overconfidence) on the EO-firm performance relationship. CEO overconfidence is defined as the “overestimation of one’s own abilities, performance, level of control, or chance of success” (Moore & Healy, 2008, p. 502). While CEO greed is defined as the “desire for and active pursuit of extraordinary material wealth” (Haynes et al., 2014, p. 6). Haynes et al. (2015) indicated that the literature has predominantly focused on the positive side of entrepreneurial leadership neglecting the negative side of entrepreneurial leadership. However, the lines between bright and dark entrepreneurial leadership can become blurry. For instance, confidence is an important trait for managers to exploit opportunities, however taken to the extreme it can lead to a dark characteristic (i.e. overconfidence). This can cause managers to be overly optimistic in their judgments and take extreme risks (Haynes et al., 2015). Thus, managers are best to be moderately confident yet not overconfident to the extent that taking extreme risky endeavors might jeopardize the firm’s success. This reiterates the association of CEO characteristics with EO, which is grounded in the upper echelon of the firm. Thereby, in the study we hypothesize that CEO characteristics (such as greed and overconfidence) significantly moderate the EO-firm performance relationship.

2. Method

To meet the study’s research objectives, a research site that consists of a sufficient number of firms facing, experiencing or pursuing an entrepreneurial imperative is needed, and one in which a sufficient amount of quantitative data can be acquired. It is also important to consider the context of the study (e.g. US or UK context). To this end, the US context is of relevance to EO since the US allows more opportunities for uncertainty and managerial discretion (latitude of action) (Finkelstein & Boyd, 1998). Furthermore, in the literature it has been shown that US firms exhibit higher levels of EO than those in other countries (Kemelgor, 2002). Data was collected from Wharton Research Data Services database (WRDS). Financial data was Compustat-North America, market data was collected from CRSP, board of directors data from Riskmetrics, Insitutional Ownership from Thomson Reuters, and CEO data from Execucomp.

The companies included are from high Tech industries according to Kile and Phillips (2009). The sample consists of large (> 500 employees) publicly traded US companies from years 2000 until 2014. The choice of large firms is based on the fact that large firms face competitive pressure to strategically prioritise entrepreneurship and innovation in order to sustain and grow their wealth and to resist competition from others in the industry and new entrants (Zahra, 1991). Thus, the utilization of large firms is of relevance in the EO context. Lastly, it is likely to find more reliable information on large publicly-listed organizations than small private organizations since it is possible to obtain reliable data on large
organizations as the latter have reporting obligations and data that is accessible publicly as part of their public listing status (Miller & Le Breton-Miller, 2011).

For computation of the variables, the SAS (statistical analysis system) software was used. The data format is panel data (longitudinal data). Panel data analysis is appropriate in instances when there are multiple variables across multiple time periods, thus it controls for company heterogeneity. It also avoids common method bias, which is characteristic of survey studies, since it allows the collection of data from different sources (Rauch et al., 2009). In order to control for any unobserved or unmeasured firm and industry effects that are constant throughout time, fixed-effect regression models would be utilized. As such the effect of the predictors and moderators on the outcome variable can be studied by controlling for any overlooked variables (Haynes et al., 2014).

There is a recurring call in the EO literature to develop new measures of EO, however few researchers have answered this call (George & Marino, 2011; Lyon et al., 2000), which is due to the complexity of developing such measures and the dominance of the Miller (1983)/Covin and Slevin (1989) scales (Covin & Wales, 2012). The Covin and Slevin EO scale (1989) has been widely used in the literature to study the EO-performance relationship (Rauch et al., 2009). However, such a summated scale combines the three dimensions of EO into a single construct, which might disregard the independent impact of each dimension on firm performance (Hughes & Morgan, 2007; Lumpkin & Dess, 1996). This was postulated by Lumpkin and Dess (1996) who suggested that the different dimensions of EO might influence firm performance differently. This was later tested by Hughes and Morgan (2007) who showed that the different dimensions of EO do have different effects on firm performance and might be context specific. Thereby, a scale that combines the three dimensions into a single construct might generate misleading interpretations and cause researchers to consider that such an interaction does not exist when in reality it does (Kreiser et al., 2002). The popularity of such a scale has discouraged researchers from developing new measures of EO (Covin & Lumpkin, 2011).

It is important to note that proxies have been shown to be problematic and might not actually measure the construct. Thus they need to be validated against content analysis of EO. Even though the proxies intended for use in this doctoral study have been outlined in past research, it is important to break from the assumption that these proxies are inherently or intuitively accurate to prevent the risk of measurement malaise and test for such proxies (Ketchen et al., 2013). Content analysis using CATA is superior to human analysis of texts since it is more reliable and faster (Short et al., 2010). Moreover, content analysis through CATA software demonstrates high test-retest reliability when covering the multiple texts along a longitudinal time frame (Short et al., 2010). Researchers have indicated that if one was to compare CATA word counts and human coded analysis, then CATA method proved to be more accurate since human coded analysis was subject to error (Short et al., 2010).
Entrepreneurial Orientation and Firm Performance: In the Context of Upper Echelon Theory

Using CATA allows one to attain construct validity of the EO dimensions (Short et al., 2010). In order to validate the proxies for EO, content analysis using CATA (Computer Aided Text Analysis) software will be run on a sub sample (50 firms) for three single years (2000, 2004, 2008) since the validation of proxies through content analysis does not require the utilization of the whole sample size and using three different time periods instead of one allows for better cross-validation. In conclusion, the research methodology selected for this doctoral study is purely quantitative as secondary data will be used in order to reflect proxies for each of the EO dimensions, CEO moderator variables (e.g. CEO greed and overconfidence and managerial discretion), board power moderator variable, and to obtain data on firm performance measures (e.g. Tobin’s Q and Total shareholder return).

The following study is of significance since there is a gap in the literature regarding exploring the role of managerial characteristics in the EO-performance relationship. The literature has predominantly taken for granted the EO as advantage perspective by accepting positive effects of EO on firm performance. However, the EO as advantage perspective has been challenged by undercurrent of studies showing an alignment between EO and extreme CEO characteristics such as narcissism (Wales et al., 2013) and overconfidence (Engelen et al., 2015). Thus, the literature should take into account the role of the CEO (especially dark CEO characteristics) in the EO-firm performance relationship. Taking into account the human agency context when understanding EO might challenge the hegemony of EO as advantage view. That is, when the CEO is accounted for in the EO-firm performance relationship, interesting findings might be revealed.

References


Entrepreneurial Orientation and Firm Performance: In the Context of Upper Echelon Theory


