



# Organizational and competitive influences of exploration and exploitation activities in small firms

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## ABSTRACT

This study explores organizational and competitive factors affecting exploration/exploitation activities in SMEs by examining the role of entrepreneurial orientation (EO), market orientation (MO) and perceived competitive intensity. We test the relationships among these variables using data collected from 55 manufacturing SMEs operating in the southern part of U. S. The findings provide a strong support for a positive association between EO, MO and exploration/exploitation activities. Perceived competitive intensity was only a significant moderator for the relationship between MO and the degree of exploratory activities. Our findings, hence, suggest the significant role organizational predictors play in enhancing exploration/exploitation activities in SMEs. Implications for research and practice are discussed.

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## 1. Introduction

Despite the substantial amount of empirical work on organizational ambidexterity among large, established business organizations, our understanding of the interplay, influence and implications of exploratory and exploitative activities in small and medium-sized enterprises (SMEs) is still limited. Research on organizational ambidexterity has only recently begun to focus more on SMEs as an important empirical context (e.g. Cegarra-Navarro & Dewhurst, 2007; Jones & Macpherson, 2006; Lubatkin, Simsek, Ling, & Veiga, 2006). The exploratory and exploitative activities in SMEs and larger corporations differ for at least three different reasons. First, SMEs, unlike larger and well-established corporations, lack the necessary slack resources needed for actively realizing the benefits of organizational learning (Cegarra-Navarro & Dewhurst, 2007). Second, senior managers in SMEs (including owner-managers) have extensive involvement in strategic and tactical decisions compared to larger organizations with more complex bureaucracies (Lubatkin et al., 2006). Finally, organizational learning processes in SMEs could be different as there is a lack of formal and institutionalized routines as well as a mechanism for acquisition and dissemination of new knowledge (Jones & Macpherson, 2006). Collectively the issues of slack resources, senior management involvement, hierarchy and organizational routines impact SMEs' exploration and exploitation activities.

The purpose of this study is to extend the on-going research on organizational ambidexterity by examining the link among market orientation (MO), entrepreneurial orientation (EO), perceived competitive intensity and the degree of exploration/exploitation activities in SMEs. Market orientation and entrepreneurial orientation are important organizational-level constructs that have been extensively shown to affect both the firm's strategic direction and performance (Ellis, 2006; Moreno & Casillas, 2008). Past studies have also shown that there is a strong combined complimentary effect of EO and MO on SME performance (Li, Zhao, Tan, & Liu, 2008).

Consistent with the established argument in the extant literature, we contend that individual exploration and exploitation activities are the origins of firm exploration and exploitation (Mom, Van Den Bosch, & Volberda, 2007) and that exploration and exploitation activities are the outcomes of managerial information processing (Lubatkin et al., 2006; Mom et al., 2007; Smith & Tushman, 2005). It is especially true in SMEs context, because unlike their counterparts in larger organizations, senior managers of SMEs are closer to the day-to-day operations of their firms (Jones & Macpherson, 2006). Accordingly, we make the assumption that firm exploration and exploitation is a reflection of individual senior manager's information processing as well as exploration and exploitation activities (Lubatkin et al., 2006). This assumption is consistent with previous studies on this issue (e.g. Cegarra-Navarro & Dewhurst, 2007; Wyer, Mason, & Theororakopoulos, 2000).

## 2. Theory and hypotheses

In the following sections, we present theoretically driven relationships among EO, MO, perceived competitive intensity and the degree

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of exploration and exploitation activities in SMEs. Fig. 1 below presents the proposed research model of this study.

### 2.1. Market orientation and degree of exploration/exploitation activities

Marketing as a boundary spanning function has an important impact on a firm's exploration and exploitation activities. Kohli and Jaworski (1990) introduce the concept of MO to describe “the organization wide generation, dissemination, and responsiveness to market intelligence” (p.3).

The adoption of MO requires firms to understand their competitors' current and future resources and capabilities as well as their own inter-functional coordination and resource utilization (Im, Hussain, & Sengupta, 2008; Slater & Narver, 1999). On one hand, market oriented firms emphasize on understanding and analyzing customer requirements in the current target market as it relates to existing product/service offerings (Slater & Narver, 1999; Zhou, Brown, & Dev, 2009). Firms for instance conduct an in-depth analysis of continuous customer feedback and demand and use such information to upgrade and improve their product/service offerings. The results may involve a series of incremental product and process innovations that are aimed at further meeting the needs of existing target market (Kirca, Jayachandran, & Berthon, 2005; Morgan & Berthon, 2008).

The role MO plays in effectively meeting existing customer needs is conceptually related to exploitative activities in organizations. Since exploitative tasks involve incremental changes, upgrades and short-term efficiency improvements (March, 1991), higher levels of MO seem to increase the degree of exploitative activities and short-term organizational adaptation (Morgan & Berthon, 2008). Morgan and Berthon (2008), for instance, empirically examined the relationship among MO, innovation strategy and firm performance using data from 160 firms in the bioscience industry. Their findings suggest a significant relationship between MO and exploitative innovation activity.

While MO facilitates firms' efforts in identifying and meeting existing customers' needs, it can also help promote long-term product/service and process innovations that are aimed at both meeting existing customers' future needs as well as reaching out to prospective customers (Atuahene-Gima, 1995; Kirca et al., 2005). More specifically, the positive effect of MO on firm innovative capabilities and outcomes has been extensively studied (e.g. Atuahene-Gima, 1995; Morgan & Berthon, 2008; Slater & Olson, 2001; Zhou et al., 2009). In his study of 275 Australian firms, Atuahene-Gima (1995) find that the extent of MO positively influences new product development performance and related development processes. Similarly, Zhou et al. (2009) observe a positive and significant association with customer orientation (which is part of MO) and the ability of the firm to achieve competitive advantage through innovation and market differentiation.

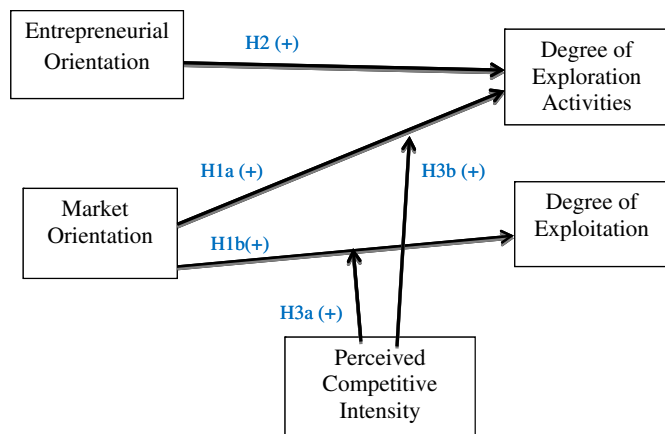


Fig. 1. Proposed research model.

We contend that the role MO plays in fostering innovation conceptually relates to the degree of exploratory activities. Accordingly, market-oriented firms not only strive to satisfy current customer needs, but they also actively seek to identify and fulfill future customer needs by introducing new products/services and entering into new businesses (Atuahene-Gima, Slater, & Olson, 2005). We hypothesize that:

**H1a.** There is a positive relationship between managers' market orientation and degree of exploration activities.

**H1b.** There is a positive relationship between managers' market orientation and degree of exploitation activities.

### 2.2. Entrepreneurial orientation and degree of exploration activities

Entrepreneurial orientation refers to the managerial characteristics of risk taking, innovativeness and proactiveness (Covin & Slevin, 1989). It also explains the degree of importance that a firm places on the activities of identification and exploitation of new opportunities (Baker & Sinkula, 2009; Shane & Venkataraman, 2000) from the dynamics of its macro and task environments (Miles & Arnold, 1991). Thus, previous research has shown that it correlates to but is distinct from MO. Hence, while MO emphasizes customer and competitor intelligence, EO is largely driven by untapped market opportunities (Baker & Sinkula, 2009; Miles & Arnold, 1991).

According to the seminal work of Covin and Slevin (1989), the construct EO has three major dimensions: innovativeness, proactiveness, and risk taking. Entrepreneurial innovativeness is defined as the “willingness to support creativity and experimentation in introducing new products/services, and novelty, technological leadership and R&D in developing new processes” (Lumpkin & Dess, 2001, p. 431). The risk-taking behavior of entrepreneurs has been examined extensively in the literature and generally is associated with the “willingness of entrepreneurs to engage in calculated business-related risks” (Kreiser, Marino, & Weaver, 2002, p. 78). Proactiveness is defined as the “opportunity-seeking, forward-looking perspective involving new products or services ahead of the competition and acting in anticipation of future demand to create change and shape the environment” (Lumpkin & Dess, 2001, p. 431). This construct had been extensively validated by several cross-sectional, longitudinal and even cross country studies (Kreiser et al., 2002).

We contend that an entrepreneurial orientation has an impact on managerial information processing and decision making related to exploration activities which usually have more uncertain and distant results. In such instances, managers of SMEs might explore many possibilities that will help them create new products and processes and initiate an aggressive attack on their competitors. Supported by risk taking dimension, ultimately these complex knowledge structures will realize in firm exploration activities. Overall, we suggest that entrepreneurial firms are more conducive to pursuing exploration activities. Hence, we hypothesize that:

**H2.** There is a positive relationship between managers' entrepreneurial orientation and the degree of exploration activities in SMEs.

### 2.3. The moderating role of perceived competitive intensity

We define perceived competitive intensity as the degree of managers' perception of competitive intensity in the industry. It can range from aggressive promotional campaigns to continuous new product introductions. One result of the intense competition is the stochastic consequences of firms' behavior (Auh & Menguc, 2005). In such situations, results of firms' behavior depend on other competitors' behavior and are less certain or predictable. Firm competitive advantage is also short-lived. Consequently firms need to perform more MO and

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