

Role of Entrepreneurs In Strategy-Making Processes In Small Firms

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SMALL FIRM STRATEGIC MANAGEMENT

The literature focusing on small firms has increased substantially in the last three decades. Robinson and Pearce (1984), for instance, presented a classification including four research thrusts on small firm strategic planning, namely: (i) Strategic Planning Practices which included papers focusing on the nature of the strategic planning process in small firms, and the decision making approaches adopted by the entrepreneurs; (ii) Value of Planning which considered how strategic planning and performance of small businesses were related; (iii) Specific Features of the Planning Process that focused on specific aspects of strategic planning, such as the search for external information and the use of consultants; and (iv) Content of Strategy that dealt with types of strategy adopted by entrepreneurs in different environment settings.

As the classification proposed by Robinson and Pearce suggests, most of the papers in small firms' strategic management have dealt with issues related to the strategic process. In this literature survey, a reasonable number of studies were found to be dedicated to different aspects of strategy content on small firms. This seems to indicate a great awareness among researchers of the importance of content analysis to a better understanding of strategic behaviour in small firms. This thrust deals mainly with types of strategy adopted by entrepreneurs in different environmental settings and their potential association with a firm's performance. Chaganti (1987) designed a comparative study of strategies adopted by 192 small firms in different industry growth environments and concluded that the environment has a contingent role on strategy formulation.

Davig (1986) studied successful and unsuccessful strategies adopted by small firms in maturing industries. The results of his study indicated that firms following the prospector and defender strategies achieved the best performance with respect to growth in profits, while reactors were the lowest performers. Davit showed that the four different strategic types could be found among a sample of small firms, and thus, in a way, dismisses the speculation advanced by Smith et al. (1986) that Miles and Snow's typology could be seen as sequential stages of strategy development, i.e., defender strategies would be linked to small firms, and prospector strategies to larger firms.

Ragman and Verbeke (1987) argued against the use of Porter's (1980) model of competitive strategy in the context of small firms and advocated the adoption of Miles and Snow's one. For them, small firms can only adopt a focus strategy and so, the choice between overall cost leadership, overall differentiation, and focus as proposed by Porter is not an issue in a small enterprise. Miles and Snow (1978) proposed a model to describe small firms' competitive strategies. They have produced a typology of competitive strategies and proposed that small firms in general develop relatively stable patterns of strategic behaviour in order to accomplish a good alignment with perceived environmental conditions. Their typology involves four strategic types: defenders, prospectors, analyzers and reactors. Many firms were identified as reactors, and a few as defenders. Contrary to what would be expected, no analyzers were identified. Lyles et al. (1993) described a more comprehensive study dealing with the relationship between planning formality, strategic decision-making process, and content of strategies and performance.

This literature review on small firm strategic management indicated that formal planners differed from non-formal planners in the degree of emphasis put on dimensions of strategic decision-making and strategic choices. Formal planners adopted a wider range of strategies. They also put greater emphasis on improving the quality of the strategic decision-making. Slevin and Covin (1987: pp.93) reported a comparison of competitive tactics adopted by entrepreneurial firms in high- and low-tech industries. Interested on investigating whether the content of strategies adopted by high- and low-tech entrepreneurial firms would be significantly different, the authors

collected data from 79 recently created entrepreneurial firms in the Western Pennsylvania area. They investigated as well, if there were any differences regarding to competitive tactics adopted by low and high performing firms in both kinds of industries.

The findings indicated that: entrepreneurial firms in high-tech industries tend to attack their environments, adopting a proactive, aggressive, innovative, focused, and future-oriented strategic posture. On the other hand, entrepreneurial firms in low-tech industries adopt a more mechanistic, structured, and standardized approach to their environments. No significant differences were found in terms of competitive tactics adopted by high and low performing small firms.

Lumpkin and Dess (1996) studied the popular five dimensions of small firms, which are: autonomy, innovativeness, risk taking, proactiveness, and competitive aggressiveness. Proactiveness refers to how firms relate to market opportunities by seizing initiative in the marketplace; competitive aggressiveness refers to how firms react to competitive trends and demands that already exist in the marketplace.

Despite these distinctions, prior research has tended to equate these two concepts and argued that they have a similar effect on firm performance. The performance of firms in the early stages of industry development was stronger when their strategy making was proactively oriented. In dynamic environments, characterized by rapid change and uncertainty, proactive firms had higher performance relative to competitively aggressive firms. In hostile environments, where competition is intense and resources are constrained, competitively aggressive firms had stronger performance. These literature review findings suggest that these two different approaches to entrepreneurial decision-making may have different effects on firm performance. The differences were particularly apparent in the way firms relate to their external environment. Proactiveness—a response to opportunities—is an appropriate mode for firms in dynamic environments or in growth stage industries where conditions are rapidly changing and opportunities for advancement are numerous. Firms in hostile environments, or in mature industries where competition for customers and resources is intense, are more likely to benefit from competitive aggressiveness—a response to threats. These literature review findings reveal a fragmented approach to the study of strategy formation in the realm of small firms.

WHO IS AN ENTREPRENEUR?

During the sixteenth century, people who organized and managed military and exploration expeditions in France were called “entreprendre”. The word entrepreneur is derived from this French word and basically means, “to undertake”. Economists have been concerned with the three factors of production—land, labour, and capital—which need to be combined to lead to production, but they often fail to consider who actually carries out the combination. The French Economist Say (1803), however, said that the entrepreneur was the fourth factor or agent of production (Koolman, 1971). Coordination was the key role of this driver of the production of goods and services, although other roles included decision making and risk bearing.

The American Economist Knight (1921) is famous for distinguishing between risk and uncertainty. He defined risk as a random event about which managers could estimate the probability of occurrence. On the other hand, uncertainty regarding an event meant that it was completely random and no estimates could reasonably be made of its occurrence. He stated that the important role of the entrepreneur in combining factors of production was to act as the risk taker, to be responsible for decisions under uncertainty and to be rewarded by profits for the decisions made. If a manager or CEO or any person assumed such responsibility for uncertain outcomes, then they were performing an entrepreneurial function.

The father of entrepreneurship in relation to economics is the German Economist Joseph Schumpeter (1934). He developed an important theory of economic development, which depended upon a process of “creative destruction”. Innovative producers of “new combinations” who led to the growth of the economy over time from the destruction of old industries and the development of new ones caused this. He saw the entrepreneur as being the innovator or the creator of “new combinations” which led to the development of: (i) new products and services; (ii) new methods of production; (iii) new markets; (iv) new sources of supply; and (v) new forms of organization. Very few people have the ability to be innovative and creative, so that this role demands exceptional people according to Schumpeter.

According to Rotter (1966), a person perceives the outcome of an event either within or beyond their personal control. People with an external locus of control believe that their destiny is controlled by people, events, luck or chance over which they have no influence. They may be reluctant to start a business venture because they feel inadequate in handling all the risks involved. On the other hand, a number of research studies support the belief that entrepreneurs tend to have an internal locus of control (Hornaday & Aboud, 1971; Shapero, 1975; and Jennings & Zeitghaml, 1983). They perform best when they are personally responsible for results because they are internally rather than externally controlled. Without, or even despite external influences, they can bring about a desired outcome. Although entrepreneurs seem to be exceptional people, the many different lists of personality traits that have been provided by various writers do not appear to be very helpful in deciding whose list is correct. An examination of the psychological attributes of internal focus of control seems more fruitful and these in turn provide a rationale for some specific personality traits. Undoubtedly, some exceptional people are born with these characteristics, but there is evidence that they can also be taught (Timmons, 1985).

In an attempt to make a distinction between different “entrepreneurs”, Black uses two dimensions: **honing and enterprising competence**. Kirzner defines entrepreneurial competence (related to enterprising) as a function of making decisions and taking actions in the face of an uncertain present or future environment and/or the realization of existing opportunities that have remained previously unnoticed. Black argues that the horizontal dimension is related to the entrepreneur’s tolerance for ambiguity while the vertical dimension is related to the entrepreneur’s risk attitude. There is an element of risk involved at higher levels of honing, when the entrepreneur leads the way, but below this level it is more about having and applying competence. Having high self-efficacy could be crucial for an entrepreneur at higher levels of honing. The idea is that entrepreneurs with higher competence in either enterprising or honing will lead firms that outperform those with lower competence.

The conventional small business entrepreneur has often not engaged much in enterprising after the initial effort in the startup. As Davidson and others have suggested, the majority of small firms fit the general description of “entrepreneur” poorly. However, many of these small firms have been successful since they have been able to hone their operations to satisfy their customers. Some have been so successful in their honing activities that they become “best in show”. Still, they are not performing any entrepreneurial act. They are merely doing what they have done earlier in a more effective way.

The balance between enterprising and honing is not trivial. The two aspects of entrepreneur’s personality, tolerance for ambiguity and self-efficacy, both have dispositional (i.e., relatively enduring preferences for a person to think or act in a specific manner) characteristics and have shown to be important in several studies. Tolerance for ambiguity is often defined as the extent to which an individual feels threatened by ambiguity or ambiguous situations and affects the individual’s level of confidence when making decisions. Tolerance for ambiguity (in actions) as the extent to which an individual’s actions are blocked or delayed by ambiguity or ambiguous situations has a direct link to the act of enterprising.

ENTREPRENEURS’ ROLE IN SMALL FIRMS

Entrepreneurs’ role in strategy making in small firms is context specific, and contingent upon many external factors or internal factors. Researchers have found hierarchical ordering relationships among the entrepreneurs’ personal initiative, achievement, and risk-taking orientation, and the firm-level strategy, and the subsequent firm performance. The dimensions of a firm’s strategy-making processes are viewed as encompassing the entire range of organizational activities that involve planning, decision-making, and strategic management. In strategic management literature, for example, Miller and Friesen (1978) identify 11 strategy-making process dimensions, including addictiveness, analysis, integration, risk taking, and product market innovation.

Stevenson and Gumpert (1985) define entrepreneurial management as a set of opportunity-based management practices, and argue that it can help firms remain vital and contribute to firm and societal level value creation. Fredrickson (1986) investigates how organizational structure influences decision-making process and reveals dimensions such as proactiveness, rationality, comprehensiveness, risk taking, and assertiveness. Empirical results also reveal that the dimensions of entrepreneurial orientation overlap with the six correlated dimensions of Stevenson and Gumpert’s notion of entrepreneurial management. These six dimensions are: strategic orientation,

resource orientation, management structure, reward philosophy, growth orientation, and entrepreneurial culture. (Brown et al., 2001).

There have been a number of approaches in the operationalization of entrepreneurial orientation; most noticeably, managerial perceptions, firm behaviours, and resource allocations. Managerial perceptions of firm-level variables such as strategy, structure, processes, and performance, often obtained from surveys using questionnaires, are probably the most frequently used in strategy research (Covin & Slevin, 1991; Miller & Friesen, 1978; and Naman & Slevin, 1993). Arditti (1973) and Gale (1972) measure a firm's debt to equity ratio and use that as a proxy for a firm's risk taking behaviour.

Entrepreneurial heuristics and entrepreneurial orientation have a very high predictive power for the firm's resultant innovativeness. It is argued that entrepreneurship is an essential feature of high-performance firms (Covin & Slevin, 1991), and entrepreneurial orientation has significant and positive impact on firm performance (Lumpkin & Dess, 1996; 2001; and Lyon et al., 2000). Lumpkin and Dess (1996) argue that the positive influence of entrepreneurial orientation on performance (measured by sales growth, market share, profitability, overall performance, and stakeholder satisfaction) is contingent upon environmental factors such as dynamism, munificence, complexity, and other industry characteristics and organizational factors such as size, structure, strategy, strategy-making processes, firm resources, culture, and top management team characteristics.

Specifically, firms with an entrepreneurial orientation that use an organic structure will have higher performance relative to those that do not use an organic structure. "Organic structure" means that firms with low structural formalization, decentralization, and low complexity (Covin & Slevin, 1991).

In firms with high entrepreneurial orientation, manager's entrepreneurial orientation also interacts with tolerance of ambiguity and co-influence performance. In firms with high entrepreneurial orientation, managers with a higher level of tolerance for ambiguity would have a higher performance. Evidence suggests that entrepreneurial firms are more likely to place an emphasis on marketing efforts.

INFLUENCING FACTORS IN SMALL FIRM ENTREPRENEURS' STRATEGIC DECISIONS

Entrepreneurship involves what Schumpeter termed "new combinations" of resources. Schumpeter suggested five situations where the phenomena of bundling resources by entrepreneurs to produce new resources occur. The focus of most current entrepreneurship research into opportunities has been on markets (Kirzner, 1997). This is true whether the market is a product market or a factor market (Shane & Venkataraman, 2000). Individuals acquire knowledge and store tacit knowledge. The entrepreneurial problem is how to secure the best use of resources to obtain profit. Thus, entrepreneurial knowledge is an abstract knowledge of where and how to obtain these resources. When the market is unable to organize distributed knowledge, the entrepreneur understands this and capitalizes upon the opportunity resulting in a new firm. Therefore, it is not the market that organizes tacit knowledge, in fact, it is often the case that markets are inefficient at knowledge transfer and integration, it is the firm that efficiently organizes knowledge. The primary role of the firm is the integration of specialized knowledge (Demsetz, 1991; and Conner & Prahalad, 1996).

THE FIRM

Firms behave creatively. Firms not only use rational and analytical decision-making, they also use creative action as a way to figure out both goals and strategies in an intrinsically dynamic process. The first step in building a strategic management based on creative action, therefore, would call for theories that explain the selection of goals as endogenous to the strategic management processes. In strategic management, researchers such as Mintzberg have called for a research program to examine strategies that were intended as well as those that were realized despite intentions (Mintzberg, 1978).

Factors such as organizational structure, culture, governance, the types of ownership and style of operation have profound influences on a firm's strategy, entrepreneurial orientation, and performance. Creative organizational climate affects market orientation, learning orientation, entrepreneurial orientation, and organizational flexibility; particularly, sound use of creativity can improve a manager's planning, implementation, and control (Barrett et al., 2005). The relationship between entrepreneurial orientation and the support from stakeholders with divergent

interests evolves dynamically over time—the support from diverse stakeholders’ influences entrepreneurial behaviours, and subsequently, these entrepreneurial behaviours influence the future of the firm.

A firm is the nexus of contracts, written and unwritten, among owners of factors of production and customers. These contracts or internal “rules of the game” specify the rights of each agent in the firm, performance criteria on which agents are evaluated, and the payoff functions they face. The contract structure combines with available production technologies and external legal constraints to determine the cost function for delivering an output with a particular firm. The firm that delivers the output demanded by customers at the lowest price, while covering costs, survives. The central contracts in any firm specify (i) the nature of residual claims and (ii) the allocation of the steps of the decision process among agents. These contracts distinguish organizations from one another and explain why specific organizational forms survive.

FIRM DIFFERENTIATION

Why are firms different? Or, what sustains the heterogeneity in resources and performance among close competitors despite competition and imitative attempts? The issue of differentiation is even an issue only if we assume homogeneity of goals, especially goals that are determined prior to choice. In reality, however, entrepreneurs do not begin with specific goals—only with vague and generalized aspirations, that are themselves contingent upon a host of situational and temporal factors. This intrinsically pluralizing role of contingent aspirations affects both demand-side and supply-side choices. For example, on the demand side, most hungry customers do not start with the “need” for a specific food such as hamburgers. Instead, they start with a generalized hunger for something to eat. The entrepreneur induces the customer to transform that generalized aspiration into a concrete demand for a specific product such as the hamburgers manufactured by a particular company.

There are two types of choice here. The first one involves the transformation of a vague aspiration such as hunger into the specific desire for a hamburger. The second one involves the choice between possible hamburger joints, given the desire for a hamburger. As proponents of the resource-based theory of the firm have pointed out, in mainstream economics and management, entrepreneurs tend to model the latter type of choice (i.e., choice between means to achieve a particular goal) rather than the earlier one—i.e., the choice between possible ends, given particular means and much generalized aspirations (Ulrich & Barney, 1984). Similarly, on the supply side, most entrepreneurs do not set out to build a particular company for a particular product within a particular market (For example, to create a profitable company for manufacturing and selling razor blades).

Instead, when setting out, the entrepreneur only has some very general aim, such as the desire to make loads of money, or to create a lasting institution, or more commonly, just an interesting idea that seems worth pursuing.

Just as exploration and exploitation are both essential to the continuing sustenance of firms, both causation and effectuation are important aspects of entrepreneurial and strategic decision making in individuals. Once an entrepreneur creates a product and establishes the existence of a market for it, others can use processes of causation to create similar products within the new marketplace brought into being by the effectuating entrepreneur. While causation models consist of many-to-one mappings, effectuation models involve one-to-many mappings.

The existence of effectuation processes in entrepreneurial decision-making has been empirically confirmed by a study (Sarasvathy, 1998), gathering and analyzing think-aloud verbal protocols of 27 entrepreneurs who had founded and grown companies ranging in size from \$200 million to \$6.5 billion. The logic behind the study was to discover commonalities in the decision processes used by expert entrepreneurs with a diverse background and experiences, and cull together a baseline model of entrepreneurial expertise. The data shows that the subjects’ decisions conform overwhelmingly to a model of effectuation rather than a causation process of choosing between means toward predetermined ends. To summarize briefly, causation processes are effect-dependent—focusing on expected returns, competitive analyses, pre-existent knowledge, and prediction and effectuation processes are actor-dependent—emphasizing affordable loss, strategic partnerships, contingent action, and control. In the effectuation processes, entrepreneurs not only end up creating new firms, but often end up creating new products and even new market niches that emerge as the residuals of their decisions rather than as pre-existent goals to be achieved through their decisions. Effectuation is essentially a divergent process that increases the dimensionality of the commodity space.

In a world where effectuation processes dominate, firm differentiation is not a phenomenon to be explained—it is the expected outcome. At the level of the firm, the corresponding means are its physical resources, human resources, and organizational resources, and the resource-based theory of the firm (Barney, 1991). It turns out, therefore, that effectuation processes bring some important perspectives and issues to the table with regard to the resource-based theory of the firm. For example, effectuation suggests what will make the resource based view of the firm powerful. It is not a focus on what the resources are and how they influence outcomes and value creation. It suggests under what circumstances which type of reasoning processes (causal and effectual) gets used -Through what routines, procedures, decisions, and actions?

FIRM SCOPE

What limits the scope of the firm? The tension between creativity and efficiency: By setting out to create a strategic management based on creative action, i.e., originative choice in the absence of pre-existent goals, entrepreneurs have moved to a world where effectuation is at least as valid an alternative as causation. But the mere existence of effectuation processes suggests that firms have to manage a continual and/or iterative tension between creativity and efficiency. Furthermore, entrepreneurs manage this tension by differential uses of causal and effectual reasoning, and that differential limits the scope of particular firms at least to a partial degree. The tension between creativity and efficiency has manifested itself in many forms both in theories and data in strategic management, as well as in management and economics.

Several suggestions have been developed in the literature on how to deal with this tension. Chandler suggests the necessity (and the historical reality) of firms in more mature and complex industries using strategic and market control techniques while firms in more technologically turbulent environments should resort to more entrepreneurial techniques (Chandler, 1962). Williamson advocates more of an efficiency perspective for the headquarters of a business firm, eschewing a more proactive entrepreneurial strategizing (Williamson, 1975). Overall, the consensus seems to be towards some kind of a balanced portfolio or diversification approach to this particular strategic management question.

THE ENVIRONMENT

The second set of factors that influence small firms' strategic decisions is the industry environmental factors. Industry organization theorists believe that external environment exerts a fundamental, if not determining influence on how firms behave and how well firms perform (Dess & Beard, 1984). In order to be successful, firms must strive to achieve strategy-environment, co-alignment (Venkatraman & Prescott, 1990) and develop a dynamic strategy to sustain the competitive advantages in the dynamic environment (Porter, 1991). Intuitively, one would assume that when firms perceive a higher degree of environmental hostility, they are more likely to adopt a more creative and innovative entrepreneurial strategy. Surprisingly, researchers find an inverse relationship between the degree of perceived environmental hostility and the likelihood that the firm will adopt an entrepreneurial orientation, among the US firms, at least (Miles et al., 1993).

Another external factor that is likely to affect the firm and its entrepreneur is the technology that is used. Technology is determined by whether task knowledge and task variety is high or low. The technology often tends to be the same in the same industry. For example, in the joinery industry, task knowledge tends to be low (in the heads and hands of the workers) and task variety low (same basic tasks are repeated), which indicates that the joinery industry uses a craft technology. Macintosh argues that the use of management control system vary with the technology used by the firm. This means that different management control systems should be used in different situations. In the joinery industry, a results-oriented management control system is fitting.

RESOURCE HETEROGENEITY

Recently, the emergence of cognitive approaches to understanding how entrepreneurs think and make strategic decisions is showing much promise (Busenitz & Barney, 1997; Baron, 1998; and Forbes, 1999). If entrepreneurs do indeed have a unique mindset or orientation (Lumpkin & Dess, 1996), then it follows that their cognitive approaches are likely to have strengths and weaknesses in various competitive environments and are a potential source of competitive advantage (Barney, 1991). Entrepreneurial cognition is defined as the extensive use of individual heuristics and beliefs that impact decision-making (Busenitz & Lau, 1996; and Wright et al., 2000).

Managerial cognition is referred to as more systematic decision-making, where managers use accountability and compensation schemes, the structural coordination of business activities across various units, and justify future developments using quantifiable budgets. Managerial cognition is more factual-based while entrepreneurial cognition builds from limited or key experiences and beliefs. An entrepreneurial opportunity invariably involves the development of a new idea that others have overlooked or chosen not to pursue. In the context of environmental change, those with an entrepreneurial cognition orientation often see new opportunities where others tend to be concerned with protecting themselves from emerging threats and changes. The cognitive ability of entrepreneurs to frame situations in an opportunistic manner is a heterogeneous resource that can be used to organize other resources.

Explanations for entrepreneurial cognition have evolved primarily around two perspectives: (i) the searching for and obtaining of information leading to new inventions and (ii) the recognition process by which new discoveries are made. From the search perspective, discoveries are generally modeled to be the result of an extensive search targeted in the direction where the discovery is to be made (Stigler, 1961; and Caplan, 1999). This stream of research generally assumes that entrepreneurs know a priori where the invention needs to be made and can accurately weigh the cost and benefits of acquiring new information relevant to the invention.

MARKET OPPORTUNITIES

Schumpeter (1934) distinguished between invention and innovation, with invention being the discovery of an opportunity and innovation the exploitation of a profitable opportunity. The importance of the distinction between invention and innovation is that it focuses on the firm as a problem solving institution (Demsetz, 1991). Instead of concentrating on the market, the focus is on the role of entrepreneurship as the integration of disparate specialized knowledge (as suggested by both Schumpeter and Coase). Firm formation is essentially an entrepreneurial act because to coordinate and transmit tacit knowledge, the coordination of the firm is required. The entrepreneur's ability to convert creative insights and often-homogenous inputs into heterogeneous outputs make the firm a superior choice over the market. The classic story is that profit maximization and efficiency require the substitution of firms for markets if the cost of using markets becomes large relative to the cost of the entrepreneur forming a firm (Coase, 1937).

EX POST LIMITS TO COMPETITION

Regardless of the nature of the firm heterogeneity, sustained competitive advantage requires that heterogeneity be preserved. Thinking on ex post limits to competition has typically been focused at the firm-level and whether competing firms can readily acquire the necessary resources to return the market to competitive parity (Barney, 1991; and Conner & Prahalad, 1996). In this review, very few studies focus on the cognitive make-up and beliefs of individual entrepreneurs. Rather than the focus being on the long-term outcome of an entrepreneurial firm, these studies are interested in better understanding how those with an entrepreneurial cognition see opportunities that others have overlooked and how they are able to bootstrap together the necessary resources to start firms that attempt to exploit entrepreneurial opportunities.

The competition for thinking of new firm opportunities tends to remain stable even though many individuals seem to wish that they had had the foresight to capitalize on the entrepreneurial opportunities once they become visible. Ex post limits and entrepreneurial cognition provide a theoretical rationale for recent research that has identified habitual entrepreneurs as an important group of entrepreneurs (Westhead & Wright, 1998). Want-a-be entrepreneurs without an entrepreneurial cognitive makeup along with the lack of entrepreneurial experience are significantly restrained from competing in the development of future innovations.

Given that individual characteristics and decision styles cannot be readily transferred to want-a-be entrepreneurs, it becomes apparent that they are sources of competitive advantage in the entrepreneurial domain. Those with an entrepreneurial cognition perspective tend to use heuristic based rather than factual-based logic, often leading them to develop and assemble resources in new ways. After the initial entrepreneur has introduced a breakthrough innovation with some initial success, other less capable entrepreneurs emerge with new businesses and incremental innovations that "swarm" the new enterprise with similar look-alike imitations. Schumpeter suggests that new combinations of resources are new ways of competing and that these new ways of competing, do not, as a rule

come from existing firms, but rather from new firms that develop alongside established firms. If a firm currently exists, it increases its output during this time, this is also the time when new firms enter markets because of the increased demand created by the lead entrepreneur.

OPPORTUNITY RECOGNITION

As indicated above, in the theory of entrepreneurial cognition, the way some people think and make decisions allows them to function effectively in the pursuit of new inventions. Given that individual characteristics and decision styles cannot be readily transferred to want-a-be entrepreneurs, it becomes apparent that they are sources of competitive advantage in the entrepreneurial domain. We argue that this is true with opportunity recognition for the following reason. Those with an entrepreneurial cognition perspective tend to use heuristic based rather than factual-based logic often leading them to develop and assemble resources in new ways. Information is certainly important to those with a heuristic-based logic; however, it is often assembled in a nontraditional nonlinear manner. More factually oriented logic builds from proven information and the rationale for a new opportunity needs to progress in a logical manner. Since new inventions and opportunities rarely evolve in a logical manner, those with a factually oriented logic tend to become very frustrated by the non-linearity of opportunity recognition while those with a heuristic-based logic tend to thrive on it.

STRATEGIC COMPLEMENTARITY

Strategic complementarity is consistent with Schumpeter's argument that the early entrepreneur appears alongside existing firms and then the swarm like appearance of other (less qualified) entrepreneurs leads to many small firms forming a mass in a concentrated area. A familiar form of monopolistic competition characterizes the resulting equilibrium, though now instead of one large firm, there are a large number of small firms. The entrepreneur's ability to continuously innovate is the primary competitive advantage of the entrepreneurial firm, leading to sustainable entrepreneurial firms and sustainable wealth creation (Alvarez & Barney, 2001).

However, as firms get larger, the costs of organizing additional transactions within the firm may rise and the returns to the entrepreneurial function decrease (Coase, 1937). Once a firm reaches the point where the cost of organizing an extra transaction becomes equal to the market costs, either the market will organize the transaction or a new entrepreneur will enter and organize the new knowledge. The entrepreneurial knowledge of resource reorganization that is critical to the transformation of inputs into heterogeneous outputs becomes lost as the firm grows (Coase, 1937) and the now large firm begins to resemble the market.

CAUSAL AMBIGUITY

Causal ambiguity is the uncertainty regarding the causes of efficiency differences among firms. Causal ambiguity muddles the link between the resources controlled by a firm and a firm's sustained competitive advantage is not understood or understood very imperfectly. As an individual firm uses its existing knowledge in exploration and exploitation, it (firm knowledge) grows and multiplies into new knowledge. Entrepreneurial firms are often built around the founding entrepreneur who identifies the opportunity and moves to exploit it commercially. An entrepreneur's expanding knowledge base and absorptive capacity becomes an entrepreneurial firm's competitive advantage.

The entrepreneurial firm's absorptive capacity determines how successful the entrepreneurial firm will be in obtaining entrepreneurial rents. Lane et al. (1998) suggest that managerial capabilities are acquired through experience and tend to be firm specific. Thus, firms differ in their level of "managerial absorptive capacity" and by extension, entrepreneurial absorptive capacity. The more entrepreneurs and their firms have previously absorbed in terms of entrepreneurial capabilities such as opportunity recognition and the continuous innovation that transforms inputs into heterogeneous outputs, the greater their absorptive capacity. Greater amounts of an entrepreneurial firm's specific experience and learning contribute to the entrepreneurial firm's absorptive capacity creating causal ambiguity preventing other firms from imitating. Increased learning and growing absorptive capacity tends to create higher levels of causal ambiguity and growing difficulty for potential imitators. Causal ambiguity may be the essence of entrepreneurship because when the reasons for firm heterogeneity are poorly understood these reasons are often entrepreneurial in nature and thus difficult to imitate. However, when the reasons for heterogeneity are understood, even within the firm itself, the entrepreneurial knowledge becomes common knowledge that can be imitated by less qualified entrepreneurs.

COORDINATED KNOWLEDGE

Entrepreneurial knowledge is the ability to take conceptual, abstract information of where and how to obtain undervalued resources, explicit and tacit, and how to deploy and exploit these resources. Kirzner (1979) and Schumpeter (1934) describe the entrepreneurial role as the decision to direct inputs into certain processes rather than into other processes.

Markets are inefficient at integrating knowledge because explicit knowledge can be easily imitated and tacit knowledge cannot be articulated (Grant & Baden-Fuller, 1995). Explicit knowledge has the character of a public good: it can be transferred at low cost. Once explicit Knowledge is made known, it is easily imitated and it becomes incapable of generating rents for the original knowledge producer. Tacit knowledge by definition cannot be articulated and thus cannot be transferred at arm's-length.

Kirzner (1979) distinguishes between entrepreneurial knowledge and the knowledge expert, suggesting that it is the entrepreneur that hires the latter. The knowledge expert does not fully recognize the value of their knowledge or how to turn that knowledge into a profit or else, the expert would act as an entrepreneur. The entrepreneur may not have the depth of specific knowledge that the specialist has (such as technology expertise) but it is the entrepreneur who recognizes the value and the opportunity of the specialist's knowledge. While the entrepreneur may have some specialized knowledge of a resource (i.e. technology), what makes the entrepreneur unusual is the entrepreneur's function relies more on their ability to organize specialized knowledge. Thus, the knowledge expert has specialized knowledge and the entrepreneur has generalized knowledge and it is through the firm that the two types of knowledge are joined to produce rents.

CONCLUDING COMMENTS

In most of the studies reviewed, research conclusions have been made that strategy does indeed impact all firms' performance and that strategy making process is different in small firms than in large ones (e.g., Fiegenbaum & Karnani, 1991; and Jarillo, 1989). In small firms, the selection of strategy is critical for survival given the disadvantages they face. It is prescribed that small firms should pursue flexibility/niche strategies. Based on certain characteristics, like small firms do not have access to the same financial resources as larger firms and are many times under-capitalized, (Cooper et al., 1994; and Rajan & Zin-gales, 1995), flexibility/niche strategies do seem to fit.

In small firms, entrepreneurs' role is the foundation upon which the other constructs are built. Entrepreneurs' role in small firms can be considered as an organizational culture, a set of organizational capabilities, or pre-dispositional propensities that focus on innovativeness, pro-activeness, and willingness to take risks; and the entrepreneur has an overall positive influence on firm performance. Although both strategy and entrepreneurship theories predict that entrepreneur's role in strategy making has a strong positive influence on firm performance, empirical evidence for this direct relationship is relatively weak. In addition to having direct influence on firm performance, entrepreneurship is also thought to have a moderating effect on the influences from other organizational factors. In explaining performance, strategy scholars have focused on a firm's entrepreneurial strategic orientation, leaving its interrelationship with internal characteristics aside.

It is argued by strategy scholars that entrepreneurial orientation captures an important aspect of the way a firm is organized. While knowledge-based resources (both discovery and exploitation of opportunities) are positively related to firm performance, entrepreneurial orientation enhances this relationship (Wiklund & Shepherd, 2003). For example, Porter (1980) posits that the industry within which a firm competes has a critical impact on its performance; particularly, industry munificence, defined as the profitability or growth rates of the industry, has a positive influence on firm performance. In this regard, Lumpkin & Dess (1996) propose that entrepreneurial orientation and industry munificence have separate, independent influences on firm performance, and entrepreneurial orientation and munificence do not interact. Yet, they argue, entrepreneurial orientation has influence and is "contingent" upon industry munificence. Another confusing point is that they propose that the influence of entrepreneurial orientation on performance is also contingent upon the firm's strategy making processes. It appears tautological if the construct of entrepreneurial orientation is captured by the characteristics of a firm's strategy making processes, and it exerts its influences contingent upon strategy.

The theoretical perspectives of this literature review provide several potential avenues for further research. In particular, it calls into question the predominant mode of empirical investigations into resource-based theories that seeks to explain firm performance as directly dependent on the resources of the firm. Instead, the ideas presented in this literature study demonstrate the importance of the more useful approach of connecting particular methods and processes of resource use with firm performance. The dominant implication here is that the mere existence of or access to resources does not by itself explain firm performance. How entrepreneurs combine, extrapolate and use those resources matter, and matter greatly. Strategic management research should investigate such differential dyadic phenomena at a process level (for example, examining the use of causation versus effectuation) in addition to testing aggregate models of direct relationships between resources and firm performance.

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