

# Moderating Effect of Dynamic Capabilities on the Relationship between Entrepreneurial Orientation and Business Performance of Small and Medium Enterprises

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## Abstract

*This paper reviewed past literature with the aim of establishing the trends in published literature on dynamic capabilities, entrepreneurial orientation (EO) and business performance of Small and Medium Enterprise's (SMEs). Based on this review the relationship between dynamic capabilities, entrepreneurial orientation and business performance of SMEs is hinged on Schumpeter theory of innovations, (Schumpeter, 1942) and dynamic capability theory by Teece et al (1997). Scholars have a common view that the association between EO and business performance is too complex hence moderated by variables. Dynamic capabilities (DC) have a moderating role between predictors of competitive advantage and business performance. The literature reviewed therefore presents the empirical studies globally and locally on moderation of dynamic capabilities on EO and business performance of SMEs. From the review it has been established that there are inconsistent findings in terms of relationships between DCs, EO and performance of SMEs which is justified by the fact that DCs, EO dimensions vary independently and may not be equally valuable across performance metrics or different stages of development of SMEs, besides different situations impacts on the relationship between DCs, EO and business performance of SMEs. In addition there is a dearth of literature on the moderating effect of dynamic capabilities on the relationship between EO and business performance thus calling for further interrogation in the context of developing countries. In conclusion there are mixed results in the linkage between EO and business performance, however effective integration and implementation of EO and DC would help the organization secure competitive advantage in the face of dynamic business environment to foster high business performance.*

**Keywords:** Dynamic Capabilities, Entrepreneurial Orientation, Business Performance

## 1. Introduction

The global economy has been fostered by the Small and Medium Enterprise's (SMEs) as they remain the fulcrum of growth of gross domestic product (GDP) by reducing the level of unemployment and promotion of entrepreneurial activity. The role of SMEs in the development of the country is significant (Bayati & Taghavi, 2007). Besides SMEs, especially those operating in developing countries take a proactive role in supporting governments and investment promotion agencies in creating concrete Sustainable Development Goals (SDGs) related project pipelines (Weber & Bolwijn, 2014). However the failure rate of SMEs remains high throughout the world (Fang, Yuli, & Hongzhi, 2009). In this regard the ostensibility of SMEs as a strategic stimulant for economic growth remains fragile. This has

invoked substantial and growing interest in the small and medium enterprises with no exception to their business performance (Hamel & Coimbatore, 2010).

SMEs survival and performance is increasingly dependent on a number of factors including resilience of SMEs to refocus some of their strategies (Gunasekaran, Rai & Griffin, 2011). It therefore behooves SMEs to be dynamic and competitive in order to survive, grow and have superior business performance. In the converse when SMEs remain adamant to the changes in their environment they become victims of inordinate closures and stagnation. This is underscored by the fact that business performance of SMEs is negatively or positively influenced by changes in the business environment (Zhang, van Doorn, & Leeftang, 2014). Competition, management experience, technology change and finance have been incriminated as the greatest obstacle to growth and performance of businesses, (FinMark., 2010; Singh, Garg, & Deshmukh, 2010; Sharmilee & Muhammad, 2016). All these together without

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prejudicedenotes the essence of entrepreneurial orientation and dynamic capabilities in enhancing performance of SMEs.

The role of dynamic capabilities and entrepreneurial orientation in enhancing performance of SME borrows from Schumpeter's theory of innovations, (Schumpeter, 1942) and dynamic capability theory by Teece *et al.*, (1997). This is because entrepreneurial orientation combined with organizational reconfiguring capabilities constitutes a potential source of competitive advantage (Ari, Kaisu, & Saarenketo, 2005). Entrepreneurial orientation is a strategy-making process that provides organizations with a basis for entrepreneurial decisions and actions (Rauch, Wiklund, Lumpkin, & Fresse, 2009). There are five developed dimensions of Entrepreneurial Orientation, namely innovativeness, reactivity, competitive aggressiveness, risk taking and autonomy (Dess & Lumpkin, 2005). Entrepreneurial orientation combined with organizational reconfiguring capabilities through dynamic capabilities therefore constitutes a potential source of competitive advantage (Ari, Kaisu, & Saarenketo, 2005).

Dynamic capabilities are processes which help a firm attain and keep up a competitive advantage over other firms despite an ever changing business environment (Gathungu & Mwangi, 2012; Helfat, *et al.*, 2007). Dynamic capability improves response speed efficiency and effectiveness with respect to dealing with environmental changes to positively affect SMEs performance by allowing the SMEs to take advantage of revenue attractive opportunities and adjust its process to cut expenses (Drnevich & Kriauciunas, 2011). SMEs need dynamic capabilities that enable them to sense and seize new opportunities and renew the existing market base. The business environment is always changing and hence SMEs have to adapt quickly to competition and new challenges through continuous renewal of their competence. This is in line with the argument of Mwangi, (2016); Mwangi and Kiiru, (2017); Adomako, (2017), who opined that dynamic capabilities have a moderating role between drivers of competitive advantage and performance.

### 2.1 Trends in published literature

Global Entrepreneurship Monitor (GEM) Reports (2001-2010) show that SME survival and business performance is one of the lowest in the world (Herrington, Kew, & Kew, 2010). Therefore it remains incumbent for SMEs to adopt EO and DC so that a country can benefit from them. Entrepreneurial orientation (EO) has received substantial conceptual and empirical attention, representing one of the few areas in entrepreneurship research (Rauch *et al.*, 2009). Trends in literature also show the positive influence of entrepreneurial orientation in various performance measures such as financial performance, growth of the firm and overall business performance (Davis, *et al.*, 2010; Rauch, *et al.*, 2009).

However, studies by Gholami & Birjandi, (2016) Simiyu, Namusonge, and Sakwa, 2016; Muthee and Karanja, 2014; Vishal and Safal, 2015 revealed a positive significant relationship between EO and business performance. Rauch, *et al.*, (2009) revealed that there is a moderately large significant relationship. However, these findings are not uncontested. Inconsistencies have also been revealed on the effect of different dimensions of EO on business performance (Ndesaulwa & Kikula, 2016; Udin & Bose, 2014; Tachia, *et al.*, 2016; kamendi, 2016). Affendy, Asmat-Nizam, and Farid, (2015); Auger, BarNir, and Gallagher, (2003); Smart and Conant, (1994) revealed no significant relationship between EO and performance of SMEs. (Hart, 1992) argues that entrepreneurial-type strategies may even be associated with poor performance.

Differences in findings may be attributed to differences in research design or methodological idiosyncrasies because it is difficult to draw general conclusions on the basis of single studies examining single samples, in particular if response rates are low. It is also possible that certain variables moderate the relationship between the two (Rauch, *et al.*, 2005). However, the relationship between EO and business performance remains complex because different patterns of relationships may form in different contexts. This scenario indicates the need for a moderating variable and reveals a condition such that EO influences business performance (Wales, Gupta, & Moussa, 2011). The significant role of a moderating variable indicates that the positive relationship between EO and FP is often conditional (Aluisius & Rosli, 2015).

Some of the studies on EO and business performance of SMEs were qualitative for instance Ndesaulwa & Kikula, (2016) while others adopted a mixed method approach, Udin & Bose, (2014); Rauch, Wiklund, Lumpkin, & Fresse, (2009); Affendy, Asmat-Nizam, & Farid, (2015); Simiyu, Namusonge & Sakwa, (2016). However researchers have different arguments about generalizability of findings. Generalization is not accepted by many researchers as the purpose of qualitative, interpretative research, Onwuegbuzie and Leech (2009). Alexandra, (2014) posits that generalizability should become the standard for reporting qualitative and quantitative reports (Alexandra, 2014).

### 2.2 Gaps in research

It is suggested that not all the dimensions of entrepreneurial orientation have a direct or positive effect on business performance (Lumpkin & Dess, 1996) cited in (Nazri, Wahab, & Omar, 2015). Thus, it is necessary to assess the relative impact of each dimension of entrepreneurial orientation on performance of SMEs (Kraus, *et al.*, 2012). Besides most studies on DCs and EO had been conducted in developed countries such as US and the UK (Nazri, Wahab, & Omar, 2015). This underscores the essence of undertaking research in

developing countries which has different business environment and management style. Moreover, recent studies focused only on a partial analysis of these constructs (Kropp, Linsday, & Shoham, 2008). This calls for studying all the five dimensions of entrepreneurial orientation in relation to business performance to ascertain whether all dimensions affect performance of SMEs with the same level of intensity amidst moderation by dynamic capabilities.

The link between entrepreneurial orientation and firm performance has remained inconsistent (Karacaoglu, *et al.*, 2012). This calls for further interrogation of what is the exact relationship between EO and business performance of SMEs in order to iron out the inconsistencies. Besides the effect of EO on business performance is not always positive and linear, but contingency-oriented and context-specific, (Sciascia, D’Oria and Bruni, 2014; Wiklund & Shepherd, 2011). More and more scholars gradually reached a common view on this issue, namely that the relationship between EO and performance is too complex, which is moderated by variables (Lumpkin & Gregory, 1996; Walter *et al.*, 2006). In entrepreneurship, scholars have emphasized the need to go beyond the investigation of direct correlations between entrepreneurship and performance variables Lumpkin & Gregory, (1996) cited in Yanlong & Xiu'e, (2012) to reduce misleading inferences about the entrepreneurship-performance relationship Walter, Auer, & Ritter, (2006). There are no known studies on the contingent effect of dynamic capabilities on the relationship between EO and business performance of SMEs in Kenya. This warrants an empirical examination of dynamic capabilities as a moderator of the EO – performance of SMEs relationship to reduce misleading inferences in the context of developing countries.

### 2.3 SMEs in Kenya

The Micro and Small Enterprises Act No. 55 of 2012 established the Micro and Small Enterprises Authority ending 40-year struggle (1972-2012) for MSME’s recognition and mainstreaming of into the formal economy in Kenya (Omukoko, 2016). The SME sector has been widely recognized as an essential driver of economic growth, innovation, employment, and social integration in both developed and developing countries (Neneh & Smit, 2013). The SMEs subsector are businesses in both formal and informal sectors accounting to more than 74% of the total persons engaged in employment per year and contributing more than 18.4% of the country’s GDP (Ong’olo & Awino, 2013).

Despite their significance, past statistics indicate that three out of five businesses fail within the first few months of operation (Kenya National Bureau of Statistics, 2007). There are 7.4 million MSMEs in Kenya; 1.5 million of these businesses are licensed by the 47 county governments and about 5.9 million are unlicensed (KNBS., 2016). This indicates that there is a high number of

undocumented businesses operating informally in Kenya. A total of 2,210,472 MSMEs were closed in the last five years including the survey year 2016. With an average age of 3.8 years (KNBS., 2016). This is an index of poor performance of SMEs in Kenya. Article 212 of the Constitution provide for county governments to promote trade development and regulation, including Markets; Trade licenses (excluding regulation of professions); Fair trading practices; Local tourism; and Cooperative societies which imply that county system is instrumental in resource allocation and planning for the development of SMEs in Kenya (Ong’olo & Awino, 2013).

## 3. Literature Review

### 3.1 Empirical review

Researchers have continued to conceptualize the relationship between entrepreneurial orientation and business performance of SMEs in order to better understand the relationship. Empirical evidences also showed the positive influence of entrepreneurial orientation in various performance measures such as financial performance, growth of the firm and overall business performance (Davis, Bell, Payne, & Kreiser, 2010; Rauch, Wiklund, Lumpkin & Frese, 2009).

Ndesaulwa and Kikula, (2016) Examined the Impact of Innovation on Performance of Small and Medium Enterprises (SMEs) in Tanzania: A Review of Empirical Evidence. The study was based on desktop and library research methodology. The literature survey revealed that the studies on innovation and its effect on performance are observed to have concentrated to Western, Middle and Far East and very little empirical evidence is noticeable in Africa. The issue of innovation and how it relate to firm’s performance and specially SMEs is thus yet to be exhaustively explored. They posit that based on extant literature review there are no consistent results on whether the innovations altogether influence firms performance. The nature of the empirical results reported in their paper indicates a need for such studies especially in Africa where the research fissure is widely observed in this area. The paper is thus a wakeup call for empirical studies that assess the impact of innovation on SMEs performance in Africa and Tanzania in particular where the studies of this nature are rarely found in the review of literature conducted in this paper. Besides innovation was the only dimension of EO considered in the study living out other dimension which dispatch from the object of the current research intention to bundle all the dimensions and see how they affect performance.

Rauch, *et al.*, (2009). Entrepreneurial Orientation and Business Performance: An Assessment of Past Research and Suggestions for the Future. Extending beyond qualitative assessment, they undertook a meta-analysis exploring the magnitude of the EO-performance relationship and assessed potential moderators affecting

this relationship. Analyses of 53 samples from 51 studies with an N of 14,259 companies indicated that the correlation of EO with performance is moderately large ( $r = .242$ ) and that this relationship is robust to different operationalization's of key constructs as well as cultural contexts. The study adopted both qualitative and quantitative approach. Internal and environmental moderators were identified, and results suggest that additional moderators should be assessed. Recommendations for future research are developed.

Vishal and Safal, (2015) studied Entrepreneurial orientation and firm performance in Indian SMEs: Universal and contingency perspectives Data collected from 1980 Indian SMEs revealed a strong positive linkage between EO and firm performance. Environmental contingencies demand growth and competitive intensity were theorized and found to have a moderating influence on the EO–performance relationship. The study adopted a mixed method approach. The implication is that as much as SMEs embrace Entrepreneurial Orientation there is need also to consider environmental contingencies which moderate the relationship.

Tachia, *et al.*, (2016) in their study on EO-Performance relationships in Reverse Internationalization by Chinese Global Startup OEMs: Social Networks and Strategic Flexibility. Using structural equation modeling, they found that during reverse internationalization, proactiveness positively related to performance; risk taking is not statistically associated with performance; innovativeness negatively related to performance. The proactiveness-performance relationship is mediated by Strategic flexibility and moderated by social networking relationships. The dynamic and complex institutional setting, coupled with the issues of overcapacity and rising labor cost in China may explain why their distinctive results occur. This implies a context sensitive nature of entrepreneurial orientation (EO) owing to inconsistencies in finding from other contexts. The adopted a mixed method approaches. This research advances the understanding of how contingent factors (social network relationships and strategic flexibility) facilitate entrepreneurial firms to break down institutional barriers and reap the most from EO.

Gholami and Birjandi, (2016) Studied the effect of market orientation and entrepreneurial orientation on the performance of SMEs. The study adopted descriptive survey design. According to the findings the amount of T-value was more than 2 (T-value = 4.40), so the hypothesis with 95% of confidence not confirmed. These findings denotes that entrepreneurial orientation have significant effect on organizational performance. This implies that Iranian SMEs should capitalize on entrepreneurial orientation to gain high performance. However this study was limited in terms of population used in small and medium-sized enterprises in industrial city of Shiraz, due to geographical constraints cannot generalize the results to the entire population. However, it is suggested that future research should also examine different statistical

societies. They further argued that measures used in this study may be less relevant in countries with different environmental and organizational conditions. This all together motivates the need for a similar study in the context of developing countries.

Affendy, *et al.*, (2015) Assessed Effect of Entrepreneurial Orientation on Market Orientation and SMEs Business Performance using Structural Equation Model Approach (SEM). The unit of analysis for this study was the Small Medium Enterprise (SME) in Malaysia and this study deals with each SME manager response as an individual data source. The study was correlational in nature. The findings show that the entrepreneurial orientation does not significantly influence the business performance among SME in Malaysia. Since positive relationship is expected, the non-significance of the relationship between entrepreneurial orientation and business performance controverts the fact that entrepreneurial orientation has been suggested as an integral part of higher business performance and essential attribute of high performing firms (Lumpkin & Gregory, 1996 ; Lee & Peterson, 2000). This inconsistency in the findings underpins the need for further research on the relationship between entrepreneurship orientation and the performance of SMEs.

Owoseni and Adeyeye, (2012) conducted a study on the role of entrepreneurial orientations on the perceived performance of small and medium-scale enterprises (SMEs) in Nigeria. The study adopted descriptive survey design. Four hypotheses were tested and the study revealed that innovativeness, risk-taking, and proactiveness jointly predicted organizational performance. Hypothesis one showed that there was a significant relationship between risk-taking and perceived SME performance there was no significant difference between low and high Risk-taking and perceived SME performance (Crit-t = 1.96, Cal t = 1.598; df = 308,  $P > 0.5$ ). The hypothesis was therefore rejected., hypothesis two showed that risk-taking and innovativeness jointly predicted perceived organizational performance, but proactiveness did not independently predict perceived SME performance where ( $F(1,308) = 12.815$ ;  $R = .334$ ,  $R^2 = 0.103$ ;  $P < .05$ ). About 11% of the variation was accounted for by the variables. Hypothesis three showed that innovativeness and proactiveness jointly predicted perceived SME performance and hypothesis four showed that innovativeness and risk-taking jointly predicted perceived SME performance. The finding was that there is no significant interaction effect of Innovativeness and Pro-activeness on SME Performance ( $F(3,306) = .622$ ;  $P > .05$ ). The hypothesis was therefore rejected. These findings imply that SMEs should pay greater attention to the role of organizational context for different dimensions of entrepreneurship.

Simiyu, Namusonge, & Sakwa, (2016) Undertook a study on effect of Entrepreneurial Orientation on the Growth of women Micro and Small Enterprises in Trans Nzoia County, Kenya. The study adopted Schumpeter

innovation theory (Schumpeter, 1942). This research study utilized mixed research design where both qualitative and quantitative approaches were used. The study found out that Entrepreneurial orientation had statistically significant relationship with growth of women MSEs ( $R^2 = 10.5\%$ ,  $F = 5.234$ ,  $P = 0.000$ ) at 0.05 level of significance. The dimensions of EO have a collective effect on women owned MSE growth when they are combined and regressed as one single EO variable. This study found that the EO dimensions of innovativeness, risk taking and reactivity are of equal importance to explain growth of Micro and Small Enterprises. This implies that the use of these dimensions by SME owners would occasion growth of SMEs. These findings also justify the probity of the three dimensions in testing the effect of EO on the performance of SMEs.

Muthee and Karanja, (2014) Sought to establish influence of entrepreneurial orientation on growth of micro and small enterprises in Kerugoya, Kenya. This research study utilized mixed research design where both qualitative and quantitative approaches were used. The objectives of the study were to; find out the effect of innovativeness on growth of Micro and Small Enterprises in Kerugoya, Kenya; to evaluate the extent to which risk taking influences growth of Micro and Small Enterprises in Kerugoya, Kenya; to assess the effect of pro-activeness on growth of Micro and Small Enterprises in Kerugoya, Kenya; and to explore the influence of entrepreneurial managerial competence on growth of Micro and Small Enterprises in Kerugoya, Kenya. The study adopted Schumpeter innovation theory (Schumpeter, 1942). The research adopted a descriptive research design. The study found that the dimensions of EO (innovativeness, risk taking, pro-activeness, and entrepreneurial managerial competence) have a significant positive influence on growth of Micro and Small Enterprises. These findings also imply that SMEs should embrace EO both at individual and firm level to secure maximal performance.

Kamedi, (2016) the role of entrepreneurial orientation on the growth of small and medium enterprises in Nairobi County. The objectives of the study was to; establish the effect of risk taking on SMEs growth, effect of innovativeness on SMEs growth, effect of pro-activeness on growth of SMEs. The study adopted Schumpeter innovation theory (Schumpeter, 1942), McClelland's Psychological Theory (McClelland, 1961). This study adopted descriptive research design. The findings indicated that risk taking had the highest effect on growth of Nairobi SMEs followed by Pro-activeness, then innovativeness which had the least effect on growth of small and medium enterprises. All the variables were significant as their P-values were less than 0.05.

Açıkdilli and Doğ,an, (2013) in their study on Dynamic Capabilities and Entrepreneurial Orientation in the New Product Development. The study contended that EO affect new product development. They concluded that new product development is an integration of two focal construct dynamic capabilities and entrepreneurial

orientation. However these findings were based on the theoretical exposition observations and not statistical evidence.

Mahmood and Hanafi, (2013) Conducted a study on entrepreneurial orientation and business performance of Women-Owned Small and Medium Enterprises in Malaysia: Competitive Advantage as a Mediator. The study tested two hypotheses; there is significant relationship between entrepreneurial orientation and business performance, and competitive advantage mediates the relationship between entrepreneurial orientation and performance. The data was purely quantitative with the use of five Likert scale. The findings revealed that significant relationships exist between entrepreneurial orientation and performance, while competitive advantage was found to partially mediate the entrepreneurial orientation and performance relationships. This means that for performance of SMEs, EO and Dynamic capabilities are capable of mediating or moderation of performance of SMEs as they predict competitive advantage.

Bahram and Azhdar, (2016) assessed technology orientation, dynamic capabilities and SMEs Performance. The study was exploratory research design. The study used survey data from a random sample of 154 small to medium-sized enterprises (SMEs) located in Science Parks in Iran. The results indicated that among three different types of dynamic capabilities, learning capability was the most effective mediator between technology orientation and performance. Given the evidence technology orientation and Dynamic capability is beneficial to business performance of SMEs.

Ari, Kaisu, Saarenketo, and Kalevi, (2005) Entrepreneurial Orientation, Dynamic Capabilities and International Performance by using survey data from 217 manufacturing and service organizations. Their findings indicate that a firm's entrepreneurial orientation and reconfiguring capabilities have an effect on its international performance. These findings provide support to the dynamic capability view of the firm. In this regard by SMEs adopting Entrepreneurial orientation combined with organizational reconfiguring capabilities they would secure competitive advantage and increased business performance.

Augusto, Moeljadi and Rohman, (2014) Effect of Entrepreneurial orientation on business performance of Timor SMEs moderated by Government Policy. The study used explanatory research design. Data Analysis Techniques is Generalized Structured Component Analysis (GSCA). Study result shows that entrepreneurial orientation affect business performance. It means better entrepreneurial orientation can improve performance of small and medium enterprises. Government policy cannot moderate effect of entrepreneurial orientation on business performance. It shows that government policy does not have direct effect and moderating effect to improve SMEs performance. These findings were in contravention with the existing role the government plays

to promote small businesses through a variety of policies to boost business performance. This implies that a moderator can have a significant or insignificant moderating role on the relationship between EO and business performance.

Kiprotich, Kimosop, Kemboi, and Chepkwony, (2015) Undertook a study on moderating effect of social networking on the relationship between entrepreneurial orientation and performance of small and medium enterprise in Nakuru County, Kenya. The specific objectives were; to determine the effect of risk-taking and pro-activeness on performance of small and medium enterprises and finally to determine the moderating effect of social networking on relationship between entrepreneurial orientation and performance of small and medium enterprises. The study utilized the resource based view theory (Barney 1991). Explanatory research design guided the study. The results indicated that Risk-taking, Pro-activeness and Innovativeness were significant in affecting performance of SMEs. Also the results revealed that social networking positively moderates the relationship between risk-taking Pro-activeness and performance of SMEs. This implies that through social networking SMEs can be able to potentiate the effects of EO on business performance. However the SMEs must also orientate themselves to the demands of these social networks through dynamic capabilities.

Rotich, Wanjau and Namusonge, (2015) Moderating Role of Entrepreneurial Orientation on the Relationship between Relationship Lending and Financial Performance of manufacturing SMEs in Kenya. The objective of this study was to determine the moderating effect of entrepreneurial orientation on the relationship between relationship lending and financial performance of manufacturing SMEs. The study used a cross-sectional survey research design. The hypotheses in this study were tested using structural equation modeling and hierarchical moderated multiple regression (MMR). The study found evidence that EO moderates the relationship between relationship lending and financial performance of manufacturing SMEs in Kenya. Further the study determined that relationship lending positively impacts on financial performance of SMEs. This implies that EO is not only a predictor but also a moderator of relationship lending and business performance.

No SME or business organization can operate successfully in isolation without dependence on supportive institutions, variables and factors (Oginni, 2010). In fine SMEs exists and operates within an environment where there is multifaceted interplay in terms of activities as well as networks of relationship between and among human resources, material resources and other systems. In this regard there is need for SMEs to direct their attention to the environment when formulating their strategies for adapting to the dynamics in the business environment to facilitate their survival, growth and profit motives. These all together calls for Entrepreneurial orientation by SMEs which would

be contingent upon other factors to stimulate performance. This study looks at the moderating role of Dynamic Capabilities on the relationship between EO and organization performance. This is premised on the recommendations of Rauch, Wiklund, Lumpkin, &Fresse, (2009) that there is need for studying other moderators on the relationship between EO and business Performance of SMEs .

#### 4. Conceptual framework

This study conceptualizes the relationship between dynamic capabilities, Entrepreneurial orientation and business performance. Entrepreneurial Orientation (EO) is often mentioned as an antecedent of business performance (Kraus, Ringtering, Hughes, & Hosman, 2012). According to Voss, Voss, & Moorman, (2005); Pearce, Fritz, & Davis, (2010) EO as a firm-level disposition to engage in behaviors reflecting risk-taking, innovativeness, proactiveness, autonomy, and competitive aggressiveness that lead to change in the organization or marketplace. entrepreneurial orientation can be measured interms of risk-taking, innovativeness, proactiveness and competitive aggressiveness.

Risk-taking is uncertainty that follows an entrepreneurial behavior. Entrepreneurial behavior involves investing a significant proportion of resources to a project prone to failure (Kraus, *et al.*, 2012). Risk taking is a dominant attribute of entrepreneurship as the higher the risk-taking orientation, the higher a firm's profitability and growth (Wambugu, *et al.*, 2015). Risk taking can be measured in terms of financial risks ,market risks and operation risks (Larisa & Margarita, 2015).

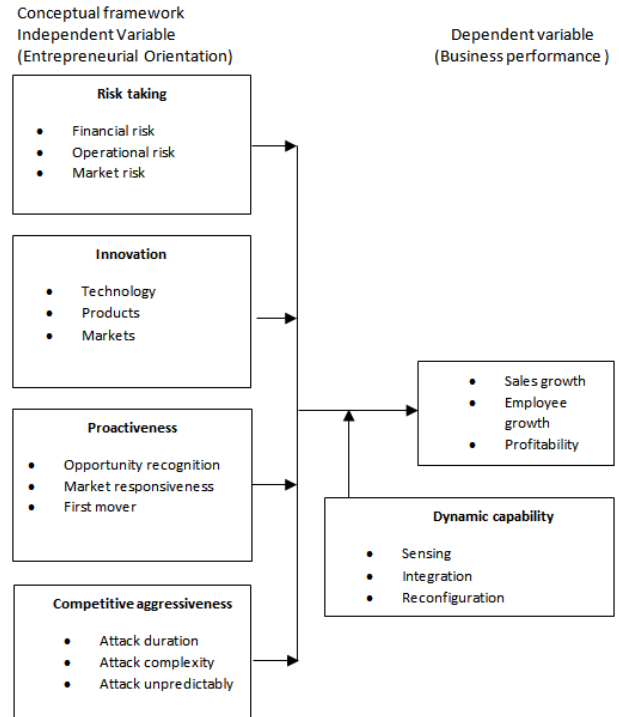
Innovativeness refers to a firm's behavior to generate new ideas leading to new or improved processes, products, or services (Rauch, *et al.*, 2009). Innovativeness is also related to creativity which is a source of ideas that can lead to innovation of products, services, processes, markets or technology which leads to increased business performance (Okeyo, Gathungu, & K'Obonyo, 2016). Innovation can be measured in terms of new technology, products and markets (Giudici & Reinmoeller, 2013; Milovanovic & Wittine, 2014).

Proactiveness refers to processes which are aimed at "seeking new opportunities which may or may not be related to the present line of operations, introduction of new products and brands ahead of competition and strategically eliminating operations which are in the mature or declining stages of the life cycle" Venkatraman (1989) cited in (Zhongfeng, En, & Dong, 2013). There is a direct positive relationship between the EO dimension of proactiveness and SME business performance (Kraus, *et al.*, 2012). Proactiveness can be measured interms of opportunity recognition, market responsiveness, first-mover (Lumpkin & Dess, 2001; Kropp, Lindsay, & Shoham, 2008; Kusumawardhani, McCarthy, & Perera, 2009).

Competitive aggressiveness is the intensity of the firm’s to improve their position to outdo and overtake their competitors in the market (Lumpkin & Dess, 1996) cited in (Azlin, *et al.*, 2014). Competitive aggressiveness is positively connected to business performance under most circumstances though context dependent (Sonja, 2017). Competitive aggressiveness comes in the form of competitive attack, which consists of a sequence of competitive actions. Ferrier (2001) distinguishes four dimensions of competitive attack: volume, duration, complexity and unpredictability (Becem, 2015). The study measures competitive aggressiveness based on the dimensions of competitive attack which include attack volume, attack duration, attack complexity and attack unpredictability.

Dynamic capability plays an important role in an organization as it underscores the accumulation of capabilities embedded in a firm and it is directly associated with its performance (Hsu & Wang, 2012). There is a variation in the previous research findings in terms of the relationship between EO and business performance. As a result, researchers began to seek internal and external factors that mediate the relationship between EO and firm performance rather than measuring the direct link between them eg (Lumpkin.G.T. & Dess, 2001; Li, Huang, & Tsai, 2009; Wang., 2008; Alegre & Chiva, 2013 ). Therefore this study, interrogates the moderating effect of dynamic capabilities on the effect of EO on business performance of SMEs. Dynamic capabilities can be measured in terms of three dimensions of sensing, integration, and reconfiguration adopted from (Teece, 2014)

In measuring business or firm performance of small and medium enterprises, both subjective and objective measures can be used. Objective measures are obtained from firm’s annual accounts or financial records while subjective measures involve seeking the perception of owner/managers on overall performance relative to that of competitors during a certain time period (Idar & Mahmood, 2011). Objective measures are difficult to obtain because owner/managers are generally conservative and unwilling to release actual financial information to outsiders (Chao & Spillan, 2010) (Wang & Poutziouris, 2010). This justifies the use of subjective measures of firm performance which is in consistence with empirical studies (Idar & Mahmood, 2011). In extant empirical works, many indicators tend to be used. ‘Performance’ is regularly measured in one or a combination of the following three ways: perceived financial, perceived non-financial and archival financial (Rauch, *et al.*, 2009). In this regard this study adopted subjective measures of business performance which includes sales growth, employee growth and profitability relative competitors adopted from (Wambugu, Gichira, Wanjau, & Mung’atu, 2015).



### 5. Discussion

SMEs performance remains essential because of their potential to generate jobs and capacity to catalyze economic growth. However from existing literature they are beset by incessant failures in performance owing to entrepreneurial incompetence. This provides a wakening call for them to embrace Entrepreneurial orientation and Dynamic capabilities as a recipe for performance. This argumentation is premised on Schumpeter theory of innovation and Teece's Dynamic capability theory. However literature points out limitations and inconsistencies in outcomes of these theories.

Schumpeter’s theory of innovation posits that innovation is an inordinate instrument of entrepreneurship for gaining competitive advantage to increase their capacity to generate wealth. This position obscures the fact that there are other factors such as economic and social factors which need to be integrated with innovation to occasion high performance of SMEs. Innovation requires some magnitude of monetary and non-monetary investments besides social networking whose absence has been incriminated for the failure of most enterprises. On the same vein lack of dynamic capabilities has been pointed out to be a source of failure of SMEs in dynamic markets which no market is an exception of. Conversely when SMEs are ingrained with dynamic capabilities they become prone to traps in their existing competencies making them incompetent to respond to environmental changes in order to realize maximal performance. However owing to DCs significant effect when effectively implemented as opined by (Helfat, *et al.*, 2007; Wang and Ahmed, 2007; Mwangi and Gathungu, 2012). Thus, SMEs are under obligation to embrace it in the face of dynamic environment.

Dynamic capabilities can enhance SMEs' capacity to develop new products and processes in response to changing circumstances while Entrepreneurial orientation involves activities like innovation, searching for the opportunity and effectively utilizing resources. Hence, the integration of both dynamic capabilities and entrepreneurial orientation owing to their assimilation of entrepreneurial resources in generating new ideas for the creation of new products and processes cannot be gainsaid. In this regard, this study draws from the Schumpeter theory and Dynamic capabilities theory to strive to identify which dimensions of Entrepreneurial orientation can affect performance of SMEs by a significant moderation of dynamic Capabilities in the Kenyan context.

Although the relationship between Entrepreneurial orientation and business performance has been researched, the effect of EO on performance is not always positive and linear, but contingency-oriented and context-specific (Sciascia, D'Oria and Bruni, 2014; Wiklund & Shepherd, 2011). Specifically, the EO-performance relationship won't remain static; the impact of EO on firm performance may differ in various industrial settings, development stages, or under market turbulence and financial crisis (Fuentes-Fuentes, Bojica, & Ruiz-Arroyo, 2015; Jones, Coviello, & Tang, 2011). Hence, despite the increasing attention, greater insights into the EO-performance linkages, there is a need to further research on this theme in different industrial settings for better understanding of the relationship. The implications of this are that we may get different results in different settings occasioned by prevailing parameters in the various business environments.

Interestingly, a handful of studies on the relationship between EO and performance of SMEs have revealed no significant relationship (Affendy, *et al.*, 2015), sometimes a moderately large significant relationship (Rauch, *et al.*, 2009) and positive significance (Gholami and Birjandi, 2016; Simiyu, *et al.*, 2016; Muthee and Karanja, 2014; Vishal and Safal, 2015). Inconsistencies have also been revealed on the effect of different dimensions of EO on business performance (Ndesaulwa & Kikula, 2016; Udin & Bose, 2014; Tachia, *et al.*, 2016; Kamendi, 2016). These inconsistencies imply that results from past studies could not be generalized. All these inconsistencies in findings from the aforementioned studies provide knowledge gaps to be filled by future studies in order to clarify the exact effect of EO on firm performance.

The studies reviewed related to EO and performance have been conducted in non-African countries (Rauch, *et al.*, 2009; Gholami and Birjandi, 2016; Affendy, *et al.*, 2015; Vishal and Safal, 2015; Tachia, *et al.*, 2016; Udin and Bose, 2014). In African countries, (Ndesaulwa & Kikula, 2016; Owoseni & Adeyeye, 2012) in Kenya (Simiyu, *et al.*, 2016; Muthee & Karanja, 2014). All the studies point to the fact that entrepreneurial orientation has an effect on SMEs' performance. However, the results cannot be generalized because the definition of SMEs

differs from country to country and especially in western countries and developing countries like Kenya. Besides, the measures used in this study may be less relevant in countries with different environmental and organizational conditions. Finally, EO is context-specific. Generalization of EO and firm performance amongst studies in the same country is not possible because of differences in industrial settings.

Most of the reviewed studies were limited in the variables that were considered for entrepreneurial orientation; (Kamedi, 2016; Simiyu, *et al.*, 2016; Owoseni and Adeyeye, 2012; Tachia, *et al.*, 2016) considered three variables; innovativeness, risk taking and pro-activeness. Autonomy and Entrepreneurs' managerial competence was studied by Udin & Bose, (2014); Muthee and Karanja, (2014) respectively besides innovativeness, risk taking and pro-activeness. From literature, EO has five dimensions namely risk taking, pro-activeness, innovations, autonomy and aggressive competition, Rauch, *et al.*, (2009). Hence, the results of the reviewed studies failed to exhaustively explore the effect of all dimensions bundled together on EO on SMEs' performance since few variables were considered. This provides a variable gap to be filled in further studies.

There are few studies that have determined the moderating effect of dynamic capabilities on entrepreneurial orientation and SMEs' performance. Açıkıllı and Doğan, (2013) in their study on Dynamic Capabilities and Entrepreneurial Orientation in the New Product Development contend that DC and EO contribute to new product development; however, the study was based on observation without statistical backing. Other studies reviewed showed other moderators on the relationship between EO and business performance for instance eg Augusto, *et al.*, (2014) studied the moderating effect of government policy on Entrepreneurial orientation and SMEs' performance where results were not significant hence no mediation which controverts the perceived role of the government in setting regulation which can moderate business performance. Mahmood and Hanafi (2013) sought to establish the mediating effect of competitive advantage on entrepreneurial orientation and performance of Women-Owned SMEs in Malaysia which revealed significant moderation.

Bahram, *et al.*, (2016) assessed the mediating effect of dynamic capabilities on technology orientation and SMEs' performance. Kiprotich, *et al.*, (2015), undertook a study on the moderating effect of social networking on the relationship between entrepreneurial orientation and performance of SMEs in Nakuru County; the study revealed a significant effect of the moderators. The review however revealed that EO can play a role of both predictors and moderators for firm performance as seen in Kiprotich, *et al.*, (2015); Mahmood & Hanafi, (2013); Açıkıllı & Doğan, (2013) and Ari, *et al.*, (2005); Rotich, *et al.*, (2015) as a moderator. DC can also moderate the relationship between EO and performance Açıkıllı & Doğan, (2013) while as a predictor of firm performance



Bahram & Azhdar, (2016). This explained by the fact that Dynamic capabilities can also manifest through characteristic such as entrepreneurial orientation, human capital and social capital to predict the business performance of SMEs.

## Conclusions

Schumpeter theory of innovation and dynamic capabilities gives credence to the conceptualization of the moderating effect of DC on the relationship between EO and business performance of SMEs. This is explained by the synergistic effect of both the theories in securing maximal business performance. EO and DC are context specific hence their effect on business performance may vary from industry to industry but what remains clear is that effective integration and implementation of EO and DC would help the organization secure competitive advantage in the face of dynamic business environment foster high business performance of SMEs. However organizations can take different paths yet possibly end up with similar dynamic capabilities. Alternatively, organizations can possess similar capability yet perform differently. Moderation effects of DCs differ in different cultural contexts.

There are mixed results in the relationship between EO and business performance, some significant other insignificant as highlighted in the discussion which warrants further scientific interrogation on their relationship. Beside literature review reveals a dearth of studies which have been done on the moderating role of DC on the relationship between EO and business performance of SMEs in the context of developing countries. These altogether motivates the need to design studies on moderating role of DC on the relationship between EO and business performance of SMEs in developing countries fill in the existing knowledge gaps in literature.

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