

## Institutional analysis of strategic choice of micro, small, and medium enterprises: a conceptual framework

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Hernan G. Roxas, Val Lindsay, Nicholas Ashill, and Antong Victorio\*

A conceptual framework is presented showing formal and informal institutions and their relationship with the strategic choice of micro, small, and medium enterprises (MSMEs) in a developing-country setting. Emphasis is placed on how institutions at the subnational level (such as a region or city) influence the strategic orientations of MSMEs in the wake of decentralization, which grants subnational government authorities more political, economic, fiscal, and administrative powers. Furthermore, the paper sheds light on the environmental (institutional) determinism-organizational (strategic) choice nexus. It offers propositions, questions, and issues worth pursuing in future empirical investigations.

*JEL classification:* L1, L2, O43

*Keywords:* MSMEs, strategic choice, institutional analysis, firm performance

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### 1. Introduction

If the micro, small, and medium enterprise (MSME) sector is an engine of economic growth, then the local institutional framework is the steering wheel—this is the underlying theme of the study. Its main thesis is that formal and informal institutions emanating from the economic, political, and sociocultural environments at the subnational level such as a region or city significantly

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influence the strategic directions of MSMEs operating in that locality. In many developing countries characterized by government deregulation and decentralization, national institutions do matter but subnational institutions matter even more.

However, the liability of smallness is known to be inherent in these MSMEs [Lall 2000]. This liability explains the fact that despite their potential to contribute to economic growth, MSMEs are unable to compete well owing to exogenous and endogenous constraints (Harvie and Lee [2002]; Kirby and Watson [2003]; Brown, Earle, and Lup [2005]; Fogel et al. [2006]). Institutional analysis has been used in a variety of ways to diagnose and offer remedies to the functional performance and competitiveness issues associated with MSMEs (Basu [1998]; Busenitz, Gomez, and Spencer [2000]; Carlsson [2002]; Carney and Gedajlovic [2002]). One stream of institutional theory replete with controversy is Douglas North's new institutional theory; North's original work on the subject focuses on institutional explanations of economic development [North 1990, 2005]. The current debate on North's work centers on how to operationalize formal and informal institutions (Glaeser et al. [2004]; Helmke and Levitsky [2004]; Gambarotto and Solari [2005]; Vatn [2005]; Demirbas [2006]; Fergusson [2006]). Furthermore, as typical institutional analysis has been repeatedly applied in countrywide settings, there is growing interest in understanding the institutional framework at the subnational levels such as a state, region, or city (Busenitz, Gomez, and Spencer [2000]; Brouthers [2002]; Meyer and Nguyen [2005]). The argument is that while national institutions do matter, it is important to recognize that there may be institutional disparities between and among subnational geo-economic and political areas within the same national boundary, especially in countries with diverse multicultural identifications situated in dispersed geographic locations [Meyer and Nguyen 2005].

Another issue concerns the use of institutional analysis to describe national entrepreneurial (that is, SME) development. Typical studies tend to examine the institutional factors to explain national or regional aggregate measures of economic and/or entrepreneurial productivity (North [1990]; Ahmadi [2003]; Glaeser et al. [2004]; Tabellini [2005]; Welter and Smallbone [2005]). While this could be helpful in macroeconomic analysis, it would be most helpful for the MSME sector to understand how specific institutional forms directly influence firm-level variables such as the functional activities and performance of firms.

This study hopes to contribute in providing more insights, if not remedies, to the issues and research gaps identified above. Specifically, it attempts to

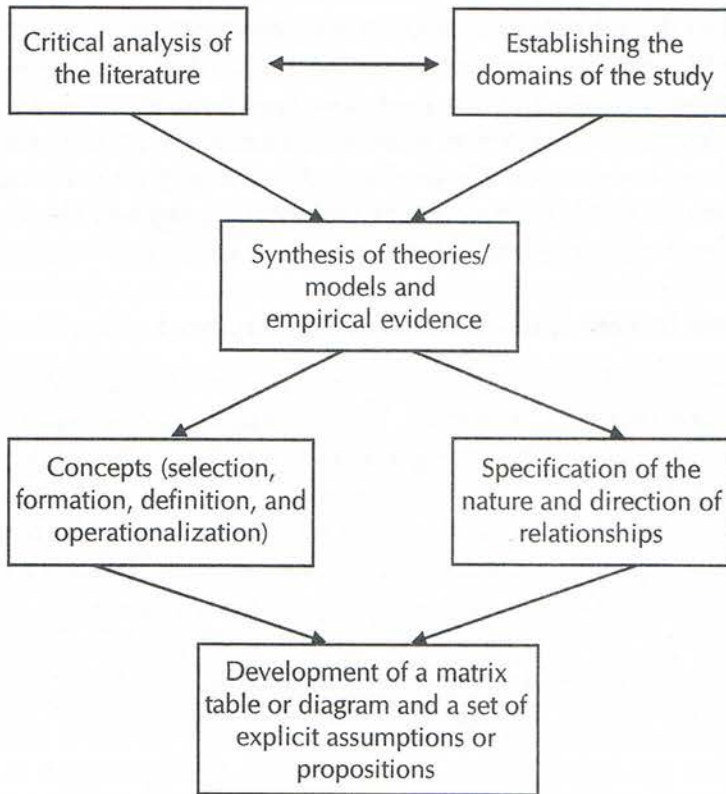
present the development of a conceptual framework illustrating the institutional environment that is argued to shape the strategic choice of MSMEs. The study focuses on the procedural and substantive development of concepts that eventually shape the framework for further analysis and/or empirical investigation. Presented in this paper are discussions of the following: (a) methodological flow in developing the conceptual framework, (b) formal and informal institutions under the new institutional theory, (c) decentralization, (d) the role of MSME in economic development, (e) strategic choice, and (f) the link between institutions and strategic choice of MSMEs.

## **2. Process of conceptual framework development**

A conceptual framework defines the concepts involved in an investigation; explains the theory, assumptions, and conditions underlying them; and elaborates the relationships among them as well as the nature and direction of these relationships (Mayer and Greenwood [1980]; Cavana, Delahaye, and Sekaran [2001]). This framework provides the structure and direction of the investigation inasmuch as it is based on sound theoretical and empirical evidence with a view to offering alternative explanations on the relationships of two or more concepts (that is, objects, phenomena, etc.) toward contributing and adding value to human knowledge. Hence, the diagram shown in Figure 1 illustrates the process through which the proposed conceptual framework emerged.

An extensive review of the literature was performed based on a priori set of domains, which was then refined as the review progressed. The domains of institutional theory, entrepreneurship, small-business economics, local economic development, organizational external environment, and strategic management were explored to gain an in-depth understanding of the research questions.

These a priori domains were continuously revised, expanded, or refined as the most current literature reveal new developments. Various models and theories were examined to define the concepts deemed relevant for the study. As broad and abstract concepts started to build up, previous studies were then examined to refine the definitions and operationalizations of concepts as well as their interrelationships validated by previous scholarly work. Emerging from this process is the proposed conceptual framework on institutions as they relate to the strategic choice of MSMEs.

**Figure 1. Process of developing the conceptual framework**

### 2.1. *New institutional theory*

There are several adaptations of institutional theory in various disciplines. One of them is based on North's seminal work dubbed new institutional economics [North 1992]. North [1992] broadly defines institutions as the "rules of the game" that provide incentives and constraints to economic players. They are humanly devised constraints that shape human interaction [North 1990], suggesting that these economic players are embedded in an external environment characterized by a high degree of uncertainty and transaction costs (Baum and Oliver [1992]; Hollingsworth [2002]). Economic uncertainty makes it costly for MSMEs to transact. Institutions are formed to reduce this uncertainty by setting the "rules of the game" in the form of formal rules and informal norms and their enforcement characteristics [North 1992, 2005].

Likewise, the same “rules of the game” provide the constraints and incentives that encourage the economic players—say, MSMEs—to switch from unproductive to productive activity, and ultimately improve the general economic well-being of a society [North 1990]. North [2005] repeatedly refers to the non-ergodic economic world and postulated that “the key to improved performance is some combination of formal rules and informal constraints and the task at hand is to achieve an understanding of exactly what combination will produce the desired results both at a moment of time and over time”. Various literature have shown that institutions take the form of rules [Ostrom 2005], collective action [Parto 2005], and structures [North 1992].

North’s new institutional theory asserts that there are two types of institutions: formal and informal. Formal institutions refer to written laws, policies, regulations, political and economic rules, and contracts [North 1990]. On the other hand, informal institutions are codes of conduct, norms of behavior, and social conventions that generally emanate from a society’s culture. Informal rules are those created, communicated, and enforced outside officially sanctioned channels [Helmke and Levitsky 2004]. Their enforcement takes place by way of sanctions such as expulsion from the community, ostracism by friends and neighbors, or loss of reputation [Pejovich 1999].

While a plethora of studies have examined the role of formal institutions (Clingermayer and Feiock [2001]; Carlsson [2002]; Carney and Gedajlovic [2002]; Veciana, Aponte, and Urbano [2002]; Co [2004]), studies that attempt to operationalize North’s informal institutions are very scarce and divergent in their approaches. The few empirical studies on informal institutions looked at sociocultural factors such as kinship, community networks, religion, norms, and values as manifestations of informal institutions having varying degrees of influence on human or organizational behavior (Hill [1995]; Pejovich [1999]; Veciana, Aponte, and Urbano [2002]; Nkya [2003]; Tabellini [2005]; Fogel et al. [2006]). Indeed there is an abundance of conceptual discussions on informal institutions alongside a dearth in empirical studies to operationalize the same [Helmke and Levitsky 2004]. One explanation for this could be that North’s seminal work did not specifically come up with operational definitions of formal and informal institutions to guide empirical investigations.

## *2.2. Decentralization of governance*

A focus on institutional environment at the city level is justified by the wave of decentralization taking place in a number of developing countries, including Cambodia, Indonesia, Philippines, Pakistan, India, Bhutan, and

Thailand. Decentralization in these countries is characterized by national governments assigning state powers, responsibilities, and resources to subnational authorities [Wescott and Porter 2002]. This is the process of restructuring or reorganizing political, fiscal, and administrative authority whereby the authority and capabilities of government units at subnational levels are substantially increased [Work 2001]. However, studies on the implementation of decentralization reveal that results were lackluster due to the underdeveloped institutional capacity at subnational levels [Work 2001; Wescott and Porter 2002].

### 2.3. *Micro, small, and medium enterprises*

The role of micro, small, and medium enterprises (MSMEs) in economic development cannot be overemphasized. Comprising more than 98 percent of total enterprises in Asia-Pacific [APEC 2002], MSMEs have assumed a lead role in economic development of many countries (Benney [2000]; Lee and Peterson [2000]; OECD [2005]). For instance, in the Philippines, 99.6 percent of the total 810,362 business establishments as of 2003 are micro (91.75 percent), small (7.5 percent), and medium (0.35 percent) firms generating 67.9 percent of the country's total employment [DTI 2005]. Moreover, 50-70 million new small and medium enterprises need to be created in APEC countries over the next two decades if developing countries are to contribute fully to the overall growth of the APEC region and to achieve international competitiveness [Hall 2002].

However, the liability of smallness is known to be inherent in these MSMEs [Lall 2000]. Despite their potential contribution to economic growth, MSMEs are unable to compete well due to exogenous and endogenous constraints [Kirby and Watson 2003]. Basic arguments such as the inability of MSMEs to sustain innovation and the lack of economies of scale, marketing skills, and financial resource have been put forward to explain the weaknesses of these small businesses. Others argue that this liability of *newness* is a creation, albeit unconsciously, of a wider environmental bias for more stable, larger firms [Harvie and Lee 2002]. Previous studies have shown that the institutional (that is, political, social, and economic) framework determines the success of MSMEs (Amin and Thrift [1995]; Nkya [2003]; Aidis [2005]).

### 2.4. *Strategic choice of MSMEs*

No business organization would survive in the long run in the absence of a strategy [Thomson 2001]. Accumulation of resources and development of capabilities with a view to pulling all of them together to achieve the goals and

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aspirations of the business form the *raison d'être* of every business enterprise. Hence, the exercise of strategic choice is a fundamental managerial and organizational function in every MSME. Strategic choice refers to the determination of courses of strategic action an organization should take [Child 1997]. Strategic choice is considered an organizational variable, although it is normally exercised by the top management of organizations. The choice is strategic as it involves matters of critical importance to an organization as a whole. Child [1997] argues that strategic choice enables an organization to relate to its external environment, set standards of operating performance, and determine the design of the organization. In this context, the environmental conditions (that is, liberality, variability, and complexity) shape the strategic choice (that is, situational analysis, choice of goals, and strategy) of organizations. Strategic choices consequently influence the organization's scale of operation, technology, structure, and human resources. Ultimately, strategic choices determine the organization's operating effectiveness and environmental receptivity.

### *2.5. Link between institutions and strategic choice*

The relationship between institutions and strategic choice needs further clarification (Pfeffer and Salancik [1978]; Clark, Varadarajan, and Pride [1994]; Child [1997]; Beckert [1999]). The strategic choice perspective of the growth of the firm builds on the assumption that the firm operates in a market economy in which it is relatively free to pursue its own strategic choice [Peng and Heath 1996]. If institutions provide the framework of rules and informal constraints within which organizations perform their economic functions, is there any room for an organization to exercise strategic choice to advance its interests and goals?

The work of Oliver [1991] argues that firms are not passive entities floating in an ocean of institutions. Institutional theory can accommodate interest-seeking, active organizational behavior when organizations' responses to institutional pressures and expectations are not assumed to be invariably passive and conforming across all institutional conditions [Oliver 1991]. By combining institutional and resource dependency theories, Oliver identified a typology of strategic responses to deal with institutional pressures under the convergent assumptions that (a) organizational choice is constrained by external pressures coming from a collective and interconnected environment; (b) organizations seek legitimacy, stability, and predictability to survive; and (c) organizations are able to protect their interests through responsiveness to external demands and expectations. The ability of an organization to adapt to changing



environmental circumstances is key to organizational survival, and the effectiveness of the adaptive response is dependent on aligning the response to the environmental circumstances faced by the organization [Strandholm, Kumar, and Subramanian 2004]. Likewise, the theory of opportunity exploitation [Shane 2003], the theory of organizational adaptation [Hrebiniak and Joyce 1985], and the concept of environmental management [Zeithaml and Zeithaml 1984] all point to the same argument that environmental structures (that is, institutions) are not necessarily antagonistic to strategic choice; rather, they both form its precondition and inform its content [Whittington 1988]. Moreover, the subjective perceptions (mental models) of organizational key players about their external environment—correctly or incorrectly—determine the choices they make, which are the ultimate sources of action [North 2005].

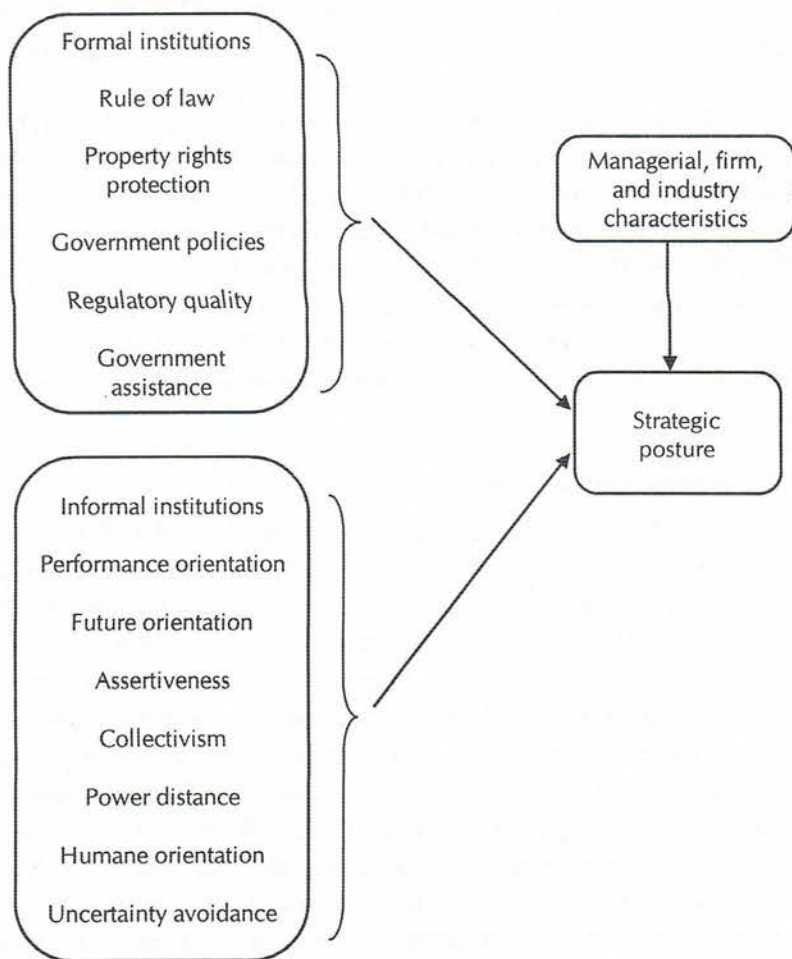
### 3. Conceptual framework development

The foregoing discussion on the theoretical domains of institutional theory, MSME sector development, and strategic choice serves as a mental map to guide the development of the framework that links institutions and strategic choice of MSMEs. Figure 2 presents the conceptual framework. The formal and informal institutions constitute the institutional matrix [North 1990] of MSMEs strategic choice, which is operationalized as strategic posture. Formal institutions constitute the “concrete” [Boland 1992] or “hard” institutional environment of the firm [Hodgson 1993] while the informal institutions constitute the “consensus” or “soft” institutional environment. Together, they determine the level of institutional thickness that shapes the productive and strategic directions of MSMEs (Amin and Thrift [1995]; Raco [1999]).

#### 3.1. Formal institutions

Formal institutions refer to the legal and political factors manifested by the rule of law, regulations, government policies and assistance programs designed to support the business activities of MSMEs [Busenitz, Gomez, and Spencer 2000]. This definition stems from previous studies arguing that formal institutions refer to laws, constitutions, contracts, and property rights that are considered the official rules of a society with a high degree of legitimacy and purposefully created by the state, by private enterprises, or by other alliances or individuals in civil society (North [1990]; Olsson [1999]; Redmond [2005]; Hodgson [2006]). These formal institutions are articulated in written forms, administered by a central authority, and violations of these “rules” entail legal

Figure 2. The conceptual framework



sanctions [Redmond 2005]. Identification of these formal institutions is mainly based on the seminal work of Kaufmann, Kraay, and Zoido-Lobaton [1999] on governance and institutional quality, which inspired more studies on the role of formal institutions in economic development [Fogel et al. 2006].

### 3.1.1. Rule of law

Rule of law refers to the supremacy of law whereby decisions are made by the application of known principles or laws without the intervention of discretion in their application [Kahn 2006]. A society with a strong rule of law

is defined as one having sound political institutions, a strong court system, and provisions for orderly succession of power as well as citizens who are willing to accept the established institutions and to make and implement laws and adjudicate disputes [Oxley and Yeung 2001]. Rule of law enhances transactional trust between contracting parties, knowing that their rights and interests are well protected by law and supported by an efficient legal and judicial system (Vandenberg [1999]; Fogel et al. [2006]). It promotes transparency and stability regarding boundaries of acceptable behavior (Scully [1988]; Oxley and Yeung [2001]). Increased transactional trust thus allows MSMEs to be more aggressive in seeking opportunities, building alliances, bearing risks, raising capital, and entering markets [Fogel et al. 2006]. Hence, proposition 1 states: *Rule of law is positively associated with entrepreneurial strategic posture.*

### 3.1.2. Property rights protection

Possession of significant assets cannot be efficiently used to increase output and promote economic growth if such assets lack the legal status of property. Protection of property rights includes the protection and enforcement of right to use, exclude others from using, modify, obtain income from, and sell assets (Reed [2001]; Landau [2003]). Property rights identify and protect the set of tangible and intangible resources that can be transferred in the marketplace and provide necessary incentives to owners to risk improvement on resources by ensuring that they would benefit from the improvement and that others would not deprive them of the benefit [Reed 2001]. Consequently, protection of property rights allows the creation of security for capital borrowing and investment [Reed 2001]. The establishment of secure and stable property rights has been a key element in the onset of modern economic growth as it not only protects ownership and control of property but provides the incentives to put the property or resource into productive use (Heitger [2004]; Rodrik [2006]). These incentives increase the confidence of MSMEs to innovate and become economically active without the fear of being cheated out of the fruits of their efforts [Heitger 2004]. Other advantages include the promotion of investment in knowledge creation and business innovation by establishing exclusive rights to use and sell newly developed technologies, goods, and services [Maskus 2000]. Consequently, it promotes widespread dissemination of new knowledge by encouraging rights holders to put their inventions and ideas in the market [Maskus 2000]. As information is viewed as a resource, it will open up opportunities for further research and development by the rights holder and other firms. Based on the foregoing arguments,

proposition 2 states: *Protection of property rights is positively associated with entrepreneurial strategic posture.*

### 3.1.3. *Government policies*

The development and maintenance of a policy framework conducive to private enterprise in general and to MSME development in particular cannot be overemphasized. In this context, government policies refer to the enacted and implemented laws, ordinances, regulations, and any other form of legislations and/or government decisions, especially those that affect the business sector [Fogel 2001]. The relevance of government policies is well supported by the argument of Rodrik [2006] that strategic government intervention may often be required to get out of the low-level traps and elicit private investment brought about by coordination failures and capital-market imperfections. Several studies could not stress nearly enough the paramount concern to establish the policy framework for local entrepreneurship and small-business development (Lall [2000]; Kirby and Watson [2003]; Lam [2003]). Government policies may be viewed as conduits through which MSMEs can engage in business activities consistent with external rules and regulations, hence reducing the level of uncertainty (for example, fear of government intervention).

Likewise, government policies open up opportunities for MSMEs such as resource acquisition, mobilization, alliance/network formation (for example, subcontracting), establishment of industry clusters, and market development or expansion (for example, export) (Lester [1992]; Skuras, Dimara, and Vakrou [2000]; Jackson [2002]; Audretsch [2004]; Tan [2004]; Tambunan [2005]). Other nonpecuniary advantages include better strategic planning on the part of MSMEs brought about by consistency, hence increased predictability in government plans and economic programs. Therefore, proposition 3 states: *Government policies perceived as conducive to MSME are positively associated with entrepreneurial strategic posture.*

### 3.1.4. *Regulatory quality*

Regulatory quality refers to the degree to which compliance with existing laws, rules, and other government regulatory procedures does not impose unreasonable burden on MSMEs (Gnyawali and Fogel [1994]; Geiger and Hoffman [1998]; Fogel and Zapalska [2001]). Closely associated with it is bureaucratic efficiency, which is measured in terms of the burdens and delays in complying with laws and regulations in the areas of starting a business, hiring and firing employees, property registration, getting credit, protecting

investors, enforcing contracts, and closing a business (Frye and Zhuravskaya [2000]; Dollar, Hallward-Driemer, and Mengistae [2005]; Djankov, McLiesh, and Ramalho [2006]). Burdensome government regulations may affect SMEs through increased prices to absorb the cost of regulatory compliance; pressure of cost inequities as small companies bear the brunt of regulatory burdens more than large firms; competitive restrictions that may significantly discourage small firms; managerial restrictions resulting from SMEs sacrificing managerial time to comply with government regulations; and mental burden arising from postponed projects, wasted time, and managerial failure due to lack of time and energy (Gnyawali and Fogel [1994]; Kuratko, Hornsby, and Naffziger [1999]; Hellman et al. [2000]; Kuratko and Hodgetts [2004]). Therefore, proposition 4 states: *Better regulatory quality is positively associated with entrepreneurial strategic posture.*

#### 3.1.5. Government assistance

Government assistance has been noted as a key component in small business or MSME development (Hill [1995]; Jackson [1999]; Helmsing [2000]; Henriquez et al. [2001]). In this study, government assistance is expressed as the extent to which the government extends various forms of assistance or incentives supportive of the MSME sector [Busenitz, Gomez, and Spencer 2000]. Jackson [1999] argues that governments play a significant role in nurturing the small business sector by being involved in the provision of nontraditional functions such as coordinating and monitoring economic agents, market development, financing, supporting producers, enabling community self-provision, supporting customers through provision of information, and direct provision of services not undertaken by the market [Jackson 1999]. The relevance of government assistance programs in MSME development has been established in numerous studies (Basu [1998]; Becchetti and Trovato [2002]; Audretsch [2004]; Arinaitwe [2006]). Government assistance as a formal institution provides direct incentives to, and remains a major force for development of, MSMEs (Kotabe and Czinkota [1991]; Kitayama [2001]; Ramsden and Bennet [2005]; Sui et al. [2006]). Government assistance can open up access to resources and markets, allowing MSMEs to realize their productive potentials. Skuras, Dimara, and Vakrou [2004] concluded that the range of business assistance programs significantly shape the tendency of rural SMEs to pursue either survival-oriented or more aggressive strategies. Proposition 5 states: *Government assistance is positively associated with entrepreneurial strategic posture.*

### 3.2. *Informal Institutions*

Informal institutions refer to the cultural factors shared by members of a society that serve as constraints and/or standards, the violation of which entails social rather than legal penalties (North [1990]; Olsson [1999]; Redmond [2005]). This operational definition stems from the characterization of informal institutions as codes of conduct, norms of behavior, unwritten rules, conventions, and generally accepted ways of thinking that come from socially transmitted information and are part of the heritage that we call culture [North 1990, 1991, 2005]. These norms, ethics, customs, taboos, and ideologies form the unofficial rules of a society, learned through socialization, and are largely the inherited view of the world from older generations (Olsson [1999]; Redmond [2005]). These institutions are created, communicated, and enforced outside officially sanctioned channels (North [1990]; Helmke and Levitsky [2004]). These are referred to by Busenitz, Gomez, and Spencer [2000] as the normative institutional profile of a given society synonymous with a country's culture, values, beliefs, and norms affecting the entrepreneurial orientations of its people.

While a number of studies discuss the theoretical and conceptual bases of informal institutions (Pejovich [1999]; Aidis [2005]; Davis [2006]), only a handful of empirical studies have attempted to measure specific constructs categorically classified as informal institutions (Peng and Heath [1996]; Nkya [2003]; Peng [2004]; Robson [2004]; Tabellini [2005]). The very scarce empirical studies on informal institutions look at sociocultural factors such as kinship, community networks, religion, norms, and values as manifestations of informal institutions having varying degrees of influence on human or organizational behavior (Hill [1995]; Pejovich [1999]; Nkya [2003]; Tabellini [2005]). There is obviously a plethora of studies examining culture using the popular framework of Hofstede [1980] whereby cultural dimensions such as collectivism and uncertainty avoidance were shown to be related to entrepreneurship in various respects [Robson 2004]. Even so, informal institutions are often treated *ex post facto* or as residuals after exhaustively discussing formal institutional mechanisms. This is anathema to North's original concept of informal institutions in which he argues that "informal constraints should not be treated as mere appendages of formal rules" [North 1990].

This study adopts the Global Leadership and Organizational Behavior Effectiveness (GLOBE) cultural framework developed by House et al. [2004] for a number of reasons. The study of Parboteeah, Bronson, and Cullen [2005]

claims that the GLOBE cultural study is the most up-to-date national culture study, providing helpful updates to the cultural dimensions identified by Hofstede [1980] whose work has been highly criticized for its conceptual and methodological issues. As such, using the GLOBE framework tends to avoid Hofstede's problematic issues and incorporates other cultural dimensions not included in Hofstede's work and that of other cultural schemes [Parboteeah, Bronson, and Cullen 2005].

The GLOBE cultural framework measures culture using the direct values inference method in which cultural characteristics are inferred from the aggregated values of respondents in a survey [Lenartowicz and Roth 1999]. One of the strengths of the framework is its predictive validity, whereby cultural dimensions are studied not just in the context of the general society but also in the context of leadership and organizational behavior [House et al. 2004]. Following are the major components of the GLOBE cultural framework, which are considered in this study as manifestation of a society's informal institutions.

### *3.2.1. Performance orientation*

Performance orientation reflects the extent to which a community encourages and rewards innovation, high standards, and performance improvement [Javidan 2004]. Performance-oriented cultures also value results, assertiveness, competition, and materialism [Javidan 2004]. Performance-oriented societies tend to value those individuals who perform and achieve and who produce results, which becomes the basis of social judgement [Parboteeah, Bronson, and Cullen 2005]. Performance orientation strongly resembles McClelland's need for achievement as well as the Protestant ethics of individual responsibility, hard work, knowledge, and challenge [Javidan 2004]. It is considered an important dimension of a community's culture as the underlying practices and values have an impact on the way the community defines success in adaptation to external challenges [Javidan 2004]. It promotes the values of seeking betterment, setting high standards of performance, ambitious expectations, and a thirst for learning [Javidan 2004]. According to Javidan [2004], societies with high levels of performance orientation tend to display strong levels of competitiveness, self-confidence, and ambition. He further argues that in these societies, time is considered nonrenewable and subject to high depletion, thereby promoting a strong sense of urgency in meeting challenges and making decisions. Hence, proposition 6 explains: *A higher level of performance orientation is positively associated with entrepreneurial strategic posture.*

### 3.2.2. *Future orientation*

Future orientation is based on the notion of time perspective explaining the unconscious process in which the continuum of social and personal events is distributed in temporal classes to provide order, coherence, and meaning [Corral-Verdugo and Pinheiro 2006]. It is a dimension of the more general construct—time orientation—that relates to the subjective experience of time [Ashkanasy et al. 2004]. Based on the above definitions, future orientation is used in this study to mean the tendency to conscientiously think and plan for the future and consider the long-term consequences of one's actions in the present.

Cultures with high future orientation display strong capability and willingness to imagine future contingencies, formulate future goal states, and seek to achieve goals and develop strategies for meeting their future aspirations [Ashkanasy et al. 2004]. Despite their tendency to lack a solid appreciation of situational realities because of neglect of their present personal and social relationships and interactions, people in societies with strong future orientation tend to have the capacity to enrich their lives and maintain self-control [Ashkanasy et al. 2004]. They are likely to be good in establishing and achieving goals and in planning strategies for meeting long-term obligations [Corral-Verdugo and Pinheiro 2006]. Furthermore, future-oriented individuals tend to visualize and formulate future objectives, which in turn influence present decisions and judgments [Corral-Verdugo and Pinheiro 2006]. Low future orientation reflects the capability to enjoy the moment and be spontaneous, free of past worries or future anxieties while seeking hedonistic pleasures [Ashkanasy et al. 2004]. Proposition 7 is expressed as follows: *Higher levels of future orientation are positively associated with entrepreneurial strategic posture.*

### 3.2.3. *Assertiveness*

Assertiveness reflects the beliefs as to whether people are encouraged to be assertive, aggressive, and tough or nonassertive, nonaggressive, and tender in social relationships (Den Hartog [2004]; Parboteeah, Bronson, and Cullen [2005]). Assertiveness behavior includes making it clear to others what one wants, refusing what one does not want and generally expressing one's intentions in clear and unambiguous terms [Parboteeah, Bronson, and Cullen 2005]. Assertiveness also entails the willingness to confront opposing views and to express one's ideas and feelings in social encounters [Niikura 1999]. It is reported that assertive societies tend to be competitive, to value success, and to think



of others as necessarily opportunistic [Den Hartog 2004]. Assertive societies tend to look at nature as something to be controlled and manipulated, take a pragmatic stance toward reality, and have a belief in human perfectibility [Den Hartog 2004]. A highly aggressive culture puts a premium on achievement, independence, heroism, monetary rewards, and decisiveness (McGrath et al. [1992]; Gleason, Mathur, and Mathur [2000]; Su [2006]). The relationship between assertiveness and MSME strategic posture may be explained in terms of the dimensions of strategy making. It is argued that assertiveness is an inherent dimension of strategy making, which concerns the levels of risk taking and reactivity or proactivity of decisions (Miller [1987]; Koberg, Tegarden, and Wilsted [1993]). Since entrepreneurial firms are viewed as risk takers and act on, rather than react to, their environment, then an assertive culture is likely to support entrepreneurial strategic posture as strategy making and implementation are considered an exercise of assertiveness (Miller [1987]; Koberg, Tegarden, and Wilsted [1993]). Hence, proposition 8 states: *A high level of assertiveness is positively associated with entrepreneurial strategic posture.*

#### 3.2.4. Collectivism

Collectivism involves the subordination of personal interests to the goals of the larger work; an emphasis on sharing, cooperation, interpersonal connectedness, group harmony and solidarity, and joint responsibility; a concern for group welfare; and hostility toward out-group members (Hofstede [1980]; Hostede [1983]; Morris, Avila, and Allen [1993]; Gelfand et al. [2004]; Parboteeah, Bronson, and Cullen [2005]; Yilmaz, Alpkan, and Ergun [2005]; Su [2006]). The opposite construct is individualism, which refers to a self-orientation, an emphasis on self-sufficiency and control, the pursuit of individual goals that may or may not be consistent with in-group goals, a willingness to confront members of the in-group to which they belong, and a culture in which people derive pride from their own accomplishments (Morris, Avila, and Allen [1993]; Yan and Hunt [2005]). Personal freedom is valued and individual decision making is encouraged in societies with high individualism culture [Gong, Li, and Stump 2007].

The link between the bipolar factor—collectivism/individualism—and strategic posture is muddled with controversy. One study, often cited in the literature, found a curvilinear relationship between the two, implying that firms tend to be entrepreneurial in their strategic posture under balanced conditions of individualism/collectivism and less so in highly individualistic or collectivist cultures [Morris, Avila, and Allen 1993]. However, the relatively small sample

size (that is, 180 firms) situated in the same state in the United States has major implications on the generalizability of the result—a limitation of the study the researchers duly recognized.

On the other hand, studies have shown that cultures that are low in collectivism (that is, high in individualism) tend to support entrepreneurial strategic posture. McGrath et al. [1992] argue that entrepreneurs must have high individualism score since under individualist culture, individual initiative, achievement, right to privacy, and formation of one's own opinion are highly valued. This is consistent with the findings of Parboteeah, Bronson, and Cullen [2005] and Yan and Hunt [2005].

Furthermore, members from individualist cultures tend to exhibit more favorable attitudes toward differentiation and uniqueness while members from collectivist cultures tend to show more favorable attitudes toward building and maintaining relationships with people within their social structure [Gong, Li, and Stump 2007]. Another study shows that there is a positive relationship between innovation and high level of individualism (Shane [1993]; Yaveroglu and Donthu [2002]). This could be explained by the fact that managers in individualistic countries tend to be more autonomous and independent than managers in collectivist cultures, and they are more likely to be willing to violate group norms [Morris, Davis, and Allen 1994]. It is argued that under McClelland's high need for achievement is the source of entrepreneurship while the need for affiliation, which is similar to collectivism, inhibits such activity because it distracts people from productive and achievement-oriented activity [Tiessen 1997]. Therefore, proposition 9 states: *High level of collectivism is negatively associated with entrepreneurial strategic posture.*

### *3.2.5. Power distance*

Power distance reflects the extent to which a community accepts and endorses authority, power differences, and status privileges [Carl, Gupta, and Javidan 2004]. Acceptance of asymmetry in power relationships explains the psychological distance separating the power holders and those who are under or subject to them [Yilmaz, Alpkın, and Ergun 2005]. A high degree of power distance leads to a less participative stance in decision making, greater reliance on rules and procedures, and higher levels of subordinate submissiveness [Yilmaz, Alpkın, and Ergun 2005]. Likewise, preservation of current status tends to be highly noticeable in societies with high power distance [Hofstede 1980].

Shane [1993] explains that high power distance is anathema to innovation because it promotes hierarchical social structure and inequality, inhibits informal communication between people in different hierarchical levels, encourages centralization of power, endorses elaborate control systems especially in organizations and upholds unwillingness to accept change in the distribution of power. All these, according to Shane [1993], inhibit innovation such that dispersed power structures create coalitions that support innovation; frequent informal communication as well as decentralization permit free flow of ideas, which facilitates knowledge acquisition and diffusion; control systems based on trust rather than rigid rules and procedures encourage active participation and creative thinking among employees; and social mobility increases occupational mobility, technical change, and innovation.

Despite McGrath et al.'s argument, other studies support Shane's [1993] findings. Innovation tends to be significantly lower in countries with high power distance [Yaveroglu and Donthu 2002]. Cultures that exhibit large power distance will be less innovative because people in such cultures are encouraged to respect authority, follow directions, and avoid standing out through original thinking [Gong, Li, and Stump 2007]. People may take less initiative to consider and discuss the introduction of new products and technologies and will generally wait for signals from authority figures or opinion leaders [Gong, Li, and Stump 2007]. Likewise, people will be less inclined to take responsibility outside the immediate scope of their jobs, to act on urgent marketplace information, and to provide individual input into strategy and planning [Yilmaz, Alpkan, and Ergun 2005]. Therefore, proposition 10 advances: *High level of power distance is negatively associated with entrepreneurial strategic posture.*

### 3.2.6. Humane orientation

Humane orientation characterizes those societies in which people's behaviors are guided by values of altruism, benevolence, kindness, love, and generosity [Kabasakal and Bodur 2004]. The need for belongingness and affiliation rather than self-fulfilment, pleasure, material possession, and power are likely to be the dominant bases [Kabasakal and Bodur 2004]. Societies that have high humane orientation tend to place greater importance on others (that is, family, friends, or community), have high need for belonging and affiliation, value obedience, and promote close monitoring of children rather than independence [Kabasakal and Bodur 2004].

There appears to be a dearth of literature examining in detail the nature of humane orientation, more so as it relates to business. What is known is that

this cultural dimension has been shown to be positively associated with GLOBE's institutional collectivism ( $r=.43$ ,  $p<.01$ ) and in-group collectivism ( $r=.30$ ,  $p<.05$ ). It is negatively associated with assertiveness ( $r= -.42$ ,  $p<.01$ ). This implies that a society with friendly members who care for others has a tendency to be collective and non-assertive [Kabasakal and Bodur 2004]. Humane orientation is also associated by Kabasakal and Bodur [2004] to humane-oriented leadership characterized by more considerate and maintenance-oriented leadership, less task orientation, and building informal and personal relationships with subordinates. The GLOBE study reveals that a humane-oriented culture tends to contradict the elements of an entrepreneurial strategic posture: risk taking, proactiveness, and innovation. Greater emphasis on affiliation rather than achievement; less emphasis on self-fulfillment, material possession, and power; less emphasis on independence; strong tendency toward collectivism; and lesser value on assertiveness—all these do not fit nor support the conceptual scope of entrepreneurial strategic posture. To achieve something is an underlying purpose of entrepreneurial risk taking. Likewise, independence is an essential element of innovation and proactiveness based on the assumption that people can only be innovative and proactive if they are willing to take a firm stand on what they think and feel (independent) and pursue ideas contrary to popular beliefs. Hence proposition 11 states: *High level of humane orientation is negatively associated with entrepreneurial strategic posture.*

### 3.2.7. Uncertainty avoidance

Uncertainty avoidance refers to the extent to which ambiguous situations are threatening to individuals, to which rules and order are preferred and to which uncertainty is tolerated in society (Gleason, Mathur, and Mathur [2000]; De Luque and Javidan [2004]). It refers to the extent to which members of collectives seek orderliness, consistency, structure, formalized procedures, and laws to cover situations in their daily lives [De Luque and Javidan 2004]. In short, uncertainty avoidance reflects the level of tolerance for ambiguity in a given culture [Parboteeah, Bronson, and Cullen 2005].

A low uncertainty avoidance implies greater willingness to take risks [Hofstede 1980]. The notion of ambiguity and risk are easily accepted [McGrath, MacMillan, and Scheinberg 1992]. Likewise, low uncertainty avoidance comes with values for risk taking, strong motivations for individual achievement, and more optimism—excellent climate, indeed, for entrepreneurs to thrive (McGrath, MacMillan, and Scheinberg [1992]; Gong, Li, and Stump [2007]).

The intention to become an entrepreneur and start up a business is characterized as risky behavior compared to establishing an employment career with predictable and steady flow of income. There is a significant amount of ambiguity and anxiety in one's intention to engage in a business venture regardless of the size. The fear of failure (usually operationalized by one's risk aversion) is a particularly critical issue for entrepreneurs due to the little separation between business and personal risk in an entrepreneurial venture [Watson and Robinson 2003]. In this case, entrepreneurship can be characterized as requiring fair tolerance of ambiguity, locus of control that is more internal than external, and willingness to take relatively well-calculated risks [Pitt and Kannemeyer 2000]. This implies that low uncertainty avoidance may be contributing factor in shaping the risk-taking behavior of MSMEs.

De Luque and Javidan [2004] cited studies showing how uncertainty avoidance can serve as a human barrier to the successful adoption of technologies and new projects with uncertain outcomes. Uncertainty avoidance turns out to be anathema to innovation as the latter tends to introduce unanticipated changes and cause uncertainty, which in turn leads to resistance to innovation (De Luque and Javidan [2004]; Erumban and de Jong [2006]).

Hofstede [1980] noted that in high uncertainty-avoidance societies, there is greater fear of failure, lower willingness to take risks, lower levels of ambition, and lower tolerance for ambiguity. These values tend to contradict the entrepreneurial values of proactiveness, innovation, and risk taking. Hence proposition 12 states: *High level of uncertainty avoidance is negatively associated with entrepreneurial strategic posture.*

### 3.3. Strategic posture

The exercise of strategic choice by MSMEs is operationalized by the concept called strategic posture. Strategic posture, as defined in the literature, reflects the top management's risk taking behavior with regard to investment decisions and strategic actions in the face of uncertainty, the extensiveness and frequency of product innovations and the related tendency toward technological leadership, and the pioneering nature of the firm as evident in the firm's propensity to compete with industry rivals aggressively and proactively (Covin and Slevin [1990]; Covin, Slevin, and Schultz [1994]; Gibbons and O'Connor [2005]). It places a firm along a continuum ranging from conservative to entrepreneurial [Covin 1991]. The concept of strategic posture is similar to the concept of strategic agency, which refers to the systematic attempt to reach conceived ends through the planned and purposeful application of means [Beckert 1999]. Likewise, strategic posture forms the basis of the entrepreneurial

orientation concept [Lumpkin and Dess 1996]. Strategic posture, while exercised by the owner of an MSME or top management of a firm, is considered an organizational variable as organizations are “reflections of the values and cognitive bases of powerful actors” [Carpenter and Fredrickson 2001]. Furthermore, compared to large firms, MSMEs may have flatter structures, and micro or small enterprises may even be a one-person business operation.

Strategic posture, therefore, hinges on three fundamental constructs: innovativeness, proactiveness, and risk taking. Innovativeness reflects a tendency to support new ideas, novelty, experimentation, and creative processes, thereby departing from established practices and technologies [Lumpkin and Dess 1996]. Proactiveness refers to a posture of anticipating and acting on future wants and needs in the marketplace, thereby creating a first-mover advantage vis-à-vis competitors [Lumpkin and Dess 1996]. Risk taking is associated with a willingness to commit large amounts of resources to projects in which the cost of failure may be high [Miller and Friesen 1982]. It also implies committing resources to projects in which the outcomes are unknown. It largely reflects the organization’s willingness to break away from the tried-and-tested and venture into the unknown [Wiklund and Shepherd 2003].

Covin, Slevin, and Schultz [1994] argue that firms with conservative strategic posture are risk averse, non-innovative, and reactive firms while those with entrepreneurial strategic posture are risk taking, innovative, and proactive. These three components comprise a basic, unidimensional strategic orientation (Covin, Slevin, and Schultz [1994]; Gibbons and O’Connor [2005]; Naldi et al. [2007]). Essentially, strategic posture reflects the firm’s strategic orientation, that is, the firm’s overall competitive orientation [Covin and Slevin 1989].

The importance of studying strategic posture or its synonymous term, strategic orientation, rests on previous research that yielded the following results, among others: (a) strategic posture is the organization’s response or adaptation to the vagaries of the external environment (that is, hostility, turbulence, complexity, etc.) (Lukas [1999]; Strandholm, Kumar, and Subramanian [2004]); (b) strategic posture is the exploitation of the firm’s resources to generate competitive advantage [Ordaz, Alcazar, and Cabrera 2003]; (c) strategic posture/orientation shapes the level of innovation within the firm (Salavou, Baltas, and Lioukas [2004]; O’Regan and Ghobadian [2005]); and (d) strategic posture shapes the performance outcome of firms (Ramaswamy, Thomas, and Litschert [1994]; Rajagopalan [1996]; Pelham [1999]; Durand and Coeurderoy [2001]; Noble, Sinha, and Kumar [2002]; Morgan and Strong [2003]; Aragon-Sanchez and Sanchez-Marin [2005]).

### 3.4. Managerial, firm, and industry characteristics

The discussion above emphasizes the external environmental influences on strategic posture being the major theme of this study. It is of equal importance to ascertain a number of managerial, organizational, and industry factors that may have a bearing on strategic posture, considering that MSMEs operate in various industries. It is argued that understanding the growth of firms requires explanations of the firm's strategies, actions, and profile characteristics [Smallbone, Leig, and North 1995]. Research has also shown that managerial characteristics make a difference in strategy formulation and implementation [Hitt and Tyler 1991]. People make decisions, and these depend on prior processes of human perception and evaluation (Hitt and Tyler [1991]; Child [1997]). These processes are shaped by the managerial orientation created by needs, values, experiences, expectations, and cognitions of the manager (Hitt and Tyler [1991]; Child [1997]).

The manager-strategy linkage is well explained by Govindarajan [1989] who argued that different strategies have different job requirements with the use of tasks, behaviors, knowledge, skills, and values. Managers differ in their behavior, knowledge, skills, and performance of tasks due to differences in their biographical background, which consequently limits their ability to function effectively in all types of strategic contexts [Govindarajan 1989]. The implication of this argument is that the congruence of managerial skills, knowledge, and behavior (as formed by their biographical background) with the requirements of particular strategic orientations is expected to generate superior performance. Hence it is important to look at managerial, firm-related and industry-related characteristics. For example, the age of the manager or executives of an organization has been shown to affect strategic decisions [Hitt and Tyler 1991]. Previous studies have noted the positive relationship between the level of manager's formal education and a firm's innovation (Hitt and Tyler [1991]; Thomas, Litschert, and Ramaswamy [1991]; Chow [2006]).

The size of the firm has also been shown to affect variables such as change in core features of an organization, R&D expenditures, and innovation (Chen and Hambrick [1995]; Entrialgo, Fernandez, and Vazquez [2001]; Yusuf [2002]). The age of the firm is also relevant as it has been shown to shape the level of innovation, risk taking, and proactiveness in the desire to achieve full capacity (Yusuf [2002]; Strandholm, Kumar, and Subramanian [2004]; Luo, Zhuo, and Liu [2005]). The structure of ownership may also influence strategic choice as it determines the type of ownership, goals, control, and sharing of liability to the business (Birley and Westhead [1990]; Bhaskaran [2006]; Kazem and van

der Heijden [2006]). Finally, the nature and dynamics of the industry may also shape the strategic posture of MSMEs. Studies have shown that industry technological sophistication can have a major impact on the individual strategic decisions, business strategy patterns, and overall strategic posture of firms (Covin, Slevin, and Covin [1990]; Yusuf [2002]). Covin, Slevin, and Covin [1990] found out that firms in high-tech industries tend to be more entrepreneurial in their strategic approach compared to those operating in "low-tech" industries. Therefore, proposition 13 posits: *Managerial, firm, and industry characteristics may moderate the relationship between the institutional environment and strategic posture.*

#### **4. Conclusion and implications for further research**

Institutions matter to MSMEs because they provide the structure, set constraints, and offer incentives that could support or inhibit the proactive, risk-taking, and innovative activities of these firms. The minimization of transaction costs as well as level of uncertainty through formal institutions plays a major role in supporting the entrepreneurial growth of MSMEs. The sociocultural support provided by the equally important informal institutions complete the institutional landscape through which productive entrepreneurial activities could take place. The conceptual framework developed in this study offers a new way of looking at the relationship between the institutional environment and the strategic choices of MSMEs. However, this study offers numerous questions and issues worth pursuing in future studies. Of major concern is the measurement of formal and informal institutions. It must be noted that there are many ways to measure a firm's external environment [Lenz and Engledow 1986]. If informal institutions are intangible, will the cognitive model of environment [Weick 1988] provide an adequate framework for measurement? Should objective measures be used to determine the quality of formal institutions? Furthermore, many developing countries are undergoing deregulation and decentralization of governance systems, making subnational (for example, regional or city) governments politically and economically more responsible and accountable. It would be interesting to know how the propositions would work in such institutionally heterogeneous localities. Finally, the ultimate objective of a business operation is to realize a predetermined goal or set of goals that may range from intrinsic to financial values. The challenge, therefore, is to establish whether an institutional environment conducive to entrepreneurial strategic posture would result in better and sustainable MSME performance.



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