

# Entrepreneurship in a Transition Economy: The Impact of Environment on Entrepreneurial Orientation

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## Abstract

The paper intends to shed some light on the impact of business environment on entrepreneurial orientation in a transition economy. It presents the basic results of an empirical survey of some business environment factors of entrepreneurial orientation development on the basis of individual evaluations. The survey data was collected by interviews with Bulgarian micro-firms entrepreneurs. Entrepreneurial orientation was operationalized by five involved characteristics – risk taking, pro-activeness, innovativeness, autonomy and aggressive competitiveness. A specifically designed questionnaire asked respondents to rate their perception about each environmental characteristic considered as inherent to Bulgarian transition economy – hostility, dynamism and uncertainty. The hypotheses outlined in the study were tested by using canonical correlation model. Entrepreneurial orientation is increasingly being shaped by environmental forces especially in a transition economy hence the study emphasizes the interrelation between environmental attributes and entrepreneurial orientation of Bulgarian micro-entrepreneurs. In this respect, the uncertainty induced by external environment is in the focus of the study as well as its main characteristics perceived by entrepreneurs. As a result it is concluded that SMEs development policy formulation should target the improvement of business environment and the provision of much more predictable and stimulating conditions for the small businesses during continuing market transition.

**Key words:** entrepreneurial orientation, business environment, transition economy.

**JEL Classification:** M13, M20, P20

## Introduction

The overall improvement of the business environment is considered as a very important factor of the market transformation success and economic reforms in transition countries. It is expected to have a crucial role for the attraction of foreign investments and economic growth acceleration. Although widely recognized as a main source of uncertainty, the business environment of a transition economy also creates chances for successful introduction of new products, market prosperity and rapid growth of the small and flexible entrepreneurial organizations.

As noted in Zahra (1999), entrepreneurship should be considered as a significant factor of the socio-economic development solving employment problems, providing wider range of consumer products, and increasing competitiveness and overall prosperity. Since transition economies move towards market-oriented models, improvement of the knowledge about entrepreneurship becomes to a greater extent important in theoretical as well as practical aspect for the formulation and implementation of economic policy. Entrepreneurship is often recognized as a response to some environmental conditions that could hinder or support business success by the nature of the climate they establish (Aldrich, Wiedenmayer, 1993).

The development of entrepreneurial potential and orientation in transition countries is considered as *a main instrument that is expected to provide their global competitiveness*. In other words, the entrepreneurs' capability to seize new business opportunities will act as major determinant of the establishment of a nation's competitive position on the global market (Zahra, 1999).

The main purpose of the paper is to present the basic results of an empirical survey<sup>1</sup> of some business environment factors impact on the development of entrepreneurial orientation on

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the basis of individual entrepreneurial evaluations. The survey data was collected by interviews with entrepreneurs (owners-managers) from Bulgarian micro-firms. Entrepreneurial orientation is increasingly being shaped by environmental forces especially in a transition economy hence this study emphasizes the interrelation between environmental attributes and entrepreneurial orientation in Bulgarian micro-enterprises. Furthermore, the uncertainty induced by external environment is in the focus of the study as well as its main characteristics perceived by entrepreneurs.

## Definition of Constructs

In different studies the environment was conceptualized as a multidimensional construct, characterized by *dynamism*, *complexity* and *hostility* (Dess, Beard, 1984). Two of these dimensions of environmental attributes – environmental hostility and dynamism – are investigated in this study.

The *hostility dimension* is reflected in a wide range of factors, e.g. the industry growth rate, the level of competitive intensity within the industry, the industry's access to necessary inputs, the perceived randomness of competitors' behavior and the availability of exploitable product-market opportunities (Potter, 1994). Miller and Friesen (1983) define hostility as "the degree of threat to the firm posed by the multifacetedness, vigor and intensity of competition and downswings and upswings of the firms principle industry". Generally it could be stated that hostility is an encompassing construct including elements of unpredictability, threat, and relative lack of control over environmental events, agents or trends.

The *dynamism dimension* includes both the rate of unpredictable environmental change and the stability of environment (Dess, Beard, 1984). In this study the dynamism is considered as an unforeseeable change in the complex of environmental factors. Dynamic environments have usually been found to encourage entrepreneurial behavior on the firm level (Miller, Droge, Toulouse, 1988). In this line Khandwalla (1987) points out that organizations often respond to challenging environmental conditions, such as those present in dynamic environments, by taking risk, innovating, and exhibiting proactive behaviors.

In addition to these two dimensions, *uncertainty* was considered as one of the most important characteristics of business environment. Milliken (1987) derives a general definition of environmental uncertainty, emphasizing the "inability of the individual to discriminate between relevant and irrelevant data" coming from external sources. Milliken further suggests three types of uncertainty originating from business environment: (1) effect uncertainty is an inability to predict the nature of the effect of environment future state on the organization; (2) response uncertainty is an inability to predict the likely consequences of a response choice; (3) state uncertainty is also referred to as perceived environmental uncertainty. Some recent studies view the uncertainty as a perceptual construct that is a matter of the state of mind of decision maker evaluating subjective estimates of the risk of disappointment (Penrose, 1995).

Previous studies on the interrelation between business environment and entrepreneurial orientation derive general conclusions stating that the environment (represented by different characteristics, e.g. dynamism, hostility and uncertainty) affects entrepreneurial perception, which in turn drives the firms to adopt strategic orientations, such as autonomy, innovativeness, risk taking, proactiveness, and competitive aggressiveness (Lumpkin, Dess, 1996).

- *Autonomy* is the catalyst of entrepreneurial activity, it is the independent spirit of freedom necessary to create new ventures. However, entrepreneurs could operate this way mainly within societies that promote independent economic behavior, maintaining personal control and seeking business opportunities under minimum societal constraints.
- *Innovativeness* is a non-argumentative crucial dimension of entrepreneurial orientation and entrepreneurship itself. When entrepreneurs operate in a society supporting

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experimentation and novel solutions endeavoring, it will be much likely for this economy to experience positive results in terms of new products or processes (technologies) and, therefore, adding up to its global competitiveness.

- *Risk taking* is an implicit component of entrepreneurial orientation. Besides, societies encouraging entrepreneurial propensity to tolerate ambiguity, as well as to involve economic resources in risky ventures, are considered to significantly benefit in terms of gaining competitive advantages.
- *Proactiveness* is another important dimension of entrepreneurial orientation. Individuals are categorized as proactive when they anticipate opportunities and systematically pursue participation in new or emerging markets. Thus, proactiveness is a core feature of entrepreneurial orientation since it is concerned with the implementation stage of entrepreneurship.
- *Competitive aggressiveness* dimension of entrepreneurial orientation relates to the individual's propensity to satisfy his/her need for achievement by challenging competitors or improving his/her relative position in the marketplace. The aggressive economic behavior and non-avoidance of intense competition are critical to the survival in the global economy, especially for the success of new start-ups.

Entrepreneurial orientation incorporates the concept of growth sources as well as of business performance. From this point of view risk-taking, innovativeness and proactiveness should keep small businesses ahead of competitors, providing the fundament of their competitive advantage. Meanwhile, the literature on the subject treats entrepreneurial orientation as a construct different from entrepreneurship itself. Since entrepreneurship generally refers to new entries in markets, the entrepreneurial orientation is rather related to *the entrepreneurial process*. It deals with issues of undertaking entrepreneurial action, e.g. particular practices and decision-making styles. Furthermore, entrepreneurial orientation destroys old business practice stereotypes and establishes new, innovative, risk tolerating pattern of economic behavior.

In addition, entrepreneurial orientation is related to entrepreneurial decision-making characteristics dealing with the match of internal capabilities/activities to the external environment in which the firm operates. Hence, the entrepreneurial orientation is considered as a "firm level phenomenon", since firm strategy is often initiated by an individual (in a small firm or micro-enterprise). In entrepreneurial context, this "firm level approach" is consistent with some postulates of classical economics that insist on the theoretical unity of the individual entrepreneur and the firm. This view is supported by other studies that emphasize the role of entrepreneurship as a firm's behavior (Covin, Slevin, 1991).

Summarizing the short previous studies review it should be noted that utilizing diverse methods and models, existed research has demonstrated that the external environment has a strong (albeit not deterministic) influence on the effectiveness of entrepreneurial activity. This view is supported by Khandwalla (1987) who considers the entrepreneurship as "organizational-level phenomenon".

## Hypotheses

Three groups of work hypotheses about the impact of environmental characteristics perceptions of micro-firms owners on their entrepreneurial orientation are raised in this study. Each group considers the relation of respective environmental characteristic to the five dimensions of entrepreneurial orientation.

H1. Perceived environmental uncertainty is positively related to: (a) autonomy, (b) innovativeness, (c) risk taking, (d) proactiveness, and (e) competitive aggressiveness.

H2. Perceived environmental hostility is positively related to: (a) autonomy, (b) innovativeness, (c) risk taking, (d) proactiveness, and (e) competitive aggressiveness.

H3. Perceived environmental dynamism is positively related to: (a) autonomy, (b) innovativeness, (c) risk taking, (d) proactiveness, and (e) competitive aggressiveness.

## Empirical Research Design

According to Bulgarian SME Law, firms employing not more than 10 persons are categorized as micro-enterprises. The fact that over 93% of all registered Bulgarian enterprises are of that type determines their important role as economic agents. Besides, this small business form has an individualized decision making process with a typical personalized risk taking consideration. Having these facts in mind, the object of the survey was limited to individual entrepreneurs owning and running (by themselves) micro-enterprises in a wide range of business sectors.

The framework of the study required the development of specific methodology for necessary data provision according to the main principles of quota sampling and face-to-face interviewing. Questionnaire data was prepared for further analysis following the standard scheme of decomposition of general concepts to operational measures and extracting indicator variables. These variables represent the level of individual entrepreneurs perception of all characteristics involved in the analysis.

The empirical survey was conducted in the period between November 2001 and May 2002 by using a quota sample of 382 active micro-enterprises. Three kinds of distributions were used for quotas determination utilizing available statistical data for the active business entities – territorial, sectoral and by number of employees. Representativeness was pursued to a maximum possible extent by unintentional choice of the firms in the respective regions according to their economic sector and the number of employed persons.

## General Sample Description

The territorial distribution of the sample covers the relative regional shares of registered active micro-enterprises that account for around 200,000. Compared to the North districts, South Bulgaria has to a great extent better business climate for SME development inducing new private business start-ups (Table 1). The concentration of micro-enterprises in South West region is also due to the belonging of the capital city to this area providing a large market and convenient infrastructure supporting the small businesses survival.

Table 1

Distribution of firms in the sample by territory, by number of employees, and by economic sector of basic activity

| Region                     | Count        | %            | Sector              | Count      | %            |
|----------------------------|--------------|--------------|---------------------|------------|--------------|
| North West                 | 20           | 5.2          | Agriculture         | 3          | 0.8          |
| North Central              | 52           | 13.6         | Forestry            | 3          | 0.8          |
| North East                 | 59           | 15.4         | Processing          | 38         | 9.9          |
| South East                 | 39           | 10.2         | Maintenance         | 9          | 2.4          |
| South Central              | 93           | 24.3         | Construction        | 14         | 3.7          |
| South West                 | 119          | 31.2         | Transport           | 31         | 8.1          |
| <b>Total:</b>              | <b>382</b>   | <b>100.0</b> | Wholesale trade     | 38         | 9.9          |
| <b>Number of employees</b> | <b>Count</b> | <b>%</b>     | Retail trade        | 152        | 39.8         |
| No one else                | 172          | 45.0         | Hotels, restaurants | 28         | 7.3          |
| 1 – 2                      | 103          | 27.0         | Business services   | 12         | 3.1          |
| 3 – 5                      | 58           | 15.2         | Communal services   | 47         | 12.3         |
| 6 – 9                      | 49           | 12.8         | Other               | 7          | 1.8          |
| <b>Total:</b>              | <b>382</b>   | <b>100.0</b> | <b>Total:</b>       | <b>382</b> | <b>100.0</b> |

As a general rule, the labor involvement in Bulgarian micro-enterprises is limited to the self-employed persons, members of their families (often without formal appointment in the firm)

and usually few additional external employees. It could be definitely stated that small business owners not only administer and control but also take an active part in the regular work at their entrepreneurial organization, especially in the typical family business case. According to the sectoral structure trade and services firms prevailed in the sample, small industrial firms are rarely found mainly in the processing industry and construction (Table 1). The fact that more than one third of micro-enterprises supply different kinds of services supporting one of the main features of market transition – the privatization and development of services sector and its GDP share enlargement.

Table 2

Distribution of entrepreneurs by their expected profit perspectives for the next 6 months

| Perceived profit perspectives | Count | %     |
|-------------------------------|-------|-------|
| Profits increase              | 69    | 18.0  |
| Keeping the same level        | 234   | 61.3  |
| Profits decrease              | 61    | 16.0  |
| Likely failure                | 18    | 4.7   |
| Total:                        | 382   | 100.0 |

It should be noted that most of the respondents have some sources of information about their competitors' financial situation as well as the branch opportunities for doing successful business, providing them with options for comparative judgments. In this line, the knowledge for their business environment gives the entrepreneurs an information basis for outlining expectations about the firm's future. The evaluation of expectations is located in a horizon of 6 months when future financial results are to be foreseen (see Table 2). This approach is a general one but it provides for adequate information about the individual perception of business climate impact on future operations of micro-firms. Over 60% of respondents express moderate confidence in keeping the reached profit level and each sixth is optimistic about future business results expecting a growth of his/her business.

## Measurement of Indicator Variables

It is recognized in similar studies that the way entrepreneurs perceive their business environment is more relevant to the chosen research approach than involving official statistical data for the environment. In this line, using perceptual measures allows to evaluate a firm's environment from the perspective of target respondents.

Questionnaire specifically designed for this study asked respondents to rate on a 7-point scale their perception about each environmental characteristics considered as inherent to Bulgarian transition economy – hostility, dynamism and uncertainty. For example, hostility perception was evaluated by a choice of a rank 1 to 7 between the extreme options (totally agree / totally disagree) for the following items: "Your firm's environment is hostile, with many entry barriers to new markets" and "Your firm's access to input resources is extremely limited". The indicator variable was obtained by averaging the ranks attached by the respondents. Analogous approach was adopted to measure the other two variables mentioned above.

Entrepreneurial orientation was operationalized by five involved characteristics – risk taking, proactiveness, innovativeness, autonomy and aggressive competitiveness. Respondents were asked to rank their propensity to take entrepreneurial decisions relevant to their firms in specific external conditions using the 7-point scale. Particularly, respondents answered three questions (items) associated to each characteristic. For example, proactiveness was measured by the expressed propensity to proactively move in order to take a lead in conditions of ambiguity and uncertainty; risk taking propensity was measured by respondents' preferences about investments with

low risk and moderate return opposed to those with high risk-return position. Indicator variables were obtained again by averaging the ranks from the three items for each of the entrepreneurial orientation characteristics<sup>1</sup>.

## Data Analysis and Statistical Results

The hypotheses outlined in the theoretical model of the study were tested by using canonical correlation model with the following sets of variables:

Right set:  $a_1$ Uncert +  $a_2$ Hostil +  $a_3$ Dynam

Left set:  $b_1$ Risktaking +  $b_2$ Proact +  $b_3$ Innovat +  $b_4$ AggresComp +  $b_5$ Auton

As seen in the correlation matrix (Table 3), all three environmental characteristics are significantly correlated to entrepreneurial orientation variables. Having the smallest coefficient of 0.21 it can be assumed that canonical correlation analysis should produce reliable statistical results for all variables of interest integrated in one model.

Table 3

Correlation matrix of indicator variables ( $N=382$ )

| Variables                     | 1     | 2     | 3     | 4     | 5     | 6     | 7     | 8     |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| 1. Risk taking orientation    | 1.00  | -0.44 | 0.51  | 0.37  | 0.32  | -0.44 | -0.32 | -0.55 |
| 2. Proactiveness              | -0.44 | 1.00  | -0.35 | -0.43 | -0.30 | 0.30  | 0.28  | 0.44  |
| 3. Innovativeness             | 0.51  | -0.35 | 1.00  | 0.54  | 0.32  | -0.42 | -0.37 | -0.60 |
| 4. Aggressive competitiveness | 0.37  | -0.43 | 0.54  | 1.00  | 0.34  | -0.44 | -0.28 | -0.34 |
| 5. Autonomy                   | 0.32  | -0.30 | 0.32  | 0.34  | 1.00  | -0.27 | -0.21 | -0.21 |
| 6. Uncertainty perception     | -0.44 | 0.30  | -0.42 | -0.44 | -0.27 | 1.00  | 0.43  | 0.41  |
| 7. Hostility perception       | -0.32 | 0.28  | -0.37 | -0.28 | -0.21 | 0.43  | 1.00  | 0.34  |
| 8. Dynamism perception        | -0.55 | 0.44  | -0.60 | -0.34 | -0.21 | 0.41  | 0.34  | 1.00  |

Note: All correlations are significant at the 0.01 level (2-tailed test).

Although canonical correlation coefficients obtained are not very high these results give some interesting evidence for the relations between environmental impact perceptions and entrepreneurial orientation (Table 4). Since the first canonical root provides a correlation coefficient much higher than the second, its estimates are used primarily for deriving the main conclusions.

Dynamism perception is found to have *the highest net impact* on entrepreneurial orientation dimensions (canonical weight 0.75). It is most strongly related to innovativeness and risk taking orientation but the negative signs of their canonical weights show decreasing willingness to behave innovatively and risky. The positive sign of proactiveness gives confirmation only of hypothesis H3(d); the other two dimensions (autonomy and aggressive competitiveness) do not seem to have significant net relations to dynamism.

The hypotheses about positive relations between uncertainty perception and the five entrepreneurial orientation dimensions of micro-firms owners are not also confirmed except for proactiveness and, to a very small extent, for autonomy of decision making. Besides, the relatively small canonical weight of this environmental characteristic does not show significant interaction with these environmental attributes comparatively to dynamism perception. The same conclusion is even more relevant for the hostility perception having the smallest weight obtained in root 1.

<sup>1</sup> Cronbach's alpha was used as a reliability measure for each group of items. It showed acceptable to very good internal consistency for these groups ranging from 0.63 to 0.85.

Table 4

Canonical correlation results (canonical weights  $a_i, b_j$ )

| Independent variables             | Root 1       | Root 2       | Root 3 |
|-----------------------------------|--------------|--------------|--------|
| Risk taking orientation           | <b>-0.42</b> | 0.17         | -0.90  |
| Proactiveness                     | 0.25         | 0.47         | -0.36  |
| Innovativeness                    | <b>-0.57</b> | <b>-0.69</b> | 0.40   |
| Aggressive competitiveness        | -0.03        | <b>1.08</b>  | -0.22  |
| Autonomy                          | 0.03         | 0.35         | 0.79   |
| Uncertainty perception            | 0.29         | <b>-1.06</b> | 0.38   |
| Hostility perception              | 0.19         | 0.06         | -1.11  |
| Dynamism perception               | <b>0.75</b>  | 0.73         | 0.39   |
| Variance extracted, % (left set)  | 46.2         | 13.5         | 13.5   |
| Variance extracted, % (right set) | 54.8         | 21.9         | 23.3   |
| Canonical R                       | 0.74         | 0.29         | 0.07   |
| Chi square tests (sig.level)      | .000         | .000         | .592   |

Canonical root 2 gives some additional information (not revealed by root 1) about the interrelation between some of the variables involved in the analysis, particularly for the uncertainty dimension (canonical weight  $-1.06$ ). Its common sign with innovation variable shows a “hidden” stimulating effect of the uncertain environment on the orientation to innovative practices ( $-0.69$ ). A possible explanation of this result could be the intrinsic entrepreneurial perception of uncertainty factors as rather providing opportunities than being a threat. In the same time, the uncertainty acts quite strongly as an obstructing factor to aggressive competitiveness of micro-firm entrepreneurs (1.08).

## Discussion

It should be pointed out that the prevailing majority of Bulgarian micro-firm entrepreneurs are likely to be risk averters. As the first implication of the analysis it could be stressed that in a highly dynamic, uncertain, and hostile environment long run business opportunities of Bulgarian micro-enterprises are easily missed because of the avoidance of innovative and risky business decisions. Decision makers in micro-firms usually pursue temporary profit (considered as more realistic in the dynamic transitional environment) instead of targeting in sustainable future business perspectives. In spite of that, they are to some extent proactive in searching new business opportunities facing uncertain but challenging conditions.

Micro-entrepreneurs in Bulgaria seem to identify the dynamism as the most influencing external factor of their business environment. To some extent, it blocks the innovative and risk taking behavior necessary for small businesses to keep and develop in the transition economy. Transitional business environment is definitely highly dynamic because of the serious structural and institutional reforms undertaken during the last 12 years. Political instability (resulting in frequent changes in business regulations, tax legislation and administrative practices) induces permanent expectations for future unforeseeable changes in business environment. Thus, the decision makers in micro-firms face greater uncertainty because of the continuing instability of the fundamental rules of the game typical for market transition. These entrepreneurs prefer to gain rapid returns on their capital emphasizing liquidity, but they are unwilling to widely reinvest for business expansion. They actually take a waiting position expecting appropriate conditions for more risky and innovative business behavior.

Furthermore, Bulgarian micro-entrepreneurs prefer risk aversion strategies having perceptions of risky, hostile and turbulent environment. This type of environment creates high barriers to entry in the respective markets as well as low chances for success of emerging small businesses. Such entrepreneurs take defensive positions in risky situations in a strategic perspective. They usually direct their efforts mainly to secure the survival of their entrepreneurial organizations.

Generally, the evaluation of business environment characteristics by micro-entrepreneurs is typically done in a situational framework. They hardly determine whether the environment is easy for managerial control according to its particular dynamism and uncertainty dimensions. Realizing that a potential change in some of the important environmental factors might induce a serious crisis situation the entrepreneur in a micro-firm chooses to avoid the possible risks. However, the proactive orientation of these entrepreneurs enables them to use *ad-hoc* emerged opportunities taking comparative advantages and gaining benefits.

The estimated canonical correlation model reveals some important features of the interrelation between entrepreneurial orientation and the three perceived environmental characteristics. Nevertheless, it is obviously necessary to conduct additional analyses in order to support or reject the main conclusions in a more precise manner. Some other relevant independent variables could be introduced as well as more sophisticated models could be constructed in order to increase the quality of research work.

## Summary and Conclusions

The questionnaire survey identified the main external factors influencing micro-enterprises performance and thus outlined the sources of uncertainty for Bulgarian small business environment. These factors are evaluated from a general perspective by entrepreneurs as unfavorable and too risky for private business development in the country. The strongest negative sources of uncertainty are found to be the low level of consumers' demand as well as the overall economic conditions in the country (identified by almost 90% of respondents). The relatively high interest rates do not encourage entrepreneurs to take long-term investment credits, which to a great extent hinders the strategic decisions making. This is usually accompanied by heavy bureaucratic procedures (78%) in combination with high tax and social security burdens (85%).

Financial stabilization and currency board system are identified as the only positive factor stimulating the survival and development of small businesses (85%). To some extent, the current state of telecommunications and the competition developed after the start of the second mobile operator are considered as positively influencing the business operations of small firms. It should be noted that a significant share of respondents also positively evaluate the overall effect of market reforms during transition period and the resulting enlargement of private sector share. These entrepreneurs particularly appreciate economic liberalization and principally tolerate strategic risk taking.

Finally, the unfavorable institutional environment, ineffective economic reforms and the large gray economy share tend to intensify the riskiness of business environment for Bulgarian micro-enterprises. It worsens the conditions for stable development of emerging small businesses in the country. From this point of view it should be concluded that the issues of national SME development policy formulation should target the improvement of business environment and the provision of much more predictable and stimulating conditions for the small businesses in Bulgarian economy during continuing market transition.

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