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ENTREPRENEURIAL ORIENTATION AND MSME PERFORMANCE: A CONCEPTUAL FRAMEWORK HIGHLIGHTING THE ROLE OF INNOVATION CAPABILITY

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Micro, Small and Medium Enterprises (MSMEs) play an important role in economic development, but many of them struggle to achieve consistent performance due to limited resources and rapidly changing market conditions. Entrepreneurial Orientation (EO), reflected through innovativeness, risk-taking, and proactiveness, is often considered essential for MSME success. However, existing studies show that EO does not always lead to improved performance, especially in small and resource-constrained firms. This conceptual paper argues that entrepreneurial orientation alone is not sufficient to enhance MSME performance unless it is supported by strong innovation capability. Drawing on the Resource-Based View and Dynamic Capabilities Theory, the study proposes a conceptual framework in which EO influences MSME performance through the mediating role of innovation capability. Innovation capability enables MSMEs to convert entrepreneurial intent into concrete actions such as new products, improved processes, and adaptive market responses, which ultimately improve innovative, market, and financial performance. By clarifying this internal mechanism, the paper helps explain the inconsistent findings reported in earlier EO - performance research. The proposed framework offers a clear theoretical explanation of how entrepreneurial orientation contributes to MSME performance and provides a foundation for future empirical studies.

Keywords: *Entrepreneurial Orientation, Innovation Capability, MSME Performance, Mediation Framework, Resource-Based View.*

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I. INTRODUCTION

Micro, small, and medium enterprises (MSMEs) are widely recognized for their substantial contribution to economic development and sustainable growth of nation, often exceeding expectations relative to their size (Endris&Kassegn, 2022). Despite their economic importance, MSMEs often struggle to achieve sustainable performance due to resource constraints, limited technological capabilities, and high levels of environmental uncertainty (Prasanna et al., 2019). Murray (1984) describes entrepreneurial strategy as widespread, cyclical changes in organizational decisions to adapt to such volatility [1]. In such conditions, entrepreneurial strategies become critical for survival and long-term success.

Entrepreneurial orientation (EO) has emerged as a central construct in entrepreneurship research, reflecting a firm's strategic posture in terms of innovativeness, risk-taking, and proactiveness [2]. A substantial body of literature suggests that EO can enhance firm performance [3,4]; however, empirical findings from prior studies on the EO - performance relationship remain inconsistent across industries, firm sizes, and national contexts [5,6]. These mixed results indicate that entrepreneurial orientation alone may not sufficiently explain performance differences among MSMEs.

One important reason for this inconsistency is that entrepreneurial orientation primarily captures entrepreneurial intent or strategic posture, but provides limited explanation of how such intent is transformed into concrete organizational actions and outcomes [7]. Innovation capability, defined as a firm's ability to develop and implement new products, processes, and practices, represents such an internal capability [8]. In resource-constrained MSMEs, entrepreneurial initiatives are likely to improve performance only when firms possess internal

capabilities that enable the effective implementation of new ideas.

From a Resource-Based View, entrepreneurial orientation can be understood as a strategic resource [9], while Dynamic Capabilities Theory explains how innovation capability enables firms to deploy this resource to respond to environmental changes and achieve superior performance [10]. For MSMEs, innovation capability allows entrepreneurial orientation to be translated into adaptive responses, innovative offerings, and improved innovative, market, and financial performance outcomes [11]. Accordingly, this paper develops a conceptual framework that positions innovation capability as a mediating mechanism between entrepreneurial orientation and MSME performance. The contribution of this study lies in conceptually clarifying the mechanism, through which entrepreneurial orientation influences MSME performance, rather than proposing new constructs or empirically testing relationships. By doing so, the study provides a coherent theoretical explanation for the inconsistent findings reported in prior EO - performance research and offers a foundation for future empirical investigation.

2. LITERATURE REVIEW

2.1 Entrepreneurial Orientation

Entrepreneurial orientation (EO) refers to a firm-level strategic posture characterized by innovativeness, risk-taking, and proactiveness [12]. Covin and Slevin (1989) operationalized EO as a strategic orientation reflecting managerial decision-making styles, while Lumpkin and Dess (1996) expanded the construct by incorporating autonomy and competitive aggressiveness, emphasizing its multidimensional nature [13]. EO proves particularly relevant for MSMEs operating under resource constraints, market volatility, and technological limitations [14,15], as firms exhibiting strong EO demonstrate superior capacity to identify opportunities, adapt to environmental changes, and pursue innovation-driven strategies [14]. Despite extensive application, EO primarily captures entrepreneurial intent and strategic posture rather than the organizational capabilities required for effective strategy implementation [7], contributing to inconsistent empirical findings regarding its direct impact on firm performance across diverse industries, firm sizes, and national contexts [16].

2.2 MSME Performance

While no studies develop performance frameworks exclusively for MSMEs, research on resource-constrained firms consistently identifies four key performance dimensions relevant to small businesses [17,18]. Financial performance includes profitability margins, sales revenue growth, return on investment (ROI), and cash flow stability - critical measures for firms with limited capital reserves [18]. Market performance focuses on market share gains, customer retention rates, repeat purchase frequency, and customer satisfaction levels, which determine long-

term viability in competitive markets [17]. Operational performance measures improvements in production efficiency, inventory turnover rates, cost reduction achievements, and supply chain reliability, addressing MSMEs' structural scale disadvantages [19]. Innovation performance tracks success in launching new products, services, process improvements, or business model innovations, enabling differentiation despite resource limitations [20]. These dimensions become especially critical for MSMEs lacking the scale, capital access, and technological infrastructure of larger competitors [21]. Without these advantages, MSMEs depend heavily on internal strategic orientations like entrepreneurial orientation (EO) to improve performance across all four dimensions and ensure survival and growth.

2.3 Innovation Capability

Innovation capability means a firm's ability to regularly create, absorb, and apply new products, processes, and practices that strengthen its market position [8], which is especially important for resource-limited MSMEs needing to stand out and adapt quickly in unstable markets [22]. Unlike one-off innovations, it involves ongoing organizational learning, combining different types of knowledge, and restructuring work processes to include better management practices and market approaches beyond just technology [23]. MSMEs with strong innovation capability better absorb outside knowledge and achieve lasting performance, and in entrepreneurship research, innovation capability works as a dynamic capability that turns entrepreneurial mindset (like EO) into real business actions and results [10].

2.4 EO, Innovation Capability, and MSME Performance Relationship

Entrepreneurial orientation (EO) cultivates opportunity recognition, risk willingness, and proactive strategic behaviors, yet innovation capability serves as the critical execution mechanism that determines successful strategy implementation [12]. While EO establishes an innovation-conducive organizational climate characterized by autonomy and experimentation, resource-constrained MSMEs require developed innovation capabilities to translate these entrepreneurial initiatives into concrete technological, product, process, and market outcomes [24]. Empirical evidence increasingly validates innovation capability's mediating role in the EO-performance relationship, particularly among resource-limited MSMEs where direct EO effects often prove weak or inconsistent [25]. These findings explain why EO alone frequently fails to deliver performance gains in capital-poor contexts without innovation capability, entrepreneurial initiatives remain unrealized potential rather than value-creating realities.

2.5 Theoretical Framework & Conceptual Model Resource-Based View: Entrepreneurial Orientation as Strategic Resource

The Resource-Based View (RBV) conceptualizes firms as bundles of resources and capabilities where sustained competitive advantage derives from

resources fulfilling the VRIO criteria i.e. Valuable, Rare, Inimitable, and Organizationally appropriated [9]. Entrepreneurial orientation (EO) emerges as a higher-order strategic resource integrating five behavioral dimensions: innovativeness, proactiveness, risk-taking, competitive aggressiveness, and autonomy [12,13]. EO satisfies VRIO attributes by proving valuable through superior opportunity recognition, rare via distinctive risk propensities uncommon among conservative competitors, inimitable through path-dependent behavioral integration embedded in organizational culture over time, and organizationally appropriated when firm governance structures capture its value; however, RBV's static resource perspective fails to explain dynamic value creation processes required for resource-poor MSMEs confronting environmental volatility, as static EO resources remain latent potential without execution mechanisms to operationalize entrepreneurial intent into market outcomes.

Dynamic Capabilities View: Innovation Capability as Mediating Process

Dynamic Capabilities Theory (DCV) resolves RBV limitations by theorizing processes enabling resource reconfiguration amid market turbulence [10,26]. Innovation capability operationalizes the DCV sensing-seizing-transforming microfoundation triad:

- Sensing: EO identifies opportunities through innovativeness
- Seizing: Innovation capability mobilizes limited MSME resources
- Transforming: Organizational renewal delivers market outcomes

Conceptual Framework

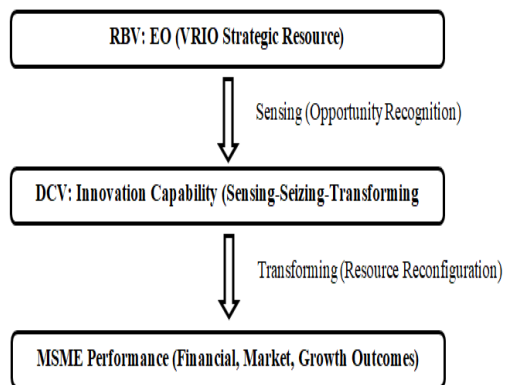


Figure 01: Innovation capability mediates the entrepreneurial orientation (EO)–MSME performance relationship.

Conceptual model showing direct and indirect effects through innovation capability, with arrows indicating proposed relationships (P1–P3).

Figure 1 illustrates how entrepreneurial orientation (EO) improves MSME performance through innovation capability. EO provides the entrepreneurial mindset - proactiveness, innovativeness, and risk-taking - that helps firms identify market opportunities [9]. However, mindset alone cannot generate business results.

Innovation capability supplies the practical execution skills needed to convert entrepreneurial ideas into actual products, improved processes, and profitable growth [10].

Many MSMEs face the "EO-performance paradox": they exhibit strong entrepreneurial behaviors but achieve inconsistent or poor financial results [14]. This occurs because they lack the operational skills to transform entrepreneurial energy into market success. Innovation capability resolves this gap through three essential steps: sensing opportunities (from EO), seizing them by mobilizing limited resources, and transforming the organization to deliver measurable outcomes.

Simply stated, EO creates entrepreneurial potential while innovation capability provides the execution mechanism. Without innovation capability, entrepreneurial MSMEs remain stuck with good intentions but poor results. Together, they create a complete pathway from entrepreneurial mindset to superior business performance.

Research Propositions

P1: Entrepreneurial orientation positively relates to innovation capability in MSMEs (RBV resource activation).

P2: Innovation capability positively relates to MSME performance (DCV process effectiveness).

P3: Innovation capability mediates the EO-MSME performance relationship (RBV-DCV integration).

3. DISCUSSION

Prior empirical studies on entrepreneurial orientation (EO) and MSME performance report direct positive effects but persistent inconsistencies across industries, firm sizes, and contexts, as confirmed by meta-analyses [5,6,14]. For instance, while some find EO's innovativeness, proactiveness, and risk-taking enhance financial and market outcomes in resource-constrained firms [3,4], others reveal weak or null links, often due to unexamined internal mechanisms rather than external moderators [5]. In contrast, this conceptual framework advances beyond direct effects by proposing innovation capability as a mediator (P3), integrating RBV's strategic resources with DCV's dynamic processes to explain why EO yields "latent potential" without execution capabilities.

Compared to prior work, studies like those emphasizing EO's standalone impact [13,27] or alternative mediators overlook the RBV-DCV synthesis here: EO as VRIO resource activating innovation's sensing-seizing-transforming microfoundations (P1-P2; [26]. Where empirical gaps persist in MSMEs due to resource limits [15,28], this model clarifies mediation over moderation, resolving why entrepreneurial intent fails without routines like knowledge absorption. This positioning reconciles mixed findings and extends EO theory by theorizing implementation pathways, providing a robust foundation for empirical tests via structural equation modeling on MSME data.

4. IMPLICATIONS

This study offers significant implications for both academics and MSME managers by clarifying how entrepreneurial orientation translates into performance through innovation capability. For academics, the paper proposes a novel mediation relationship where innovation capability bridges entrepreneurial orientation and MSME performance. This resolves inconsistencies in prior literature and strengthens theoretical understanding of resource-constrained firms. Scholars can build on the testable propositions for empirical validation across different contexts. For managers, MSME owners should develop innovation capability alongside entrepreneurial culture through training in prototyping, process improvement, and knowledge absorption. This converts entrepreneurial ideas into financial growth and market gains. Policymakers can design incubator programs that pair entrepreneurial development with practical innovation support to help MSMEs scale in competitive markets.

5. CONCLUSION

This paper concludes that entrepreneurial orientation creates entrepreneurial potential in MSMEs, but innovation capability provides the essential execution mechanism that converts this potential into superior financial, market, operational, and innovation performance. The proposed mediation framework resolves long-standing inconsistencies in prior EO-performance research by clarifying that mindset alone fails without practical implementation skills.

6. LIMITATIONS AND FUTURE RESEARCH DIRECTIONS

This study presents a conceptual framework rather than empirical findings, relying on theoretical synthesis from existing literature without primary data collection or statistical validation. While the RBV-DCV integration provides theoretical coherence, the proposed mediation relationships (P1-P3) remain untested, limiting generalizability until empirically confirmed across MSME contexts. The framework uses established constructs, but MSME-specific measurement scales may require adaptation or development, particularly for innovation capability in resource-constrained settings where standard tools like Lawson & Samson (2001) were designed for larger firms. Moreover, future research should prioritize empirical validation through structural equation modeling on multi-industry MSME samples, testing mediation effects in high-uncertainty environments like emerging economies. Scale development studies can refine MSME-appropriate measures for EO, innovation capability, and multidimensional performance, enabling cross-national comparisons.

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9. CONFLICT OF INTEREST

The authors declare that they have no known financial or personal conflicts of interest that could have influenced the work reported in this paper.

10. INFORMED CONSENT

NA

11. ETHICAL STATEMENT

This study is a conceptual research paper based exclusively on published literature. It did not involve human participant.

12. AUTHOR CONTRIBUTION

Sweksha Singh contributed to the conceptualization of the study, literature review, framework development, drafting of the manuscript, and manuscript revision. Dr. Ruchi Singh Maurya contributed to research supervision, critical review of the literature, refinement of the conceptual framework, manuscript editing, and final approval of the monoscript. Both authors reviewed and approved the final version.

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