

## **THE RELATIONSHIP BETWEEN TQM, EO AND BUSINESS PERFORMANCE OF SMES: MEDIATING ROLE OF MARKET ORIENTATION**

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### **ABSTRACT**

*Unprecedented challenges have become more intense in today's globalized economy. The firms, that provide quality and innovative products, focus on cost reduction, emphasize on increased customer satisfaction, can survive and prosper well, and can exceed the other firms. Small and medium enterprises (SMEs) have been regarded as a back bone of the financial system of any country. Role of SMEs has become even more significant in developing countries like Pakistan, where more than 90 % enterprises are SMEs, but their dismal performance is a key issue today. Total quality management (TQM), entrepreneurial orientation (EO) and market orientation are important business strategies that can enhance the performance of SMEs. The aim of this paper is to examine the mediating effect of market orientation on the relationship between total quality management, entrepreneurial orientation and business performance of SMEs in Pakistan. On the basis of a thorough literature review, the research model is proposed and four research hypotheses have been presented. Questionnaire protocol was used to collect the data from owner/managers of SMEs and SPSS was employed to test the hypotheses. The findings revealed that significant relationship exist between total quality management and business performance, while market orientation was found to mediate the total quality management and business performance relationship and entrepreneurial orientation and business performance relationship respectively. This paper provides an insightful contribution for better understanding of owner/managers of SMEs to adopt business strategies to survive the intensely competitive market environment and develop a competitive edge.*

**Keywords:** Total Quality Management, Entrepreneurial Orientation, Market Orientation, Business Performance, SME

## INTRODUCTION

In this globalized business world, organizations are confronted with unprecedented challenges such as rapid technological changes, increased competition, demand for quality and social responsibilities towards the society. The important role of small and medium enterprises (SMEs) cannot be denied in this competitive and challenging business world. Several researchers such as, Acs and Audretsch (1990); Brock and Evans (1986) evaluated that, SMEs have the capacity to create employment with minimum cost, are pioneer in innovation realm and have high flexibility which allow them to consider customers needs and wants. Hence, SMEs role is very vital for the emerging economies from the perspective of creating employment and economic growth and stability.

In most of the countries, SMEs are responsible for more than half of the employment, in generating revenue and technological advancement (Neck & Dockner, 1987; Acs & Audretsch, 1990; Kotey & Meredith, 1997). Similar trend is also observed in Pakistan where more than 90 percent enterprises are considered as SMEs. According to (Pakistan Economic Survey 2010- 2011) small medium enterprises in 2010-2011 contributed 30 percent to GDP, whereas the real GDP of Pakistan rose only by 2.4 percent in 2010-2011. Hence, it is logical to say that, even in the times of economic instability and turbulence, SMEs can significantly maintain and enhance business performance (Haroon *et al.*, 2012). The Government of Pakistan (GoP) established SMEDA (Small and Medium Enterprise Development Authority) in October 1998 with the aim of developing this sector (Bhutta *et al.*, 2008). SMEDA is the official managerial authority for small business management in Pakistan (Rauf *et al.*, 2008). According to SMEDA definition, SME is referred to as firm upto 250 employees or paid up capital upto 25 million or annual sales upto 250 million.

Although some steps were taken for the improvement of SMEs in Pakistan, still more concrete efforts are required to achieve substantial growth of economy, which will also help to increase foreign exchange reserves (Khattak *et al.*, 2011). Researchers such as De Jong and Marsili (2006); Audretsch (1995) identified that, though large companies are capital intensive, can invest in new technologies, provide training of new skills, while it is also noted that, SMEs are continually entering the market with new products, ideas and process (Laforet & Tann, 2006). Moreover, study done by Werner and Moog (2009) revealed that, self-employed or workers working in SMEs are more knowledgeable than employees working in large firms.

## RATIONALE OF THE STUDY

The impact of globalization and free trade agreements led to the opening up of the local market, therefore there is an increase importance to meet the need of customers with superior quality products and services. As stated by Chong (2004); Agus, (2004) organizations must adapt to the changes and keep striving to redefine and re-establish the factors, to compete with the best in the world and to maintain their competitive edge and survive in this new business scenario, taking place in the market.

Study of extant literature shows that, the quality adoption by SMEs has been minimal (Elmati & Kathawala, 1999). Researchers and academicians have done extensive studies examining the implementation of TQM practices in industrialized countries such as the United States of America, Japan, the United Kingdom and other European countries; it is only recently that a few researchers have started to examine quality practices in developing countries specifically in the context of large firms. According to Demirbag *et al.*, (2006) TQM is a comprehensive and integrated approach for continuous improvement in all firms. TQM gurus, Crosby, Deming, Drucker, Juran, Ishikawa, Feigenbaum and countless other researchers have studied TQM, practiced it and tried to improve the organizational outcome. As pointed out by Demirbag *et al.*, (2006); Kumar, Garg and Garg (2011) it is indispensable for firms to develop and implement proper quality practices to respond to the challenges faced by rapidly increasing global trade. Furthermore, Saizarbitoria (2005) examined that, firms which believe in producing high quality products and services, will attain greater customer satisfaction, increase profitability and higher market share.

In the light of the resource based view of (Barney, 1986) organizations can create competitive advantage by utilizing all its internal resources and capabilities. Both Total quality management (TQM) and entrepreneurial orientation (EO) are considered as important business strategies and capabilities that can enhance the performance of a firm. Hambrick (1980) views strategy "as a pattern of important decisions that guide the organization in its relationship with its environment". In the recent Pakistan Economic Survey 2011- 2012 it was noted that, in order to achieve higher performance, firms should emphasize on implementing different strategies.

Nooteboom (1994) and Vossen (1998) observed that SMEs in general, face substantial resource constraints, but they often exhibit successful entrepreneurial characteristics. Entrepreneurial orientation is the

tendency of firm's top management to be innovative, proactive and can take risk in strategic decisions (Morris & Paul, 1987). It is significant to note that, SMEs are more agile, flexible, and proactive and risk keen than larger organizations (Ndubisi *et al.*, 2003). In the same vein, Porter (1980) argued that, SMEs being more nimbler have an additional opportunity to attract niche markets by introducing innovative products and services. Studies showed that, both TQM and EO strategies are directed from within the firm and view employees, as internal customers, who should be given special emphasis to achieve objectives of the firm. Likewise, satisfaction of external customers is basic principle of marketing concept (Santos-Vijande & Álvarez-González, 2005). Lamb *et al.*, (2005) stated that, firms that adopt and implement marketing concepts are known as market oriented firms. Hence, it is appropriate to say that MO is more externally oriented strategy. Market orientation is defined differently by different researchers such as Kohli and Jaworski (1990); Narver and Slater (1990); Deshpande *et al.*, (1993). However, the basic concept of market orientation is, to generate, disseminate, share information, and respond properly to continuously changing market needs and wants (Wang *et al.*, 2012). Market orientation is basically the first step to response the ever changing business environment.

The customers have become increasingly sophisticated thus intensifying the competition in the business arena. To compete, SMEs require extensive tangible and intangible resources and capabilities to transform them into more flexible and profitable forms to meet the needs of the changing business market. This study examines the mediating effect of market orientation on the relationship between TQM, EO, and the business performance of SMEs in Pakistan. Empirical studies have largely overlooked the mediating role of market orientation on TQM, EO and business performance relationship. By introducing Market Orientation (MO) as a mediator, this study has examined the direct and indirect effects of TQM and EO on business performance of SMEs and fill the gaps in the literature. In this study questionnaire protocol was used to collect the data from SMEs and test the theoretical model. SPSS was employed for analysis and testing the hypotheses.

## LITERATURE REVIEW

### TQM and Business Performance

TQM has evolved as a significant strategy over the past two decades. Feng *et al.*, (2006) emphasized that, TQM practices lead to superior quality and overall business performance. According to Kumar *et al.*, (2009) TQM is a

holistic approach that integrates all organizational functions to focus on meeting customer needs and wants and organizational objectives. Reed *et al.*, (2000) revealed that, TQM is the main factor for gaining sustainable competitive advantage and improved performance. Several researchers, like (Flynn *et al.*, 1995; Froza & Flippini, 1998; Samson & Terziovski, 1999; Demirbag *et al.*, 2006) concluded that, TQM effects organization performance, in terms of waste reduction, fewer process mistakes, financial improvements, and overall improvement of the quality of the product or the service. It is adequate to say that, TQM is a strategy that can flexibly create an environment where organizations are committed to satisfy customer's current and latent needs through continuous improvement in process management, and product and service innovation (Bayraktar *et al.*, 2008). On the basis of above mentioned argument following hypothesis is proposed,

**H1: There is a significant impact of TQM on business performance**

**EO and Business Performance**

EO is defined as an organizational strategy of acquiring the specific entrepreneurial aspects of practices, methods and decision making (Frank, Kessler, & Fink ,2010). While, Zahra and Covin (1995) defined EO as the potential tool to achieve competitive advantage through innovation, proactiveness and risk taking. The three dimensions of EO i.e innovation, proactiveness, and risk taking have been suggested earlier by Miller (1983) and later Lumpkin and Dess (1996) added other two dimensions namely, aggressiveness and autonomy. However, the majority of the research conducted regarding EO have used the three dimensions namely innovativeness, proactiveness and risk taking to measure the EO construct (Wiklund, 1999). Study of literature revealed that entrepreneurial orientation (EO) has a positive impact on the organizational performance. Firms that innovate frequently while taking risks in their product and processes development perform better (Miller & Friesen, 1982). Research shows that the efforts to anticipate demands of customers and aggressively position new product/service offerings often result in strong performance (Ireland, Hitt, & Sirmon, 2003).

Meanwhile, (Keh, Nguyen & Ng, 2007) advocated that, organizations with high entrepreneurial orientation (EO) capabilities can explore and exploit opportunities in business market and subsequently secure a high competitive edge over their competitors. However, the extent of the relationship between EO and performance vary across studies. Some studies reported that the firms that adopt EO perform much better than

firms that do not adopt an entrepreneurial orientation (Covin & Slevin, 1986; Hult, Snow, & Kandemir, 2003; Wiklund & Shepherd 2003). On the other hand, some other studies showed lower relationship between EO and firm performance (i.e., Dimitratos, Lioukas, & Carter, 2004; Lumpkin & Dess, 2001; Zahra, 1991) or some studies did not find any significant relationship between EO and performance (George, Wood, & Khan, 2001; Covin, Slevin, & Schultz, 1994). Thus, conceptual arguments mentioned above leads to the following hypothesis.

**H2: There is a significant impact of entrepreneurial orientation on business performance.**

#### **Relationship between TQM-MO and Business Performance**

Firms adopting TQM strategies lead to better product and service quality and create higher value perception among customers and a source of differentiation to the organization. TQM enables the firm to increase its responsiveness to customer needs, which is part of market orientation, and finally will lead to a longer association between the customer and firm (Sparks, 1993). Several researchers argued that, TQM directly and positively affects market orientation (Santos-Vijande & Álvarez-González, 2009; Yam *et al.*, 2005). Similarly, (Mohr- Jackson, 1998) argued that, TQM also benefits market orientation. Though, prior studies show that there is a clear relationship amid TQM and MO, but the empirical findings are mixed about their relationship. Santos-Vijande *et al.*, (2005) evaluated that Marketing practices are important in enhancing firm performance. Menguc and Auh (2006) suggested that MO implementation depends on other constructs to strengthen its relationship with performance. Mohr-Jackson, (1991) identified that, TQM focuses to continuously improve the internal processes that can lead to improve the implementation of the marketing concept. Therefore, it is argued that, TQM offer a systematic approach in order to develop a work environment, which help to adopt market orientation, and further enhance performance of organization. On the above mentioned arguments the following hypothesis is proposed

**H3: Market orientation mediates the relationship between TQM and business performance.**

#### **Relationship between EO-MO and Business Performance**

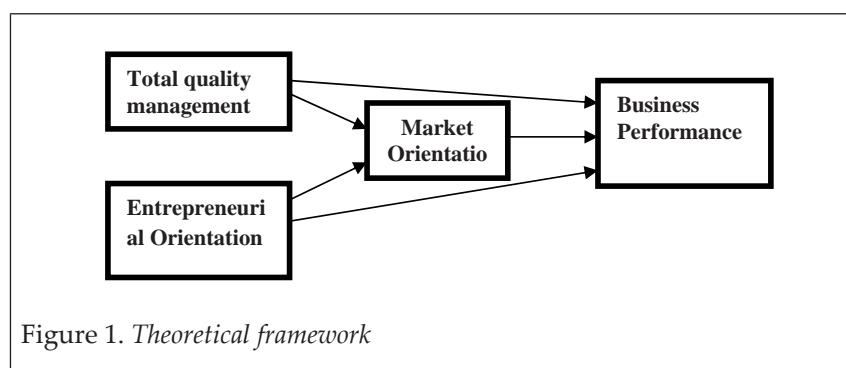
Atuahene-Gima and Ko (2001); Slater and Narver (1995) explored that, a firm with high EO and high MO is considered competitive and out performs than other firms. Several researchers (i.e Baker & Sinkula, 1999;

Covin & Slevin, 1991; Greenley, 1995; Jaworski & Kohli, 1993; Wiklund, 1999) supported the notion that both EO and MO are linked to firms' performance. The relationship between EO and MO suggests that the market focus is an important element of EO (Todorovic & Ma, 2008). They suggest that, a change in either one of the construct will affect the other one, and hence, effect the whole relationship on performance. Some other researchers argue that, the synergy amid EO and MO determines firm's performance, thus there exist a correlation between the two constructs (Frishammar & Horte, 2007; Slater & Narver, 1995; Zhou *et al.*, 2005). Atuahene-Gima and Ko (2001) found that both MO and EO when combined together maximize organizational performance. Study of extant literature shows a positive relationship between market orientation and increased firm performance (Narver & Slater, 1990; Ruekert, 1992; Desphande *et al.*, 1993). Slater and Narver (1995) explored that, businesses can achieve market orientation's full potential when facilitated by EO. In a similar vein, Matsuno *et al.*, (2002) noted that, EO drives MO that is; the greater the level of EO, the greater is the level of market orientation. Thus, conceptual arguments mentioned above suggest the following hypotheses:

**H4: Market orientation mediates the relationship between EO and business performance.**

#### THEORETICAL FRAMEWORK

Theoretical framework in this paper is proposed on the basis of the previous literature review. Fig 1 shows the causal linkages amongst the variables. Market orientation mediates the linkage between TQM, EO and business Performance.



## RESEARCH METHODOLOGY

Target population of this study was SMEs in Pakistan. Unit of analysis was SME. The total sample size of this study was 70 SMEs operating in Rawalpindi/Islamabad region in different categories, i.e manufacturing, service, retailers/traders. Questionnaire protocol was used to collect the data. Random sampling technique was employed. In this study data was collected from both males and females, as both contribute equally towards the success of the business performance. Five points Likert scale was used to measures the responses, where one is strongly disagree and five strongly agree. Only 55 respondents filled the questionnaires and returned back with response rate 79%. SPSS 19 software was used for analysis.

### **Reliability Analysis**

Cronbach alpha test was used to check reliability and internal consistency of the instrument. The overall Cronbach's alpha values of the instrument of 57 items was 0.93, whereas for independent variables is above 0.7 which means that the constructs were reliable to measure the business performance. Whereas alpha value of dependent variable 'business Performance' was 0.73. According to Aggarwal (2004) the data is considered reliable if the Cronbach alpha value is greater than 0.60. Table 1 illustrated the results of reliability analysis.

Table 1

*Reliability statistics of the construct (N=55)*

Variable	No of items	Cronbach alpha
Total Quality Management	25	.82
Entrepreneurial Orientation	10	.79
Market Orientation	16	.81
Business Performance	6	.73
<b>Total (All Variables)</b>	<b>57</b>	<b>.93</b>

### **Regression analysis**

Multiple regression analysis was employed to assess the relationship between dependent variable and the predicting variables. It explains that how many variables are able to predict a certain outcome. The results from Table 2 model summary shows the results of two independent variables (predictors) against business performance. R (0.710) is the

correlation between independent variable and dependent variable. Whereas R square value (0.504) explains that 50% variance in business performance is explained by predicting variables.

Table 2

*Model summary*

Model	R	R Square	Adjusted R Square	Durbin-Watson
1	.710	.504	.485	1.513

Table 3 illustrates that P value for TQM substantiates that H1 is accepted and TQM has significant relationship with business performance while EO does not contribute towards measurement of business performance. Moreover, MO plays a mediating role between TQM, EO and business performance with p values (.000 and 0.001) respectively. Hence H3 and H4 are also accepted.

Table 3

*Results of multiple regression*

Hypothesis	B	t	P value	Conclusion
H1	.602	4.137	.000	Accepted
H2	.138	.946	.349	Rejected
H3	.397	3.772	.000	Accepted
H4	.356	3.492	.001	Accepted

## DISCUSSION

Considering the significant role of SMEs in emerging and transitional economy the results of this study showed that TQM is an important business strategy aims to improve the performance and satisfy the customers. The findings of the results depicts that successful implementation of TQM will enhance the business performance. Further, it is also demonstrated from the study results that EO does not directly affect the business performance, but do so when mediated by MO. Hence, it is substantiated that MO is a prerequisite to implement the strategies i.e Total quality management and Entrepreneurial orientation. MO being externally oriented gathers the information about customers and competitors and share that information within the firm. While, using the tools and techniques of TQM and EO a firm can anticipate

the ever growing competition and satisfy the needs and requirements of customers. Previous studies however, have investigated the direct relationship between TQM, EO and business performance while its very rare to determine the mediating role of MO on TQM, EO and business performance.

### **RESEARCH IMPLICATIONS**

As stated by (Davidsson, 2004; Asian Productivity Organization, 2011) SMEs face lot of problems such as, lack of entrepreneurial capabilities, weak management systems, unavailability of appropriate and timely information, lacking in use of information technology, poor product quality and insufficient financial resources. Therefore they are less productive and show low level of performance.

The result of this study has exposed some useful managerial implications. Previous studies have investigated the direct impact of TQM and EO on business performance. This study however demonstrated the role of MO as a mediator on the relationship between TQM, EO and business performance of SMEs in the context of emerging economy like Pakistan. It is believed that the outcome of this study will be helpful for managers and policy makers to devise different strategic decisions for firms.

### **CONCLUSION**

The SMEs play a significant role in accelerating the economic development and growth of a country. Due to unprecedeted challenges in today's globalized economy the role of SMEs has become even more prominent throughout the world. More than 90 % enterprises in Pakistan are considered as SMEs and act as a catalyst for economic development and growth of the country. Factual evidences showed that, though SMEs being the biggest industrial contributor to the Pakistani economy, but experiencing dismal performance and are battling for the survival of their business. This scenario provides the rationality to investigate the business performance of SMEs and to come up with some likely proposition that how their performance can be enhanced and avoid business failures.

This paper attempts to describe the mediating role of market orientation on the relationship of TQM, EO and business performance in SMEs in Pakistan. Study of extant literature shows that TQM, EO and MO

are considered as important business strategies meant to enhance the performance of organizations. The research model proposed in this paper integrates two business strategies with the mediating role of MO into a model. Questionnaire survey method was employed to collect data. By using random sampling technique, the data was collected from SMEs firms located in Islamabad and Rawalpindi region. In this study data was collected from both males and females, as both contribute equally towards the success of the business performance. Five points likert scale was used to measure the responses, where one is strongly disagree and five strongly agree. Only 55 respondents filled the questionnaires and returned back with response rate 79%. SPSS 19 was used for analysis and testing the hypothesis. To check the reliability and internal consistency of the instrument, Cronbach alpha test was conducted. The Cronbach's alpha values were well above 0.7 for all the variables involved. This means that the constructs were reliable to measure the business performance.

Multiple regression analysis was solicited to evaluate the relationship between dependent variable and the predicting variables. The correlation between independent variable and dependent variable was demonstrated by R (0.71). Whereas R square value (0.504) explains that 50% variance in business performance is explained by predicting variables. The results validated the previous studies in which it was concluded that total quality management has a significant impact on business success. While there was no significant relationship found between entrepreneurial orientation and business performance which is in accordance to the studies conducted by (George, Wood, & Khan, 2001; Covin, Slevin, & Schultz, 1994). In addition to that, Hierarchical regression analysis was employed to assess the mediating role of MO. The results suggested that influence of entrepreneurial orientation on business performance was significant when mediated by market orientation but insignificant when not mediated by market orientation. Moreover, market orientation significantly mediates the relationship between TQM and business performance.

## LIMITATIONS AND FUTURE RESEARCH

In this study the survey was conducted in selected regions, i.e Rawalpindi/Islamabad in Pakistan, therefore it may not reflect the views and practices of SMEs in other regions of Pakistan. Hence, it is necessary to conduct the study on other regions as well. Future research may include

more sample size to further validate the results. Despite some of the limitations discussed above it is believed that this study will significantly contribute to the body of knowledge especially in the context of SMEs in developing country.

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