University of Groningen

Strategic orientation and firm risk

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Published in:
International Journal of Research in Marketing

DOI:
[10.1016/j.ijresmar.2019.01.004](https://doi.org/10.1016/j.ijresmar.2019.01.004)

IMPORTANT NOTE: You are advised to consult the publisher's version (publisher's PDF) if you wish to cite from it. Please check the document version below.

Document Version
Final author's version (accepted by publisher, after peer review)

Publication date:
2019

[Link to publication in University of Groningen/UMCG research database](#)

Citation for published version (APA):

Bhattacharya, A., Misra, S., & Sardashti, H. (2019). Strategic orientation and firm risk. *International Journal of Research in Marketing*, 36(4), 509-527. <https://doi.org/10.1016/j.ijresmar.2019.01.004>

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STRATEGIC ORIENTATION AND FIRM RISK

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STRATEGIC ORIENTATION AND FIRM RISK

ABSTRACT

Entrepreneurial orientation (EO) and market orientation (MO) have received substantial conceptual and empirical attention in the marketing and management literature and both orientations have consistently been linked to stronger financial performance. Yet the way in which market-oriented firms seek to achieve superior rents is substantively different from that of entrepreneurially-oriented firms which could lead to differential impacts of EO and MO on firm risk. In this study, the authors employ a text mining technique to assess firms' EO and MO and examine the impact of these two strategic orientations on shareholder risk outcomes. The results show that while EO increases idiosyncratic risk, MO decreases it. However, only EO decreases systematic risk. Overall, the results of this study demonstrate that a firm's decisions regarding strategic orientation should be examined in light of both likely risks and returns in order to make appropriate resource allocation decisions.

Keywords: Market Orientation; Entrepreneurial Orientation; Shareholder Return; Firm Risk; Text Analysis.

INTRODUCTION

Strategic orientations are firms' guiding principles with regards to their marketing and innovation activities, representing a multidimensional construct that captures an organization's culture embodying the relative emphasis in understanding and managing the environmental forces acting on it (Gatignon and Xuereb 1997; Noble et al. 2002). These forces include: (1) upstream suppliers of product inputs, including intellectual capital and innovations; (2) downstream channels and customers; and (3) current and potential competitors. While a number of different strategic orientations have been identified, the two most widely studied are Entrepreneurial Orientation (hereafter EO) and Market Orientation (hereafter MO). MO is the extent to which a firm is devoted to meeting customers' needs and outwitting competitors in doing so (Narver and Slater 1990) while EO concerns the decision-making styles, processes, and methods that inform a firm's entrepreneurial activities (Lumpkin and Dess 1996).

A core purpose of any firm is creating and sustaining value (Conner 1991). As posited by the resource-based view (RBV), heterogeneity in firms' assets and their deployment strategies ultimately explain firms' (sustained) competitive advantage and performance (Barney 1991). We view EO and MO as distinct organizational cultures comprising of organizational routines and practices developed over time, which as a result are not easily acquired or imitated (Barney 1986; Peteraf 1993). While MO represents a market-driven culture that places highest priority on the profitable creation and maintenance of superior customer value (Narver and Slater 1990), EO represents a culture driven to the pursuit of new market opportunities and the renewal of existing areas of operation (Hult and Ketchen 2001).

Prior work in marketing and strategic management has extensively focused on the utility of these orientations in enabling a firm to achieve a sustained competitive advantage and superior

financial returns. For instance, previous work in marketing has linked MO to improved new product performance (Im and Workman 2004), increased customer satisfaction and loyalty (Brady and Cronin 2001) and superior organizational performance (Hult and Ketchen 2001). Similarly, the literature in management has demonstrated the relationship between EO and firms' profit margins (Zahra and Covin 1995) and growth (Rauch et al. 2009). However, all of the studies to date have focused on financial returns—there is little empirical research on how firms' EO and MO affects firm risks. Yet, senior executives are incentivized to maximize shareholder wealth, which includes returns *and* risk. Understanding the strategic orientation-risk relationship is therefore important for managers in order to maximize shareholder wealth by adopting an appropriate strategic orientation. Marketing managers have a keen interest in reducing financial risk rather than focusing exclusively on return maximization. Focusing only on returns while ignoring risk may lead managers to adopt a myopic perspective that can be detrimental to the long-term financial health of the firm (Fiegenbaum and Thomas 1988).

Managers have a number of incentives to reduce firm risk. The first concerns managers' role as shareholders' agents. Transaction costs, such as brokerage fees and time costs prevent stockholders from diversifying away risk completely (Constantinides 1986). Investors therefore wish to reduce the overall riskiness of their portfolios. Second, managers are often compensated on the basis of their firm's earnings and they prefer a stable earnings stream. They may thus take a variety of risk reducing actions (Holmstrom 1979). Third, lowering the risk associated with returns results in a lower cost of capital and cost of debt. Therefore, if managers can make returns more predictable by reducing firm risk, they have a higher net present value for the firm and its shareholders (Brealey, Myers and Marcus 1995). Thus, examining how firms' strategic orientations are associated with risk can provide valuable insights to managers, enabling them to

better choose between alternative orientations.

From a theoretical standpoint, capital market equilibrium posits a lower market return on the stocks of firms with lower business risk. This is also the basis of much entrepreneurial thought as riskier actions are purported to be justified because they provide greater returns (Lumpkin and Dess 1996). However, the marketing literature demonstrates that high return–low risks are associated with both market based assets and marketing capabilities (e.g., Fornell et al. 2006; Srivastava, Shervani and Fahey 1998). Since MO and EO embody these divergent principles of strategic positioning, a simultaneous examination of both risk- and return-related outcomes of strategic orientations would afford academics and managers insights into whether one is necessarily superior to the other.

Therefore, in this study we directly address the question of the relationship between strategic orientations and the return-risk paradigm. In doing so we contribute to the marketing literature in two ways. First, while the effectiveness of marketing activities and assets have been investigated (e.g., Gao et al. 2015), little is known about the financial market performance effect of a firms' strategic orientation—a knowledge gap filled by this study. Importantly, classical asset pricing literature assumes that higher risk is associated with greater probability of higher returns and vice versa (e.g., Ghysels, Santa-Clara, and Valkanov 2005). We identify one condition where this is not true and show that a combination of MO and EO enables a firm to achieve a low(er) risk-high(er) return trajectory. In addition, we show that focusing only on returns outcomes leads to a biased view that EO is superior to MO while also examining their impact on firm risks reveals that EO a firm would be best served by having both EO and MO.

Second, only a small number of prior studies have examined the combined effects of EO and MO on firm performance. For example, Atahuene-Gima and Ko (2001) show that firms with

a combination of the two orientations have higher new product performance. When modeled separately, extensive research has reported direct effects of EO and MO individually on firm profitability. When modeled simultaneously, however, the direct effect of EO has disappeared (Baker and Sinkula 2009). This has led to consistent calls for more research on the complementarity (or lack thereof) between EO and MO (e.g., Cadogan 2012). In addition, the majority of research looking at MO and EO uses cross-sectional survey data, and the difficulty of collecting managers' responses repeatedly for multiple firms and over multiple years has made it challenging to empirically establish the impact of MO and EO on firm performance¹. In this study, the use of textual analysis of firms' annual reports allows us to develop continuous measures of EO and MO covering a larger and more representative sample and over a long period of time using panel data capturing objective indicators of firm risks and returns. Further, our analytical methods enable us to account for potential sources of endogeneity, firm specific effects, heteroscedasticity, and serial correlation within firms—potential issues in the analysis of any organizational relationships. Table 1 provides a sample of the representative literature and specifies our contribution in this context.

[INSERT TABLE 1A, 1B HERE]

The rest of the paper is organized as follows. In the next section, we develop and discuss the conceptual framework and hypotheses concerning the likely impact of MO and EO on firm risks and returns. Next, we develop an empirical model that investigates the individual and joint impact of a firms' strategic orientation on various financial risks, describe our data and analysis approach, and present the results. We end with a discussion of our findings, contributions to theory and implications for managerial practice.

¹ Noble et al. (2002) study the longitudinal impact of MO of a single retail firm using human coder text analysis.

CONCEPTUAL FRAMEWORK AND HYPOTHESES

Growing pressure for financial accountability means that marketers are increasingly asked to “speak the language of finance” (McAlister, Srinivasan, and Kim 2007). As a result, scholars have increasingly recognized the importance of marketing actions and assets in generating shareholder returns and reducing risk (e.g., Han, Mittal, and Zhang 2017; McAlister, Srinivasan, and Kim 2007; Rego, Billett, and Morgan 2009). However, a firm may achieve superior performance not just because it has better assets, but also the distinctive organizational cultures that allow the firm to make better use of its assets through selecting appropriate strategies (Mahoney and Pandain 1992). These cultural values and beliefs define the resources to be used, transcend individual capabilities, and unify the assets and capabilities into a cohesive whole (Day 1994). Clearly, shareholder value should be contingent on the firm’s organizational culture which determines how the firm seeks to achieve a competitive advantage in its chosen market(s). Since firms with different cultures may seek to employ different marketing actions and leverage their assets differently, we cannot simply use the findings of past research on the direct impact of marketing assets and actions on firm risk to deduce the impact of organizational cultures.²

From a RBV viewpoint, organizational cultures are considered to be assets that provide economic value to the firm and may enable sustained superior financial performance (Barney 2001). Both MO and EO cultures share some commonalities. For example, both are concerned with the identifying and selecting market segments, designing appropriate offerings, and assembling the assets required to produce and deliver them (Srivastava, Fahey, and Christensen 2001). However, there also differences. For example, MO culture emphasizes the generation and

² Tables 1A and 1B identify and specify our study’s contribution to literature. Table 1A shows that past literature on orientations has mostly focused on EO or MO but not both, and mostly used self-reported surveys. Further, the outcome of interest has mostly been innovation or financial performance. Table 1B shows past literature on risk has mostly focused on the impact of a firm’s marketing actions or assets but not its culture.

use of customer and competitor intelligence to best address customer needs while an EO culture involves the identification and exploitation of untapped market opportunities where market intelligence may not be readily present. Thus, while both orientations are pathways for the firm to achieve superior returns, they present fundamentally different approaches to dealing with the probability of loss (i.e. risk). As a result, evaluating the performance benefits of EO and MO by only focusing on returns and ignoring risk would be myopic. Examining the link between strategic orientations and risk should thus enable scholars to develop new insights on how marketing activities can go beyond return maximization to also address risk management.

THE RISK-RETURN PARADIGM

The Capital Asset Pricing Model (CAPM) states that the riskier the firm's cash-flows, the more return shareholders are entitled to expect from their investment in the long run to compensate. However, at the same time with the higher expectations in returns, greater risk means higher variability in expected returns. The relationship between risk and return has been widely studied using financial data from the stock market, and the beta of CAPM has been used as the risk measure in both finance (e.g., Nickel and Rodriguez 2002) and marketing (e.g., Rego, Billett and Morgan 2009). Although some research questions this paradigm (e.g., Bowman 1982), early studies in the area showed a significant positive relationship between risk and return, as the CAPM theory posits (see Fama and Macbeth 1973). The positive risk-return trade-off is also tested by using techniques other than the CAPM, and a large number of studies in finance have found a positive significant relationship between expected market return and conditional variance (i.e. risk) on equity indices (e.g., León et al. 2007).

However, management research demonstrates that effective management makes a difference and can positively influence both the mean and variance (i.e. risk) of performance

(e.g., Baird and Thomas 1985). This “strategic conduct” approach proposes that good management practices engendered through appropriate organizational cultures can produce inverse risk–return relationships which are the result of firm heterogeneity in type and effectiveness of strategic orientations (e.g., Miller and Chen 2003). From this perspective, it would seem likely that a firm’s marketing and/or entrepreneurial orientations can impact both risk and performance. Conversely, poorly chosen strategies or their ineffective implementation may result in a high risk-low return continuum where anticipated returns are achieved less often.

More specifically, higher risk may arise from groups of customers rejecting a firm’s offerings or from customers migrating to a competitor, both of which cause demand fluctuations. This variability in demand can also result from innovative products or ventures into new markets since customers in either case may face higher risks in making such purchases (Hellöfs and Jacobson 1999). In contrast, a reduction in demand variability may be engendered through better attuning products to customer needs and avoiding competitive confrontation through building switching barriers, both of which require extensive knowledge of customer needs and the competitor environment. Thus EO, which reflects the degree of a firm’s orientation towards the pursuit of new market opportunities seeking higher growth and financial profits, may expose the firm to more demand uncertainty and risk while MO, which refers to the firm’s orientation towards customer needs, may reduce fluctuations in demand by ensuring the firms’ products or services are always attuned to customer requirements.

While various types of risk have been conceptualized in past literature, we focus on systematic and idiosyncratic risk as (i) these are the most commonly used risk measures in both marketing and finance (e.g., Thomaz and Swaminathan 2015); and (ii) both EO and MO are mainly adopted by firms seeking to deliver growth, which is conceptually aligned with changes

in returns captured in these two measures of firm risk. From the investor perspective, there are two key stakeholders—debtholders and equity holders. From a debtholder perspective, the vulnerability of the firm's future cash flows is the primary aspect of risk interest because this determines the firm's ability to service its existing debt and its capacity to take on and service new debt. In this study, although we describe the impact on firm risk, we are not examining the debtholder but rather the equity holder (shareholder) expectations of the underlying risk of a firm through assessments of idiosyncratic and systematic risk. This is because the equity viewpoint emphasizes growth and equity investors are therefore more risk-tolerant, while debt investors are typically concerned with protecting themselves from the downside, and therefore focus more strongly on firm survival issues (Saunders and Cornett 2003). Since both MO and EO are primarily aimed at increasing the returns for a firm (rather than reducing the debt levels of a firm or ensuring its survival), we use equity risk as the outcome measure of interest.

From an equity-holder perspective, equity risk is the variability of a firm's stock returns. Total equity risk can be divided into "systematic" equity risk—the extent to which a firm's stock return variability is related to that of the rest of the stock market and "idiosyncratic" equity risk, which is firm-specific and unrelated to the market as a whole. Therefore, systematic equity risk reflects the variability in a firm's stock returns associated with macroeconomic events that affect the entire stock market, such as adjustments in interest or exchange rates and changes in energy prices. Systematic risk is important both for managers and investors. For managers, lower systematic risk means that the firm can better withstand the impact of negative market movements and deliver consistent more cash flows. For investors lower systematic risk means higher stock prices since the stock price is the discounted value of expected cash flows. Furthermore, systematic risk cannot be diversified away through portfolio construction and

hence becomes important to manage.

Idiosyncratic equity risk reflects the variability in a firm's stock returns associated with events that primarily affect only that firm, such as a labor dispute or the launch of an innovative new product (e.g., Saunders and Cornett 2003). Idiosyncratic risk is an important source of value for firms. Lower idiosyncratic risk can benefit all stakeholders by lowering the cost of debt (Anderson and Mansi 2009), promoting stability (Groening et al. 2014), and helping to improve overall returns (Srivastava, Shervani, and Fahey 1998). While total risk consists mainly of idiosyncratic risk (80% is idiosyncratic and 20% systematic) and is more important to managers (e.g., Han, Mittal and Zhang 2017), systematic risk is important to investors since it cannot be easily diversified away in a portfolio (e.g., Thomaz and Swaminathan 2015).

This overall conceptual framework is represented in Figure 1. Next, based on both the individual dimensions and aggregate constructs, we provide detailed arguments as to why and how EO and MO may impact both idiosyncratic and systematic risk of a firm.

[Insert Figure 1 here]

MARKET ORIENTATION AND IDIOSYNCRATIC RISK

Drawing on Narver and Slater (1990), MO is composed of three components: customer orientation (understanding customers' needs and wants), competitor orientation (understanding rivals' strengths and weaknesses), and interfunctional coordination (the holistic use of the firm's assets in creating superior customer value)³. Prior literature offers some arguments regarding how MO may impact firm risk via identifying and responding with new actions if the firm faces

³ We adopt the Narver-Slater conceptualization rather than the more process-driven conceptualization of Kohli and Jaworski (1990) in this study as: a) our data which consists of 10-K reports are more likely to contain information regarding a particular strategy or orientation than details about specific processes prevalent within the firm; and b) the behavioral aspects of the concept of MO are more emphasized in the Narver-Slater conceptualization allowing a more direct comparison with the EO construct which also adopts a behavioral perspective (Covin and Slevin 1991).

rapidly changing customer needs and competitive conditions. However, the literature is generally equivocal on whether MO encompasses greater risk taking. Some have posited that MO increases openness and collaboration and therefore encourages new ideas and risk taking (e.g., Jaworski and Kohli 1993). Others posit that by focusing on existing customers MO may not encourage a sufficient willingness to take risk (e.g., Slater and Narver 1995). We argue that MO does not necessarily discourage risk taking, but rather its emphasis helps reduce the risks of actions which may be inherently risky such as new product introductions.

At the heart of a MO firm is its customer focus. A motivation to keep current customers and make them happy might make managers more averse to trying out very different product ideas. If they market offerings that are different from the norm, these carry greater perceived risk and learning costs (Chen and Hitt 2002). Not deviating from a prior legitimate position leads to reduced stock-market risk (Bansal and Clelland 2004). This is in line with Hamel and Prahalad's (1994) argument that MO limits firms' focus mainly to the expressed needs of customers, making innovations resulting from MO less risky and thereby lowering firm risk. Further, MO firms seek to systematically mitigate risk factors of innovations or other "riskier" actions by continually scanning its external environment (Bhuian, Menguc, and Bell 2005). Customer focus has also been linked to greater customer satisfaction (e.g., Webb, Webster, and Kreppa 2000) and loyalty, both of which reduce risks to (or variance in) the firm's demand (e.g., Fornell et al., 2006) thereby reducing the firm's cash flow volatility and ultimately its idiosyncratic risk.

A second characteristic of MO firms is a competitor orientation—an emphasis on understanding the short-term strengths and weaknesses and long-term capabilities and strategies of both current and potential competitors (Narver and Slater 1990). Understanding market competition is important for increasing profitability and market share, and competitor-oriented

firms tend to closely and continuously monitor rivals to stay ahead of competition (Han, Kim, and Srivastava 1998). This continuous monitoring of current and possible future competitor actions allow the firm to safeguard against risks to performance arising from competitive actions (and therefore less fluctuation in demand).

The third characteristic of MO firms is inter-functional coordination—the coordinated use of firm resources in creating superior value for target customers. MO firms respond to market intelligence generated and disseminated within the firm through the collective efforts of design, production, distribution and promotion of the product offering (Day 1994). This coordination reduces the risks of failure of a certain action or venture by ensuring the commitment and participation of the entire firm—not just a particular department. Coordination among different departments within the firm also allows decisions to be weighed more evenly and from a broader variety of viewpoints. Further, interfunctional coordination may also enable greater knowledge sharing across departments, breaking down silos and facilitating differentiated product introductions and marketing action more attuned to customer needs, once again reducing variance in demand. Therefore, we argue that this aspect of market orientation should also reduce firm risk.

Overall, we therefore expect that,

H₁: Market orientation reduces idiosyncratic risk

ENTREPRENEURIAL ORIENTATION AND IDIOSYNCRATIC RISK

Since its introduction by Miller (1983), EO has become a highly influential conceptualization of a firms' strategic orientation. EO concerns entrepreneurial aspects of a firm's decision-making styles and methods and incorporates five key dimensions that facilitate the entrepreneurial process—autonomy, innovativeness, proactiveness, competitive

aggressiveness, and risk taking (Covin and Slevin 1988; Lumpkin and Dess 1996). Managerial risk taking is therefore embedded in the concept of EO and of entrepreneurship itself. In fact, Åstebro et al. (2014) define entrepreneurship as the perception of opportunities in the face of unknown distributions of risk. Lumpkin and Dess (1996) state that firms with higher EO are typified by risk-taking behavior, such as incurring heavy debt or making significant resource commitments, in the interests of obtaining greater returns through innovative endeavors. Overall, risk taking is embedded in the culture of an entrepreneurially oriented organization.

Market proactiveness refers to the extent to which a firm anticipates and acts on future needs (Lumpkin and Dess 1996) by “seeking new opportunities which may or may not be related to the present line of operations, introduction of new products and brands ahead of competition, strategically eliminating operations which are in the mature or declining stages of life cycle” (Venkatraman 1989, p.949). Proactively entering new and uncertain markets obviously involves a high degree of risk (e.g., Lieberman and Montgomery 1988) with firms facing both demand and ability uncertainty (e.g., Wu and Knott 2006).

Competitive aggressiveness refers to “a firm’s propensity to directly and intensely challenge its competitors to achieve entry or improve position, that is, to outperform industry rivals in the marketplace” (Lumpkin and Dess 1996, p.148). Both proactiveness and competitive aggressiveness involve activity and action-taking. Firms high in competitive aggressiveness are intensive, forceful, and combative, implying willingness to formulate and execute actions directed at challenging rivals. This goes beyond simply monitoring the competition and responding to competitor actions, and runs the underlying risk of a continuing attack/response dynamic which tends to hurt firm profitability (e.g., Young, Smith, and Grimm 1996).

Autonomy within an organization has been closely related to both decentralization and

widespread employee participation in decision-making (Lumpkin and Dess 1996). In EO organizations, operational autonomy is the freedom granted to individuals or teams to engage in and support new ideas, experimentation, and creativity, and take action free of organizational constraints (Lumpkin and Dess 1996). Granting autonomy within an organization requires a propensity for taking risk by top management (Nystrom 1990) and commitment of a relatively large proportion of a firm's assets to risky endeavors (Das and Joshi 2007).

Overall, the different dimensions of EO have a singularly common theme—a willingness to take risks and engage in risky actions. EO reflects top management's propensity towards risk-taking (rather than a commitment towards reducing the risk of an action) and motivates management to invest in high risk-high return projects. Thus, from a risk perspective, EO results in selection of investment opportunities by top management that have higher return even if they incur higher risks of failure. We therefore propose:

H₂: Entrepreneurial orientation increases idiosyncratic risk

EFFECT ON SYSTEMATIC RISK

Systematic risk concerns the sensitivity of a company's returns to macroeconomic trends captured in terms of the correlation between variations in the firm's returns and those of the overall stock market (e.g., Lubatkin and Chatterjee 1994). Systematic risk therefore reflects the portion of firm stock risk that moves in concert with market-wide shocks.

We posit that increased MO can help reduce systematic risk for two main reasons. First, MO firms are known to make more appropriate to market environment decisions when faced with unavoidable environmental uncertainties (Keh, Nguyen, and Ng 2007). Further, MO firms do better than their rivals in terms of satisfying and retaining customers, reducing the chances of customer flight during industry-wide downturns. Second, a MO firm's products or services

generally show increased differentiation thereby making them less easily substitutable (Mela, Gupta, and Lehmann 1997). This is supported by Narver and Slater (1990) who found a significant difference between the MO/differentiation strategy correlation (.45) and the MO/low-cost strategy correlation (.28).

We also posit a negative relationship between EO and systematic risk for a number of reasons. First, EO firms exhibit competencies which may allow them to combat industry-specific shocks more effectively including: increased speed in understanding and commercializing promising opportunities (Zahra and George 2002) and greater flexibility than competition, enabling EO firms to better adapt to environmental changes (Wiklund and Shepherd 2005). Second, a market-wide shock may demand a risk-taking, innovative, and proactive response in order for a firm to stay competitive (Rosenbusch et al. 2013) all of which are characteristic of EO firms. Third, the greater the degree of similarity between a firm and the rest of the firms in the same industry, the higher the susceptibility of the firm to any common shock to the market (Brealey, Myers, and Allen 2008). Hence, since EO firms are differentiated from others an industry by being more proactive and autonomous and less market-led (Lukas and Ferrel 2000), they should be less susceptible to industry-wide shocks.

Thus, with greater EO and MO, firms may decrease their exposure to negative macro-environmental trends. Hence, we expect that:

H_{3a}: Market orientation decreases systematic risk

H_{3b} Entrepreneurial orientation decreases systematic risk

THE COMBINED EFFECT OF MARKET AND ENTREPRENEURIAL ORIENTATION

Although correlated, EO and MO are conceptually and empirically distinct constructs. MO reflects the degree to which firms' strategic market planning is driven by customer and

competitor intelligence. EO reflects the degree to which firms' objectives and actions are driven by the identification and exploitation of untapped market opportunities (e.g., Baker and Sinkula, 2007). For these reasons, Miles and Arnold (1991) conclude that EO and MO do not represent the same underlying business philosophy and are independent of each other. However, we posit that the unique aspects of MO should temper the inherent riskiness of EO for three main reasons.

First, in general, greater EO engenders a proclivity towards emphasizing the positives (returns) rather than the negatives (risks) of planned actions (e.g., Palich and Bagby 1995). As a result of its emphasis on scanning existing customers and competitors and learning from current market demands and product offerings, MO will allow the firm to better anticipate and be cognizant of the “true” risks which may arise in new product markets. Second, since greater emphasis is placed on customer and market needs, MO should lead a firm’s new innovative products or market moves to be more attuned to market needs, thus reducing chances of new product failures (e.g., Narver et al. 2004). Third, inter-functional coordination introduces a more balanced approach in deciding the merits of a particular R&D project and thus in decisions of allocation of resources (e.g., Schilling and Hill 1998). This may offset the negative impact of autonomous risk since the collective business group should be better able to weed out suboptimal strategic choices taken by individual managers or teams.

In turn, EO may also be expected to temper any inherent risk averseness of MO. MO firms will give customers what they seek and match or aim to surpass rival offerings but may get locked into incremental responses and may be in danger of being leapfrogged by more innovative firms (e.g., Christensen, Cook, and Hall 2005). A completely customer-led philosophy is primarily concerned with satisfying customers' expressed needs, and is typically reactive in nature (e.g., Lukas and Ferrell 2000). However, tempered with an EO, a MO firm

goes beyond satisfying expressed needs to understanding and satisfying customers' latent needs and, thus, is longer-term in focus and more proactive in nature (Slater and Narver 1995). Thus, overall, a firms' MO and EO complement each other—reducing the risk propensity of EO ventures while enhancing the chances of the success of entrepreneurial moves.

Both MO and EO serve to differentiate the firm, thereby reducing its exposure to systematic risk. However, EO is more related to differentiating and exploring unknown territories in terms of markets, customers and products. For instance, Zahra and Covin (1995) argue that firms with EO can “skim” markets ahead of their competitors by targeting premium market segments and charging high prices. This may potentially increase the number of macroeconomic forces to which it is susceptible, increasing the set of macroeconomic vulnerabilities and thus systematic risk (Rowley et al. 2000). MO, more than EO, emphasizes generating, disseminating and responding to market intelligence effectively. This knowledge would be useful in known domains but critical in unknown ones. This knowledge along with a customer focus would help attain customer satisfaction and stimulate loyalty even in new markets or with new products. This will help the firm creates a situation in which consumption of its products suffers less from fluctuations in the macroeconomic conditions.

Overall, we expect that:

H4: *The interaction between a firm's MO and EO is (a) negatively associated with idiosyncratic risk, and (b) negatively associated with systematic risk*

[INSERT TABLE B HERE]

RESEARCH SETTING AND METHODS

DATA

To test the hypotheses we collected secondary data from a variety of sources. We obtained firm financials from COMPUSTAT, which collects financial information for all U.S. listed companies

from 10K/10Q disclosures. These data are used in measures of our *financial performance* control Return on Assets (ROA), firm-*specific controls* including firm size, marketing expense, liquidity and leverage and *credit ratings* (which were used for generating additional insights). Firm 10-K's were obtained from the SEC and were used for computing measures of *market* and *entrepreneurial orientation*. In addition to COMPUSTAT, data from CRSP on daily stock returns was used to calculate systematic and idiosyncratic risk. After combining data from these various data sources, missing data for one or more variables resulted in a final hypothesis testing sample containing data from 444 firms over 10 years (2002 through 2011), for a total of 4110 firm-year observations. These firms represent 24 NAICS three-digit industries. The average firm in the database has \$22.4 billion in assets, profits of around \$675 million, \$4.3 billion in sales, market shares of around 10% and has been operating for 51 years. Table 1 shows the summary statistics and correlations for the variables in our sample.

[INSERT TABLE 1 HERE]

MEASURES

Risk: Equity risk, composed of systematic and idiosyncratic components, arises from and resides in the financial/equity market (Han, Mittal, and Zhang 2017). Hence our measures of risk relate to the volatility of a firm's stock returns. We obtain estimates of risk and return using the Carhart four-factor model, following Srinivasan and Hanssens (2009) who recommend marketing researchers tackling the investor related questions to use the Carhart model. We estimate the Carhart four-factor explanatory model (based on daily stock returns) to obtain the three components of shareholder value: levels of abnormal returns, systematic risk, and idiosyncratic risk. The Carhart four-factor explanatory model (Carhart 1997) is estimated as follows:

$$R_{id} - R_{fd} = \alpha_i + \beta_{1i} (R_{md} - R_{fd}) + \beta_{2i}SMB_d + \beta_{3i}HML_d + \beta_{4i}UMD_d + \varepsilon_{id},$$

where R_{id} is the stock return for firm i at day d , R_{fd} is the risk free rate of return in day d , R_{md} is the average market rate of return in day d , SMB_d is the return on a value-weighted portfolio of small stocks minus the return of big stocks, HML_d is the return on a value-weighted portfolio of high book-to market stocks minus the return on a value-weighted portfolio of low book-to-market stocks, and UMD_d is the average return on two high prior-return portfolios minus the average return on two low prior-return portfolios. The parameter α_i captures abnormal stock returns that should not be present in the case of an efficient market. The parameter β_i measures systematic risk. Finally, the standard deviation of the residuals (σ_{id}) is a measure of *idiosyncratic risk* (Tuli and Bharadwaj 2009).

Market & Entrepreneurial Orientation: To glean information about a firm's strategic orientation we use firm annual reports. Annual reports are useful sources of information, because managers of companies commonly signal what is important through this reporting mechanism (Brennan, 2001). They also have the advantage of being regularly produced thus offering the researcher the opportunity to perform comparative analyses (in this case of management attitudes) across reporting periods. In addition, annual reports can be accepted as an appropriate barometer of a company's attitude towards social reporting for two reasons: the company has complete editorial control over the document (except the audited financials section); and it is usually the most widely distributed public document produced by the company.

We use content analysis of firms' annual reports as a technique to obtain information about a firm's strategic orientation. This has been used, and held to be empirically valid, in accounting and finance research (e.g., Gray et al. 1995). Content analysis is a method of codifying text (here we use a combination of manual and automated coding) into various groups or categories based on selected criteria. It assumes that frequency indicates the importance of the

subject matter (Krippendorff, 1980). To assess firms' strategic orientation we employ a text analytic approach (Weber 1990) that has been widely used by strategy scholars to extract constructs of interest from archival data (e.g., Osborne, Stubbart, and Ramaprasad 2001). We use a computer aided text analysis software (LIWC) which is an individual word count system. Since the analyses are at the firm-level, we select company annual reports as the communication of choice. Such reports have previously been used to extract firm level characteristics such as corporate values and organizational networks (e.g., Kabanoff and Brown 2008). Annual reports contain textual information pertaining to the path the firm is following and its goals, which allows us to extract the firm's strategic focus. These text based reports are then filtered through a lexical reference system, in this case CAT Scanner (Short et al. 2010), to remove most company, location, personnel names and numbers to reduce the effects of firm specific terminology on the content analysis process. We then use a four-step procedure to obtain the orientation construct.

First, we obtain the relevant narratives from 10-K (i.e. annual) reports (and also shareholder letters which are later used for a robustness check) using a custom built Python scraping program which queries the U.S. Securities and Exchange Commission (SEC Edgar) website. 10K texts from 10 years (matching the years of data we have for the rest of our measures) are labeled according to their Central Index Key (CIK) number and these are matched with their GVKEY (Global Company KEY) code to merge with the rest of the data. The data are also cleaned so as to remove all non-textual words and symbols. Second, we obtain a list of words and phrases used to characterize and describe MO and EO from dictionaries used in past literature (specifically, Zachary et al. 2011 for MO and Short et al. 2010 for EO). Third, after obtaining the dictionaries for each construct, we use a text analysis software (LIWC) to arrive at the total count of relevant words for a particular strategic orientation. The ratio of this total to the

overall number of words in the document (e.g. $T_{\Sigma \text{Mod}}/T_{\text{total}}$) gives a measure of the strategic orientation focus score for the firm for the past year and ‘d’ represents a sub dimension. We scale the score ranges for purposes of better comparison and standardize them relative to industry. Finally, since each of the sub dimensions of EO and MO were measured individually, to arrive at an aggregate EO/MO score, we take the mean of those sub dimensions.

We also run a series of robustness checks for our measures to ensure that they are accurate. First, we compare our measures with that observed in survey-based studies of EO and MO. Rauch et al. (2009) in their meta-analysis find that the average correlation between manager reported EO and business performance is 0.192. In our sample we observe this correlation to be 0.175 with net income as the performance variables of interest. For MO and business performance, Kirca, Jayachandran and Bearden (2005) in their meta-analysis note that the range of correlation coefficients with range from -0.13 to 0.46 with a mean of 0.270. The correlation of our measure with net income is 0.175. We expect that the differences in magnitude may be partly due to: a) exaggeration by firm managers as to the effectiveness of their strategic orientation; b) our use of objective measures of performance; and c) measurement and sample differences including the number and variety of firms.

Second, it is likely that not all words in each dictionary are equally representative of a strategic orientation. Further, negative pre-words (such as ‘not’ price sensitive is not the same as price sensitive) may bias the counts. We thus created a second dictionary using the Word2Vec package in Python where words were given weights depending on their vector distance from each other and from a focal word, where the focal word is either “customer” (for MO) or “innovation” (for EO). This is done through skip-gram modeling using negative sampling i.e. we maximize the similarity between the vectors for words which appear close together with our

focal word, and minimize the similarity of words that do not. Similarly, we eliminate words from the count if they belong in a negative phrase (e.g., Mikolov et al. 2013). Using this second dictionary to check the robustness of our results we do not observe any substantive differences. Overall, this content analytic approach allows us to obtain a measure of the strategic orientation of the firm which is objective, dynamic (over years) and fluid (i.e. allows a firm to be both MO and EO)⁴.

Control Variables:

Financial leverage. We calculate financial leverage, as the ratio of firm's long-term debt to its total assets (Jensen and Meckling 1976). Financial leverage can decrease expected cash flow from the next period through interest payment commitments which may impact future risk.

Size. To control for economies-of-scale effects and firm-level heterogeneity, we used Compustat data on firm size (total assets).

Liquidity. We control for firm liquidity using current ratio (Grewal, Chandrashekar, and Citrin 2010). A firm needs liquid assets to meet its payment obligations, and liquidity ratios indicate how quickly a firm can convert its assets into cash, which in turn impacts the risk of the firm.

ROA: It is a historical and backward looking accounting metric that captures a firm's financial efficiency and is computed as the ratio of the firm's income before extraordinary items to the firm's total assets. High profitability of current assets (ROA) implies high marginal returns to investment, and therefore more growth opportunities and greater returns. In such a model, profitability, investment, and cumulative abnormal returns are strongly positively related to each other and each is a sufficient statistic for the firm's conditional market beta and thus its risk premium. Similar to Novy-Marx (2012), we control for ROA and do not treat it as a summary

⁴ Appendix 5 tabulates the measures we use for this study.

statistic for a firms' risk premium. Thus, our use of ROA exemplifies firms' cumulative returns independent of the economic performance of the firm. We also control for profitability (ROA) to deal with the potential for “risk seeking by troubled firms” (Bowman 1982) as past performance may induce future risk taking and we need to control for this.

Marketing expenses: To control for the effect of marketing expenses, we subtract R&D from SG&A, both of which we obtain directly from COMPUSTAT, as a control.

MODEL

We use a time series longitudinal approach to estimate the relationship between firms' strategic orientation and equity holders' risk (i.e., stock return variance). We use a fixed-effects with first-order autoregressive correlation structure (FE-AR1) estimation method, which also accommodates for moderately unbalanced panels (Wooldridge 2015).⁵ We address heteroskedasticity concerns by computing cluster-adjusted robust standard errors, to assess the significance of the estimated coefficients. The fixed effects approach allows us to control for unobserved heterogeneity—suggested as appropriate by the Hausman test ($\chi^2=23.40$).

Additionally, the autoregressive correlation structure allows us to address any remaining serial correlation concerns. Variance inflation and condition indices statistics are well below standard cutoffs which indicate no particular problems with multicollinearity. Overall, we estimate the following full models for testing the hypotheses:

$$\begin{aligned} \text{Abnormal Return}_{i,t+1} = & \alpha_0 + \alpha_1 EO_{i,t} + \alpha_2 MO_{i,t} + \alpha_3 MO \times EO_{i,t} + \alpha_4 Firm\ Size_{i,t} + \\ & \alpha_5 Marketing\ Expense_{i,t} + \alpha_6 Liquidity_{i,t} + \alpha_7 Leverage_{i,t} + \alpha_8 ROA_{i,t} + \eta_i + \varepsilon_{i,t} \end{aligned}$$

⁵ Our data is mildly unbalanced since we have firms which drop out of the sample due to bankruptcies and mergers and acquisitions. Since M&A could influence the strategic orientation of a firm, we used SDC Platinum to extract out firm-years during when there was M&A.

$$\textbf{Systematic Risk}_{i,t+1} = \alpha_0 + \alpha_1 EO_{i,t} + \alpha_2 MO_{i,t} + \alpha_3 MO \times EO_{i,t} + \alpha_4 Firm\ Size_{i,t} + \alpha_5 Marketing\ Expense_{i,t} + \alpha_6 Liquidity_{i,t} + \alpha_7 Leverage_{i,t} + \alpha_8 ROA_{i,t} + \eta_i + \varepsilon_{i,t}$$

$$\textbf{Idiosyncratic Risk}_{i,t+1} = \alpha_0 + \alpha_1 EO_{i,t} + \alpha_2 MO_{i,t} + \alpha_3 MO \times EO_{i,t} + \alpha_4 Firm\ Size_{i,t} + \alpha_5 Marketing\ Expense_{i,t} + \alpha_6 Liquidity_{i,t} + \alpha_7 Leverage_{i,t} + \alpha_8 ROA_{i,t} + \eta_i + \varepsilon_{i,t}$$

where i stands for firm and t for time (year), η_i is the time-invariant unobservable firm-fixed effects (e.g., supplier and labor relations), and $\varepsilon_{i,t}$ is the random error representing all unobserved influences on future returns or risk. Following Aiken et al. (1991), when estimating the interaction between MO and EO, both variables were first mean-centered and then the interaction term was computed and added to the model.

RESULTS

Table 2 (Models M1 and M2) results indicate that the effect of both EO and MO on Abnormal Returns is significant and positive ($\beta=0.212$, $p<0.001$ and $\beta=0.025$, $p<0.05$ respectively) as is their interaction ($\beta=0.080$, $p<0.05$). These findings are in line with Ritala and Hurmelinna-Laukkanen (2013) who examine independently the effects of EO and MO on business growth and find a positive effect for both. Thus, investors seem to appreciate the demand-side benefits of EO and MO. Our results suggest that an EO emphasis provides stronger returns to the firm than MO. Further, these results seem to support the assumption of a positive relationship between the risk and return in finance theory as we find that a firm's EO increases both future risk and future returns more than a firm's MO.

We also find that there is additional value and increased returns if both EO and MO are present. Firms with a high level of EO are innovative, proactive and risk-taking, which typically result in an increase in the introduction of new products and services (Lumpkin and Dess 1996).

However, in order to achieve superior returns, EO firms also have to orient themselves towards market demands, and our results indicate that this is also appreciated by the stock market.

[INSERT TABLE 3 HERE]

Table 4 provides insights into the impact of the two strategic orientations on firm risk. For idiosyncratic (firm-specific) risk (Models M5 and M6), we find that an emphasis on EO leads to greater risk while an emphasis on MO leads to reduced risk ($\beta=0.097$, $p<0.05$ and $\beta=-0.139$, $p<0.001$ respectively). In general, the marketing literature indicates that market-based assets decrease firm risk (e.g., Morgan and Rego, 2009), and increasing MO has been found to be associated with increasing levels of market-based assets (e.g., Matear, Gray, and Garrett 2004). Further, greater MO may signal to shareholders a market-based outlook to new product introductions and market entry, and in general, indicate that future actions will be more likely to be aligned with market conditions.

Shareholders on the other hand associate greater risk with EO firms and with the proactive and risky strategies that is fostered by greater EO (e.g., Baker & Sinkula, 2007). The interaction effect of MO and EO on idiosyncratic risk is negative and significant ($\beta=-0.075$, $p<0.05$)⁶ and implies that shareholders value a combination of EO and MO in a firm. Risky, proactive and innovative actions carry less risk if those actions are informed and guided by MO considerations. These findings expand previous research focusing on the isolated or even moderated effect of EO on new product performance (Atuahene-Gima and Ko 2001) or on sales/profitability (e.g., Desutscher et al. 2016), as firms with high levels of EO are perceived to

⁶ Risk = $B1*EO + B2*MO + B3*EO*MO$, where B1 is positive, B2 is negative, and B3 is negative. In terms of marginal effects, we have $d \text{ Risk} / d EO = B1 + B3*MO$ (with B1 + and B3 -). Thus the marginal effect of EO on risk starts positive (B1), but it decreases as MO increases—and it may even become negative after some level of MO. Similarly, $d \text{ Risk} / d MO = B2 + B3*EO$ (with B2 - and B3 -). Thus the marginal effect of MO on risk is negative (B2), and it becomes more negative as EO increases.

be less risky if EO is combined with MO.

In terms of systematic risk, our results confirm H_{3a} and partially confirm H_{3b}. The coefficients for EO (Model M3 and M4) are negative and significant ($\beta = -0.117$, $p < 0.05$) but for MO while negative, are insignificant ($\beta = -0.033$, $p > 0.10$). This suggests that greater EO makes a firm “different” from others in the same industry through a greater emphasis on innovation and proactiveness. While this may lead the firm to be more susceptible to idiosyncratic risks as a result, the upside is that it may also enable the firm to be less susceptible to industry specific ailments or shocks. We do not find a significant interaction effect of EO and MO on systematic risk ($\beta = -0.044$, $p > 0.10$) and hence reject H_{4b}. This suggests that the effect of EO and MO on systematic risk rely on distinct competencies which may not be synergistic.

Post hoc, we further analyzed the impact of EO and MO on risk in conditions of turbulence since such environments are known to be correlated with greater systematic risk (e.g., Jaworski and Kohli 1993). We find that the interaction effect of EO and turbulence on systematic risk is negative and significant ($\beta = 0.227$, $p < 0.05$) while that of MO on systematic risk is positive and non-significant ($\beta = 0.177$, $p > 0.1$). This provides further support to our results and implies that EO may be more beneficial for a firm under conditions with greater environmental risk.

[INSERT TABLE 4 HERE]

Impact of Individual dimensions of EO and MO on Risk: We also examined the results (Appendix 2) for the individual sub-dimensions of EO and MO to further investigate the rationales behind their impact on risk. We observe that among the sub-dimensions of EO, proactiveness ($\beta = 0.107$, $p < 0.01$) significantly drives up the effect on idiosyncratic risk of the firm (the coefficients for all the other sub-dimensions are positive but non-significant) while for MO, competitor orientation and inter-functional coordination decrease idiosyncratic risk

significantly ($\beta=-0.098$, $p<0.01$; $\beta=-0.209$, $p<0.001$ respectively). For systematic risk, we see that only the customer-orientation sub-dimension for MO is significant ($\beta=-0.016$, $p<0.01$) while for EO, the dimensions of risk taking and autonomy ($\beta=-0.107$, $p<0.01$; $\beta=-0.062$, $p<0.05$ respectively) are significant and negative.

ADDITIONAL RESULTS AND ROBUSTNESS CHECKS

Environmental Turbulence: Following Keats and Hitt (1988), we measure *market munificence* as the three-year industry averaged growth in sales. To calculate *competitive dynamism*, we use the three-year change in Hirschmann-Herfindahl Index (HHI) (Keats and Hitt 1988). We then compose an index consisting of the product of competitive dynamism (inverse of HHI) and the inverse of market munificence to capture environmental turbulence.

Advertising and R&D Expenses: We obtain advertising and R&D expenses directly from COMPUSTAT (items xad and xrd respectively). Missing values were replaced with 0.

Strategic Emphasis: Following Mizik and Jacobson (2003), relative strategic emphasis on value appropriation (compared with value creation) is measured as $SE = (\text{Advertising expense} - \text{R\&D expense}) / \text{total assets}$. Positive values indicate an emphasis on value appropriation while negative values indicate an emphasis on value creation.

Results

Continuous EO-MO: We also generated a continuous variable aiming to capture a firm's emphasis between EO and MO by dividing our EO by our MO measure. This allows us to provide a measure of a firm's relative emphasis on EO vs MO. The results from using this measure confirm our previous findings. We observe this continuous term to significantly and positively affect Abnormal Returns ($\beta=0.119$, $p<0.001$) indicating that as emphasis shifts to more EO, the effect on abnormal returns is more positive. We also include a polynomial term to

investigate whether there are any asymmetric effects. That term is negative and significant ($\beta = -0.045$, $p < 0.05$) which implies that as a firm slides towards much more EO and away from MO, shareholder expectations about future cash flows actually decrease.

For idiosyncratic risk, our emphasis term is positive and significant ($\beta = 0.081$, $p < 0.05$), meaning that as a firm's emphasis shifts towards more EO, the firm's idiosyncratic risk is greater. The 2nd order term in this case is negative and non-significant ($\beta = -0.019$, $p > 0.10$) implying an increase, though not significantly, at very high levels of EO to MO.

EO, MO and Strategic Emphasis: Previous studies clarifying the constructs of EO and MO (e.g., Dess and Lumpkin 2005; McNoughton et al. 2002) posit that both EO and MO signify a firm's focus on value creation rather than value appropriation, though, through different means. EO focuses mainly on new markets and customers and/or new products and services while MO mainly focuses on best satisfying existing customer needs through tailoring existing products or introducing new ones. Empirically, for the high EO-low MO firms (firms lying in the top quartile of EO and bottom quartile of MO), we find their strategic emphasis to be tilted more towards value creation (mean emphasis is -0.033 compared to a sample mean of -0.009 and SD of 0.039). For the high MO-low EO firms (top quartile MO and bottom quartile EO) the variable still indicates a stronger emphasis on value creation but less so than EO (mean emphasis is -0.011). We also find that the high EO-low MO firms spend much more on R&D (\$ 648.5 million) as compared to the high MO-low EO firms (\$470.0 million) though both are above the sample mean (\$427 million). Conversely, average advertising spends are higher for high MO-low EO firms (\$996.4 million) than high EO-low MO firms (\$682.7 million) though both are considerably higher than the sample mean (\$470.3 million). Overall, the results seem to indicate that EO is more strongly geared towards value creation than MO, which instead places emphasis

on both creation and appropriation, which may partly explain the negative relationship between MO (and positive one with EO) and firm idiosyncratic risk.

DISCUSSION AND IMPLICATIONS

In seeking superior performance firms can err either by excessive risk taking or insufficient risk taking. While EO can induce firm susceptibility to excessive risk taking, MO may lead to greater instances of insufficient risk taking. A combination may allow the firm the ability to not only take advantage of opportunities afforded by scanning the environment (customers and competitors) but also opportunities which are generated internally through independent technological development. Based on our results, we argue that an EO culture is about proactively pursuing new opportunities of growth, while a MO culture is a more deliberate process that aligns the growth pursuit to market conditions. MO provides a market-based alignment to EO; therefore they complement each other. MO helps to avoid technological myopia and direct firm's efforts toward relevant market needs (Bhuian, Menguc, and Bell 2005), thus creating a market (and customer) centric platform for entrepreneurship.

That a firm's culture may enable it to behave in ways with positive economic impact does not necessarily imply that a firm can obtain *sustainable* competitive advantages from its culture (Barney 2001). In addition, these cultural attributes must be rare. From a theoretical standpoint, a firm's ability to combine and orchestrate these two separate assets creates synergistic effects such that the sum exceed the parts. This combination is rare because it is difficult to accomplish and maintain a high level of diverse strategic orientations (in Appendix 3B) we see that only 6% of firms have achieved this), non-substitutable because of a clear orientation towards the market, product as well as knowledge of conditions and changes in both and, finally inimitable by

competitors because it is tacit and organizationally complex—thus satisfying RBV theory criteria for it to lead to *sustained* competitive advantage (Barney 1991).

Classical asset pricing literature posits that shareholders should trade off a stock's risk and expected return leading to a positive correlation of risk and expected return in equilibrium (Fama and Macbeth 1973). Even much of the literature on innovation, organizational change, and general management has assumed that greater risk has a positive influence on future returns (e.g., Kanter 1983). However, our results indicate that greater returns need not be associated with greater risk and that a high return-low risk position can be obtained through a combination of strategic orientations. As indicated by Andersen, Denrell and Bettis (2007), there are three widely accepted explanations for Bowman's (1982) negative risk-return paradox: (1) contingencies that influence the risk behavior of organizational decision-makers; (2) outcomes from strategic conduct; and (3) statistical artifacts. Our results indicate that in line with the strategic conduct perspective, the observed inverse risk-return relationship is a result of favorable management practices engendered by an integration of the marketing concept (MO) in the culture of the firm, whether by itself or (more favorably) in combination with EO⁷.

The hypothesis testing results show that greater EO results in higher risks and returns for the firm while greater MO results in lower (but still significant and positive) returns and risks when compared to EO. Our findings also show that the best way for a firm to occupy a low risk-high return trajectory is through a positioning combining EO and MO. However, the above may not hold true in cases where systematic risk is high. These could be under macroeconomic conditions of low or negative GDP growth (recessions) or in industries facing high sector specific risks due to turbulence (such as in highly competitive industries or fast changing

⁷ Appendix 6 provides greater detail from a finance point of view.

technologies). Under such conditions, it is EO which reduces systematic risk and hence shareholders looking to buy shares in a turbulent market may look for firms high in EO rather than MO or even a combination of the two. We demonstrate that while EO emphasizes risk taking, aggressively competing and innovating which increase the idiosyncratic component of risk, it also differentiates the firm sufficiently which ironically reduces the industry related component of risk of the firm.

Our study's results offer two main theoretical contributions. First, we contribute new substantive insights to understanding strategic orientation by showing the complementarity between EO and MO in not only generating greater returns but also, at least in the case of idiosyncratic risk, reducing the risk of those returns. We also provide a theoretical understanding of why that complementarity may exist. Specifically, our results suggest that MO guides EO firms by providing a market based understanding, thereby reducing the risk of EO firms' actions. Overall, we show that a firm's culture (as embodied by EO and MO) are valuable assets for the firm and their combination can produce superior rents with lower risk.

Second, we provide a theoretical foundation that explains the differences in shareholder valuations of risk for MO compared to EO firms. EO firms seek to achieve superior performance by embracing risk in their actions while MO firms seek to fulfil their performance objectives through mitigating risk, not by evading riskier ventures but more as a by-product of seeking to match marketplace conditions. We empirically demonstrate the importance of these strategic orientations, for a stakeholder group hitherto largely ignored—shareholders. Since a large number of firms operating today are publicly owned, failing to consider their interests is an important omission.

This study also has important implications for firm's top management, board of directors,

financial analysts, and shareholders. Our results suggest that a firm's managerial choice with regard to emphasizing EO versus MO affects firm risk. As per our findings, EO increases returns more than MO but also increases idiosyncratic risk. Firms solely focused on returns would erroneously adopt an EO culture and suffer from increased risk. Instead, managers should look to choose a combination of EO and MO to achieve an optimal risk-adjusted return and not face a tradeoff in the higher risk that goes hand-in-hand with higher returns. However, an EO culture may be preferable under turbulent market conditions or, in general, conditions which increase the exposure of the firm to systematic risk (i.e. where an EO based culture would be more valuable).

Further, firm managers may also look to align a firm's orientation depending on the ability and willingness to take and absorb risks. For example, a firm operating with sufficient slack to absorb higher risks of failures may look to be more EO to achieve higher growth. Conversely, a firm struggling to survive may look to minimize risks and adopt a more MO stance. Lastly, in industries with high systematic risk, managers may look to increase the levels of EO of a firm rather than MO. Since a firm's resources are typically finite, our results should provide some understanding to managers regarding what orientation may be emphasized more. From the standpoint of the practitioner who wishes to maximize stock value, our findings imply that investors may reward some strategic orientations more than others.

LIMITATIONS AND DIRECTIONS FOR FUTURE RESEARCH

Our research has several limitations which could also serve as avenues for future research. First, we demonstrate that a firm's strategic orientation matters by performing a content analysis of annual reports. Future research may re-examine the results using longitudinal survey data. This would serve not only to investigate the validity of our results but also provide possible

additional insights. For instance, one may explore whether risk-taking is embedded in all functions of an EO organization or is it just a characteristic of certain SBUs?

Second, there could be several moderators for the relationship we observe. Specifically, our use of a fixed effects estimation does not allow us to make inferences regarding industry-level moderators that may play a role. For example shareholders may expect (and suitably reward) younger firms or firms in certain industries (such as technology) for adopting a more risk-taking profile while they may desire firms operating in more mature industries to undertake less risks.

Third, we indicate that firms should aim to achieve a combination of EO and MO. Future research may investigate how can a balance of EO and MO be achieved and whether achieving one is harder than the other. In this context, considering the ‘stickiness’ of such orientations and the embeddedness of firm cultures in general, additional research can explore the role of other important firm resources and capabilities, such as physical assets or organizational ambidexterity to facilitate changes in strategic orientations.

Fourth, strategic orientation as culture values and norms do not necessarily guarantee a superior performance. Instead, they accomplish this by guiding actions based on learned information and knowledge. Therefore, further research may identify some of the underlying action components to understand the impact of strategic orientation on both risks and returns.

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Table 1 (A)
Literature Review I (Contribution to Strategic Orientation Literature)

Study	Considers Both MO & EO	Looks at Both Risk & Returns	Objective Measures of Strategic Orientation?	Longitudinal Effect?	Findings
This study	Yes	Yes	Yes	Yes	EO reduces systematic risk while increasing unsystematic risk. MO reduces unsystematic risk. EO and MO have an independent as well as combined effect on risk and return.
Arunachalam et al. (2018)	No	No	No	Yes	Architectural Marketing Capability Specialized Marketing Capability
Jaeger et al. (2016)	No	No	No	Yes	RMO has inverted U shaped effect. PMO has U shaped effect.
Baker and Sinkula (2009)	Yes	No	No	No
Noble et al. (2002)	No	No	Yes	Yes	Competitor Orientation and Inter-functional Orientation increase Firm Performance
Atuahene-Gima and Ko (2001)	Yes	No	No	No	The study shows that the interaction between MO and EO plays an important role in fostering product innovation. With that have high MO and EO have higher new product performance.

Table 1 (B)
Literature Review II (Contribution to Marketing-Risk Literature)

Study	Considers Organizational Culture	Data Source	Looks at Both Risk & Returns	Looks at Both Systematic & Idiosyncratic Risk	Findings
This study	Yes	Text Analysis of Annual Reports	Yes	Yes	EO reduces systematic risk while increasing unsystematic risk. MO reduces unsystematic risk.
Han et al. (2017)	No – strategy as R&D, Advertising	Financial Accounting Measure	No	No	Strategic emphasis $t-1 \rightarrow$ - Firm-idiosyncratic risk t
Hsu et al. (2016)	No – Brand architecture	Brand Equity Measures	No	Yes	Brand houseseed $\rightarrow$ + Alpha/Beta/Sigma Sub-branding $\rightarrow$ + Alpha/Beta/Sigma
Jindal and McAlister (2015)	No – R&D, Advertising	Financial Accounting Measure	No	No	ADV $\times$ Market turbulence $\rightarrow$ + Bankruptcy risk R&D $\times$ Market turbulence $\rightarrow$ - Bankruptcy risk
Luo and Bhattacharya (2009)	No – CSR	CSR Reports	No	No	CSP $\rightarrow$ - Firm-idiosyncratic risk CSP $\times$ ADV/ R&D $\rightarrow$ - Firm-idiosyncratic risk
Fornell et al. (2006)	No – Customer Satisfaction	ACSI	No	No	Satisfaction reduces risk

Figure 1
Conceptual Framework

TABLE 2
DESCRIPTIVE STATISTICS AND CORRELATIONS (N=4110)

VARIABLE	MEAN	SD	1	2	3	4	5	6	7	8	9	10	11	12
1 Entrepreneurial Orientation _{i,t}	1.54	0.42	1.000											
2 Market Orientation _{i,t}	0.53	0.16	.143	1.000										
3 Firm Size _{i,t} (Millions \$)	22365	14707	.099	.005	1.000									
4 Marketing Expense _{i,t} (Millions \$)	1870	3189	.214	.077	.415	1.000								
5 Liquidity _{i,t}	1.443	0.710	-.123	.040	-.250	-.191	1.000							
6 Leverage _{i,t}	0.211	0.144	-.131	-.151	-.171	-.099	-.160	1.000						
7 ROA _{i,t}	0.052	0.059	.090	.142	-.130	.150	.176	-.313	1.000					
8 Abnormal Returns _{i,t+1}	0.051	0.094	.063	.020	-.001	.072	.063	-.163	.354	1.000				
9 Systematic Risk _{i,t+1}	0.943	0.515	-.032	.044	.140	.017	.298	-.187	.068	.112	1.000			
10 Idiosyncratic Risk _{i,t+1}	0.018	0.008	.018	-.087	-.065	-.121	.186	.165	-.164	-.088	.166	1.000		
11 Credit Ratings _{i,t+1}	16.560	4.13	.030	.024	.045	.218	-.076	-.143	.061	-.094	-.166	-.144	1.000	
12 Turbulence _i	0.019	0.029	-.091	-.048	-.177	-.298	.215	.073	-.036	-.074	.106	.137	.103	1.000

Note: Correlation coefficients larger than |.041| are significant at the $p < 0.01$ level, while those greater than |.031| are significant at the $p < 0.05$ level.

TABLE 3
EFFECT OF STRATEGIC ORIENTATION ON FIRM SYSTEMATIC RISK (BETA) AND IDIOSYNCRATIC RISK (SIGMA) & RETURNS

STANDARDIZED ESTIMATES	(M1) Abnormal Returns_(t+1)	(M2) Abnormal Returns_(t+1)	(M3) Systematic Risk_(t+1)	(M4) Systematic Risk_(t+1)	(M5) Idiosyncratic Risk_(t+1)	(M6) Idiosyncratic Risk_(t+1)	(M7) Total Risk_(t+1)	(M8) Total Risk_(t+1)
MAIN EFFECTS								
<i>EO_(t)</i>	0.212*** (0.000)	0.199 (0.158)	-0.117* (-0.060)	-0.057* (0.035)	0.097* (0.043)	0.481*** (0.083)		
<i>MO_(t)</i>	0.025* (0.012)	0.129* (0.052)	-0.033 (-0.017)	-0.028 (0.037)	-0.139*** (0.042)	-0.161* (0.073)		
CONTROLS								
<i>Firm Size_(t)</i>	-0.710* (0.310)	-0.423 (0.400)	0.009 (0.007)	-0.450* (0.228)	-0.397 (0.300)	-0.538 (0.285)		
<i>MExp_(t)</i>	0.153** (0.054)	0.152* (0.055)	-0.023 (0.014)	0.138** (0.047)	-0.003 (0.059)	0.027 (0.056)		
<i>Liquidity_(t)</i>	-0.060 (0.037)	-0.057 (0.037)	-0.024 (0.088)	0.200*** (0.040)	0.105* (0.040)	0.141*** (0.038)		
<i>Leverage_(t)</i>	-0.197*** (0.056)	-0.194*** (0.059)	-0.031*** (0.000)	-0.788** (0.287)	0.185* (0.079)	0.184*** (0.044)		
<i>ROA_(t)</i>	0.046 (0.044)	0.046 (0.044)	0.010 (0.008)	-0.011 (0.044)	-0.201* (0.070)	-0.193** (0.033)		
INTERACTION								
<i>MO X EO_(t)</i>		0.080* (0.030)		-0.044 (0.039)		-0.075* (-0.037)		
TESTS								
<i>Wald χ^2</i>	440.07***	470.32***	30.82***	57.57***	31.25***	35.54***		
<i>AR(1)</i>	0.19	0.28	0.29	0.03	-0.85	-0.82		

Notes: All coefficients standardized. *** significant at $p < 0.001$; ** significant at $p < 0.01$; * significant at $p < 0.05$. $N=4110$
Exact p -values with robust SE estimation are in parentheses.

APPENDIX 1
EFFECT OF STRATEGIC ORIENTATION ON SYSTEMATIC AND IDIOSYNCRATIC RISK (DETAILED)

<i>STANDARDIZED ESTIMATES</i>	<i>(A3)</i> <i>Systematic Risk_(t+1)</i>	<i>(A4)</i> <i>Idiosyncratic Risk_(t+1)</i>
MAIN EFFECTS		
<i>MO: Cust. O._(t)</i>	-0.016* (0.008)	-0.183 (0.121)
<i>MO: Comp. O._(t)</i>	0.051 (0.033)	-0.098** (-0.033)
<i>MO: Int. Coord. _(t)</i>	0.012 (0.037)	-0.209*** (-0.046)
<i>EO: Risk Taking_(t)</i>	-0.107* (-0.034)	0.019 (0.042)
<i>EO: Autonomy_(t)</i>	-0.062* (0.031)	0.012 (0.043)
<i>EO: Proactiveness_(t)</i>	-0.012 (0.030)	0.107** (0.039)
<i>EO: Comp. Aggr._(t)</i>	-0.017 (0.037)	0.065 (0.039)
<i>EO: Innovativeness_(t)</i>	-0.022 (-0.042)	0.021 (0.051)
CONTROLS		
<i>Firm Size_(t)</i>	0.193 (0.310)	-0.673 (0.397)
<i>MExp_(t)</i>	-0.116* (0.059)	0.068 (0.063)
<i>Liquidity_(t)</i>	-0.150*** (0.034)	0.087* (0.037)
<i>Leverage_(t)</i>	-0.740*** (0.288)	0.128* (0.051)
<i>ROA_(t)</i>	0.046 (0.031)	-0.181** (-0.067)
TESTS		
<i>Wald χ^2</i>	61.69***	162.64***
<i>AR(1)</i>	0.23	-0.12

Notes: All coefficients standardized. *** significant at $p < 0.01$; ** significant at $p < 0.05$; * significant at $p < 0.1$.
N=4110. Exact p-values with robust SE estimation are in parentheses.

APPENDIX 2
EFFECT OF EO AND MO ON RISK UNDER TURBULENCE

STANDARDIZED ESTIMATES	Systematic Risk_(t+1)	Abnormal Returns_(t+1)	Systematic Risk_(t+1)	Abnormal Returns_(t+1)
MAIN EFFECTS				
<i>EO_(t)</i>	0.066* (0.031)	0.028** (0.011)	-0.012 (-0.042)	0.025 (0.018)
<i>MO_(t)</i>	-0.112*** (0.031)	0.015* (0.007)	-0.036 (-0.034)	0.028 (0.017)
CONTROLS				
<i>Firm Size_(t)</i>	-0.279 (0.291)	-0.129*** (0.017)	0.100 (0.289)	-0.128 (0.017)
<i>MExp_(t)</i>	0.029 (0.045)	0.523*** (0.050)	0.019 (0.050)	0.528*** (0.050)
<i>Liquidity_(t)</i>	0.111*** (0.030)	-0.042* (0.017)	0.016 (0.033)	-0.041* (0.017)
<i>Leverage_(t)</i>	0.480* (0.244)	-0.442*** (0.138)	0.130*** (0.024)	-0.435** (0.139)
<i>ROA_(t)</i>	-0.193*** (0.026)	0.099*** (0.017)	-0.045 (0.032)	0.104*** (0.017)
<i>Turbulence_(t)</i>	0.475*** (0.052)	0.206*** (0.049)	0.639*** (0.127)	0.218*** (0.051)
INTERACTION				
<i>Turbulence_(t) X EO_(t)</i>			-0.227* (0.114)	0.155 (0.530)
<i>Turbulence_(t) X MO_t</i>			0.177 (0.181)	0.525 (0.543)
TESTS				
<i>Wald χ^2</i>	31.24***	224.56***	81.77***	236.73***
<i>AR(1)</i>	0.72	0.72	0.49	0.71

Notes: All coefficients standardized. *** significant at $p < 0.001$; ** significant at $p < 0.01$; * significant at $p < 0.05$.
N=4110. Exact p-values with robust SE estimation are in parentheses.

APPENDIX 3A
MODEL COMPARISONS

	Wald Chi Square	-LL	BIC	Adjusted R²	N
M1	440.07	1273.99	2600.80	16.11	1973
M2	470.32*	1260.96*	2541.34*	21.41*	1973
M3	30.82	949.78	1957.86	12.56	1973
M4	57.57*	949.21	1952.39	13.20	1973
M5	31.25	571.44	1151.01	12.98	1973
M6	35.54*	545.81*	1115.06*	13.97*	1973

*denotes significance at $p < 0.05$

APPENDIX 3B
EO-MO CATEGORIES

	Returns	Idiosyncratic Risk	Systematic Risk	Example Firm	Example Industry
Low EO - Low MO (~18% of sample)	Low (-.013)	High (.021)	High (1.036)	Ryder System Inc.	Gas Stations, Construction
Low EO - High MO (~15% of sample)	Medium (.016)	Low (.007)	High (.974)	Home Depot	Airlines, FMCG
High EO - Low MO (~10% of sample)	High (.097)	High (.024)	Low (.453)	Advanced Micro Devices	Industrial Products manufacturing
High EO - High MO (~6% of sample)	High (.101)	Low (.013)	Medium (.565)	Johnson and Johnson	Software, Pharmaceuticals

APPENDIX 4 EO-MO INTERACTIONS

APPENDIX 5

<i>VARIABLES AND MEASUREMENT DETAILS</i>	<i>DATA SOURCE/LITERATURE</i>
Abnormal Returns The parameter α in the Carhart 4 factor model. $R_{id} - R_{fd} = \alpha_i + \beta_{1i} (R_{md} - R_{fd}) + \beta_{2i}SMB_d + \beta_{3i}HML_d + \beta_{4i}UMD_d + \epsilon_{id}$,	COMPUSTAT. Tuli and Bharadwaj (2009)
Idiosyncratic Risk The standard deviation of the residuals ϵ_{id} in Carhart 4 factor regression model.	CRSP Tuli and Bharadwaj (2009)
Systematic Risk The parameter β_{1i} in the Carhart 4 factor model.	CRSP Tuli and Bharadwaj (2009)
Market and Entrepreneurial Orientation The ratio of total MO (or EO) words to the overall number of words in the document (e.g. $T_{\Sigma MOd}/T_{total}$).	10-K ANNUAL REPORTS Zachary et al. (2011); Short et al. (2010)
Financial Leverage The degree to which a firm uses debt to acquire assets. The ratio of firm's long-term debt (Sum of Compustat items dd2-dd5) to total assets (Compustat Item at).	COMPUSTAT Jensen and Meckling (1976)
Size The firm's reported total assets (Compustat item at).	COMPUSTAT (Rego, Morgan and Fornell 2013)
Liquidity The current ratio (i.e., the ratio of current assets to current liabilities) (Compustat Item ac/cl)	COMPUSTAT Grewal, Chandrashekar, and Citrin (2010)
Returns-on-Assets (ROA) The ratio of the firm's income before extraordinary items to the firm's total assets (Compustat items ib/at).	COMPUSTAT Novy-Marx (2012)

APPENDIX 6

The Risk-Return Tradeoff: Insights from Finance Literature

The fundamental concept of asset pricing is that investors are rewarded with (higher) returns to compensate for (greater) exposure to risk. There is a tradeoff between risk and return: if one invests in a portfolio with greater risk, then one can earn higher returns on average; and, if one invests in safe assets, one expects to earn lower average returns. The capital asset pricing model (CAPM), originally put forth by Sharpe (1964), postulates that an asset's exposure to overall market movements i.e. systematic risk, is the relevant risk measure. Idiosyncratic can be diversified away and will not command a risk premium. Thus, according to CAPM, higher beta assets should command a higher average return.

However, Malkiel and Xu (2002) argue that idiosyncratic volatility is to be priced if investors are not fully able to diversify this risk. This is indeed true in practice since transaction costs, such as brokerage fees and time costs prevent stockholders from diversifying away idiosyncratic risk completely (Constantinides 1986). Hence, both types of risk are deemed to be important.

More importantly, Ang, Hodrick, Xing and Zhang (2009) find that across a variety of countries, stocks with low idiosyncratic volatility (based on the Fama-French three-factor model) outperform stocks with high idiosyncratic volatility which rejects the risk-return tradeoff paradigm. Even with regards to systematic risk, Baker, Bradley and Wurgler (2011), analyzing a period of 50 years from 1968 through 2008, find that high beta stocks have underperformed compared to low beta stocks. Finance theory explains that this departure may be explained by short term volatilities (seasonality) and/or the effect of leverage (e.g. Koutmos 2015). Yet, Ang, Hodrick, Xing and Zhang (2009) find no evidence for either and the reasons behind a negative risk-return relationship is still subject to much debate.

Unfortunately, finance literature mostly tends to neglect the impact of firm strategies or actions in explaining such a tradeoff. In our paper we show that even after accounting for leverage (a covariate in the model) and seasonality (time fixed effects and yearly aggregated stock measures), a negative risk return tradeoff exists which can be explained, at least in part, owing to the strategic orientation of the firm.

References:

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