Transformation as a challenge: New ventures on their way to viable entities

Marc Gruber

Introduction

It is the common understanding that entrepreneurship entails a process (see, e.g. Faltin, Ripsas, Zimmer 1998, Bygrave 1997). This basic observation implies several things, most notably that (1) certain stages of organizational development can be distinguished, and (2) an important challenge in entrepreneurship is managing the process of building a company.

In order to arrive at a deeper understanding of the organizational development of new ventures, various growth models have been developed (Greiner 1972/1998, Quinn, Cameron 1983, Churchill, Lewis 1983, Garnsey 1998, Farrell, Hitchens 1988), with Penrose (1959) being among the first to study phenomena of firm growth in more detail. Although there is not an all encompassing understanding amongst entrepreneurship researchers on the question which stages of development should be distinguished (Hofer, Charan 1984), new ventures typically pass through

- a *pre-founding stage* (including e.g. opportunity identification)
- a *founding stage* (including incorporation and market entry) and
- an *early development stage* (including market penetration)

unless they fail early on in the process.

Compared to managing established organizations, the transformation of new ventures poses a special challenge for founders, as they have to deal with the usual day-to-day business operations and in parallel have to build a viable organization. In the process, many firms never arrive at becoming established entities. As evidence from business mortality statistics shows, discontinuance rates can be as high as 70% in the first five years depending on the industry under study (Yoon, Lilien 1985, Timmons 1999, Cooper, Bruno 1977).

Against this backdrop, the purpose of this article is to arrive at an integrative understanding of new venture development. In order to gain fresh insights, we apply a novel framework for studying the transformation process of new ventures which distinguishes challenges on a normative, a strategic and an operational level.

The remainder of this paper is organized as follows. In the next section, we briefly describe the key organizational characteristics of new ventures as well as characteristics of their (competitive) environment, in order to assess the challenges these firms typically face in their development. We then present an integrative framework for the development of new ventures and conclude this paper with a brief discussion.

Characteristics of new ventures and their environment

New ventures have distinct characteristics that distinguish them from larger, more established firms. They can be characterized by their newness and smallness as well as the inherent uncertainty. In addition, new ventures typically face extremely challenging competitive environments as they tend to operate in dynamic, emerging markets compared to the more stable environments established firms often compete in.

- *Newness of the firm*: There is ample empirical support for the argument that new organizations face liabilities of newness, which lead to higher failure rates of new firms compared to older ones (Stinchcombe 1965, Freeman, Carroll, Hannan 1983). Stinchcombe (1965) suggests that new organizations must rely to a high degree on social interactions among strangers. New firms usually do not have the access, links, experience, reputation as well as legitimacy of older firms, making it necessary to establish credibility and trust (Hannan, Freeman 1984, Romanelli 1989).[1] However, there are also advantages to being "new", as aging firms often become inert and thus experience liabilities of aging. This increasing reluctance to undergo processes of change poses a serious threat for the survival of an organization for instance when external changes require a corporate transformation.
- *Smallness of the firm*: Empirical research has also shown that being small has a negative correlation with survival rates (Aldrich, Auster 1986, Birch 1987, SBA 1983). There are plenty of arguments being discussed in the small business literature as to why smallness is a liability. Notably, the lack of resources in small firms which arises partly because of problems in raising capital (Aldrich, Auster 1986), makes them vulnerable and limits their ability to survive during unfavorable conditions. In addition, lack of resources restricts the amount of power a firm can exercise. The limited size of small firms also makes it more likely that critical skill gaps are encountered (McGrath 1996). Nonetheless, smallness can also be a valuable asset. Because of their flexibility, direct communication channels and sometimes unconventional procedures, small firms tend to arrive at decisions quicker than their larger counterparts and can act in a speedy and nimble way when discovering chances in the marketplace (Pleitner 1995, Füglistaller 2001, Schumpeter 1929, Li 2001). Peters and Waterman (1983) explicitly concluded in their well-known research study on successful large corporations that probably the most important factor of their success is their ability to be large, but simultaneously act as if they were small (Peters, Waterman 1983).
- *Uncertainty and turbulence*: Uncertainty is an unavoidable aspect of entrepreneurship and essential to the existence of opportunities (Knight 1921, Kirzner 1973, McGrath 1996). Yet, uncertainty poses a major challenge, as the superior way of doing business may only be known ex post and wrong decisions may have fatal consequences for a small firm with limited resources. In emerging industries the fundamental rules for conducting business have yet to be determined. In this process, the competitive

---

1 Brüderl and Schüssler (1990) propose a "liability of adolescence" and argue that firms face a time of adolescence, where the mortality rate is very low (because of their initial amount of resource endowments), and after which the death risk suddenly rises to a high level, followed by a declining rate.

structure of the industry is changing causing turbulence in the marketplace (Anderson and Zeithaml 1984, Tushman and Anderson 1986).

New ventures and their organizational transformation

The preceding discussion of the characteristics of new ventures and their environment already elaborated on the challenges new ventures typically face. In order to become an established organizational entity, new ventures have to deal with these challenges in a comprehensive way. In the following discussion we therefore distinguish a normative, strategic and operational dimension of venture management – a perspective, which has proven to be valuable for understanding firms in a comprehensive, integrative fashion (Bleicher 1999, Gruber 2000). In our belief it is a very fruitful approach for research in entrepreneurship, as it allows to conceptualize a very diverse set of challenges such as overcoming an emerging firm's liabilities of newness or developing a market entry strategy (Gruber, Harhoff 2002, Gruber 2002).

In his concept for integrative management, Bleicher (1999) distinguishes three dimensions of management, namely a normative, a strategic and an operational level: At the *normative level*, management lays down the general, mid- to long-term goals of a firm, defines the basic codes of behaviour as well as generally accepted company norms and principles, thereby establishing the identity, culture and structure of the company. At the *strategic level*, the firm focuses on establishing favourable prerequisites for achieving above normal returns by developing valuable resources and capabilities, by positioning its own activities relative to the competition, by bundling its strengths, and by developing suitable strategies for gaining as well as sustaining competitive advantages; all within the normative guidelines of the firm (Bleicher 1999, Schwaninger 1994, Bowman 1974). At the *operational level*, the firm deals with the execution of strategies within the normative scope of the firm (Bleicher 1999, Ulrich, Krieg 1974).

Building on this generic description of management tasks, we are able to focus on specific tasks in new venture management. In this respect, figure 1 gives an overview of the key normative, strategic and operational tasks of new ventures in the pre-founding, founding and early development stage of their organizational evolution.

At first glance it is obvious that as firms advance from the pre-founding stage to the early development stage, there are a multitude of tasks which have to be accomplished in order to succeed and which require a very versatile and devoted founding team.

As this framework shows at the *normative level*, one of the core challenges in the pre-founding stage of a new venture is the definition of a company vision and its values. It is basically up to the founders to develop a vision for the future development of their company, yet they have to take into account that (1) these long term goals define the guiding lines for all other decisions, and (2) influence the perceptions various actors in the environment will have of the emerging firm. E.g., if the founders conclude that they want to remain independent and follow a low growth strategy, they will not be prime candidates for venture capital financing.

	Pre-founding stage	*Founding stage*	*Early development stage*	
Normative level	· Defining company visons and values	· Sharing of company vision and values in firm · Forming of organizational culture · Building credibility / trust · Definition of roles	· Sharing of company vision and values in firm · Fostering organizational culture · Building credibility / trust · Refining organizational structure	t
Strategic level	· Opportunity recognition · Conception of business model and identification of competitive advantage	· Market entry strategy · Resource building · Strategic alliances	· Growth strategy · Replication resources · Sustaining competitive advabtage / erecting barriers to market entries	t
Operational level	· Business intelligence · Networking	· Business intelligence · Networking · Presentations and negotiations · Market tests	· Business intelligence · Networking · Management of personnel · Customer relationship management	t
	↓ Founder(s)	↓ Team	↓ Organization	

Figure 1: Normative, strategic and operational challenges of new venture management (cf. Gruber, Harhoff 2002)

Corresponding to the definition of a company vision, the core values of the firm have to be defined. In practice, this happens more or less implicitly, as the founders discuss for instance how to tackle certain problems or argue about venture strategies and in doing so arrive at a common understanding of their values.

These core values as well as the vision of the company impact the gradual development of a company culture. As reported by several studies, a market orientation is found to be beneficial to the success of new ventures. E.g., Raffa and Zollo (1995), and Roberts (1991) found that firms that were quick in adopting a market orientation achieved a higher performance level than firms that did not.[2] As the firm evolves and more and more employees join the organization, its culture has to be fostered and its vision shared. Otherwise the firm would evolve into a heterogeneous entity, losing its clear orientation and focus.

Entrepreneurs also face normative tasks such as the definition of new roles and the institutionalization of an organizational structure. Also, strategic alliances as well as

2 Narver and Slater (1990) defined market orientation as the "organization culture that most effectively creates the necessary behaviors for the creation of superior value for buyers and, thus, superior performance for the business." Because the organizational culture sets standard social routines within the firm, it also supports the new venture in reducing its liabilities of newness.

measures to establish credibility and trust – e.g., through communication activities – can be regarded as key challenges at the normative level, helping the firm to establish itself as a respected organizational entity. Thus, normative management is able to make major contributions to overcoming the liabilities of newness of a venture. As the firm evolves into a larger and more mature entity, also liabilities of smallness are gradually overcome, however, the previously mentioned risk of becoming inert must be addressed in the process.

As we move from the pre-founding stage to the early development stage at the *strategic level*, major tasks include opportunity recognition and market identification, the development of a business model and a market entry strategy. Market entry presents a major milestone for the new venture. As Schonhooven, Eisenhardt, Lyman (1990) point out, "(w)hen the first shipment for revenues is made, the new firm is on its way to a more favourable resource-dependence position." (Schoonhoven, Eisenhardt, Lyman 1990, p. 177).

Special attention has to be paid to gaining and sustaining competitive advantage in new ventures, as empirical studies have repeatedly shown that competitive advantage is the prime determinant of new product success in the marketplace (Zirger, Maidique 1990, Cooper, Kleinschmidt 1987/1993). The ability of a firm to gain and sustain its competitive advantage is closely linked to its resource base. While classical economic theory follows a very broad understanding of the term resources (cf. Ricardo 1817), strategic management mainly focuses on those key resources which enable a firm to achieve sustainable competitive advantages in the marketplace (Leonard-Barton 1992, Dierickx, Cool 1989, Williams 1992). According to Amit and Schoemaker (1993) strategically valuable resources have characteristics such as scarcity, low tradeability, inimitability, limited substitutability, appropriability and durability. As new ventures typically start out with very limited strategic resources, they need to replicate these resources in order to be able to grow. However, due to the very characteristics of strategically valuable resources, firms sometimes face severe problems in this replication process (Szulanski, Winter 2002, Dierickx, Cool 1989).

An equally challenging task for a new venture is to sustain its competitive advantage, even in the face of more established, resource-rich corporations going after the same target segment. When the new venture is a pioneer or an early mover in the market, one possibility is to erect barriers to market entry for potential new competitors. In a comprehensive literature study, Karakaya and Stahl identified 19 different market-entry barriers such as access to distribution channels, incumbent's cost advantages or customer switching costs (Karakaya, Stahl 1989). However, the consideration of pioneering advantages has to be complemented by consideration of a laggard's disadvantages and careful analysis of a new venture's ability for erecting entry barriers or overcoming them. Narasimhan and Zhang (2000) observe that new ventures often race into a market only to avoid the disadvantages of entering late, rather than being able to capture pioneering advantages.

Another factor influencing the sustainability of competitive advantage is environmental turbulence. In order to sustain its advantage a new venture should continuously devote energy to staying competitive and foster its dynamic capabilities: „The term 'dynamic' refers to the capacity to renew competences so as to achieve congruence with the changing business environment (…). The term 'capabilities' emphasizes the key role of strategic management in appropriately adapting, integrating, and reconfiguring internal and external organizational skills, resources, and functional competences to match the requirements of a changing environment." (Teece, Pisano, Shuen 1997, p.515).

As firms progress through the various stages of development, more and more knowledge and experience is gathered on internal operations and on the environment, reducing the initial uncertainty and allowing the firm to refine its initial strategy.

At the *operational level*, tasks such as business intelligence or networking are important throughout all three stages of development, while for instance presentations at venture capital firms, market tests as well as the management of customer relationships gain importance with the gradual evolution of the new venture and the successful completion of certain milestones such as market entry. Due to environmental uncertainty operational management can be very turbulent at times (Macdonald 1985).

Looking at the overview in figure 1, it can easily be concluded that entrepreneurs need to manage a new venture with much anticipation. Especially in firms that need to rush to market in order to capture first mover advantages, the duration of these stages is compressed (Greiner 1972/1998), posing further challenges to the founders. For instance, with new employees joining the rapidly growing firm on a daily basis, fostering a strong culture and common vision is a major challenge at the normative level (Gruber, Harhoff 2002). Developing a market entry strategy and engaging in supportive strategic alliances within a short time frame are critical challenges at the strategic level of a high growth venture. When looking more closely at the scope and complexity of these tasks, it is evident that the time for setting up a successful new venture cannot be shortened arbitrarily.

From a managerial perspective it should also be considered that normative, strategic and operational tasks complement each other. Entrepreneurs who neglect certain tasks will have problems in establishing a successful company. Thus, normative, strategic as well as operational tasks should be addressed in a well-orchestrated manner, making it necessary to manage "hard factors" as well as "soft factors" simultaneously (Gruber, Harhoff 2002). Contemplating these challenging tasks, it is not surprising that venture capitalists typically attribute higher importance to the quality of the management team than to the quality of the venture idea. In this respect it is also not surprising that many new ventures fail, as the high failure rates cited earlier in the paper indicate.

Conclusion

This paper studied the organizational transformation of new ventures on their way to viable entities. We applied a novel perspective for entrepreneurship research by distinguishing a normative, strategic and operational dimension of new venture management. This perspective has already proven to be of value for understanding larger corporations as well as small and medium sized enterprises in a comprehensive and integrative way. In addition, it allows for conceptualizing transformation processes in firms (Bleicher 1999). We therefore believe that it can principally serve as a very fruitful approach for studying a wide range of phenomena in entrepreneurship in a comprehensive as well as integrative fashion. By additionally distinguishing several stages of new venture development, we are also able to adhere to the common understanding that entrepreneurship entails a process.

As we have seen in the preceding discussion, there are distinct challenges an entrepreneurial team has to master in order to establish the emerging firm as a viable entity. While some are quite obvious tasks of new venture management (e.g., the process of developing and launching an offering), others in many cases are not on the top of minds of entrepreneurs (e.g., fostering a beneficial company culture), yet are likely to have a profound impact on the overall ability to succeed in the marketplace and to establish the firm as a viable economic actor. Besides its research implications, the presented framework therefore can have quite practical applications, e.g., in teaching a comprehensive understanding of the entrepreneurial process.

References

Aldrich, H., Auster, E.: Even dwarfs started small: liabilities of age and size and their strategic implications, in: Cummings, L., Staw, B. (Eds.): *Research in Organizational Behaviour.* San Francisco, 1986, pp.165–198.

Anderson, C., Zeithaml, C.A.: Stage of product life cycle, business strategy, and business performance, in: *Academy of Management Journal.* 1984, pp. 5–24.

Amit, R., Schoemaker, P.J.H.: Strategic assets and organizational rent, in: *Strategic Management Journal.* 1993, pp. 33–46.

Birch, D.: *Job creation in America.* New York 1987.

Bleicher, K.: *Das Konzept integriertes Management.* 5. Auflage, Frankfurt/Main 1999.

Bowman, E.H.: Epistemology, corporate strategy and academe, in: *Sloan Management Review.* 1974, pp. 35–50.

Brüderl, J., Schüssler, R.: Organizational Mortality: the Liabilities of Newness and Adolescence, in: *Administrative Science Quarterly.* 1990, pp. 530–547.

Bygrave, W.D.: The Entrepreneurial Process, in: Bygrave, W. D. (Ed.): *The Portable MBA in Entrepreneurship.* New York et al. 1997, pp. 1–26.

Churchill, N.C., Lewis, V.L.: The five stages of small business growth, in: *Harvard Business Review.* May–June 1983, pp. 30–50.

Cooper, A.C., Bruno, A.V.: Success Among High-Technology Firms, in: *Business Horizons.* 1977, pp. 16–22.

Cooper, R.G., Kleinschmidt, E.J.: New products: What separates winners from losers?, in: *Journal of Product Innovation Management.* 1987, pp. 169–184.

Cooper, R.G., Kleinschmidt, E.J.: Major new products: What distinguishes the winners in the chemical industry? in: *Journal of Product Innovation Management.* 1993, pp. 90–111.

Dierickx, I., Cool, K.: Asset stock accumulation and sustainability of competitive advantage, in: *Management Science.* 1989, pp. 1504–1511.

Faltin, G., Ripsas, S., Zimmer, J. (Hrsg.): *Entrepreneurship – Wie aus Ideen Unternehmen werden.* München 1998.

Freeman, J., Carroll, G.R., Hannan, M.T.: The Liability of Newness: Age Dependence in Organizational Death Rates, in: *American Sociological Review.* 1983, pp. 692–710.

Füglistaller, U.: *Tertiarisierung und Dienstleistungskompetenz in schweizerischen Klein- und Mittelunternehmen (KMU).* St.Gallen 2001.

Garnsey, E.: *A theory of the early growth of the firm, Industrial and Corporate Change.* 1998 pp. 523–556.

Greiner, L.: Evolution and Revolution as Organizations Grow, in: *Harvard Business Review.* March–April 1972, pp. 37–46 (also: *HBR.* May–June 1998, pp. 55–66).

Gruber, M.: *Der Wandel von Erfolgsfaktoren mittelständischer Unternehmen.* Wiesbaden 2000.

Gruber, M.: *Toward an integrative framework of marketing in new ventures.* Working paper ODEON Center for Entrepreneurship, Ludwig-Maximilians-Universität, München, 2002.

Gruber, M., Harhoff, D.: Generierung und nachhaltige Sicherung komparativer Wettbewerbsvorteile, in: Hommel, U., Knecht, T. (Hrsg.): *Wertorientiertes Start-up Management.* Stuttgart 2002 (in press).

Karakaya, F., Stahl, M.J.: Barriers to entry and market entry decisions in consumer and industrial goods markets, in: *Journal of Marketing.* No. 2, 1989, pp. 80–91.

Kirzner, I.: *Competition and Entrepreneurship.* Chicago 1973.

Knight, F.H.: *Risk, Uncertainty and Profit.* Chicago 1921 (Reprint 1971).

Li, H.: How does new venture strategy matter in the environment-performance relationship?, in: *Journal of High Technology Management Research.* 2002, pp. 183–204.

Macdonald, R.J.: Strategic Alternatives in Emerging Industries, in: *Journal of Product Innovation Management.* 1985, pp. 158–169.

McGrath, R.G.: *Options and the entrepreneur: Toward a strategic theory of entrepreneurial behaviour.* Working Paper Columbia University, New York 1996.

Narasimhan, C., Zhang, J.Z.: Market entry strategy under firm heterogeneity and asymmetric payoffs, in: *Marketing Science.* No. 4, 2000, pp. 313–327.

Narver, J.C., Slater, S.F.: The effect of a market orientation on business profitability, in: *Journal of Marketing.* No. 4, 1990, pp. 20–35.

O'Farrell, P., Hitchens, D.: Alternative theories of small firm growth: a critical review, in: *Environment and Planning.* 1988, pp. 1365–1383.

Penrose, E.: *The theory of the growth of the firm.* London 1959.

Peters, T.J., Waterman, R.H.: *Auf der Suche nach Spitzenleistungen: Was man von den bestgeführten US-Unternehmen lernen kann.* Landsberg/Lech 1983.

Pleitner, H.J.: Das Unternehmerbild aus unterschiedlichen Perspektiven der Gründung, in: Mugler, J., Schmidt, K.-H. (Hrsg.): *Klein- und Mittelunternehmen in einer dynamischen Wirtschaft: Ausgewählte Schriften von Hans Jobst Pleitner.* Berlin 1995, pp. 90–99.

Quinn, R.E., Cameron, K.: Organizational life cycles and shifting criteria of effectiveness: Some preliminary evidence, in: *Management Science.* 1983, pp. 33–51.

Raffa, M., Zollo, G.: Marketing strategies of small innovative software companies, in: Hills, G.E., Muzyka, D.F., Omura, G.S., Knight, G.A. (Eds.): *Research at the Marketing/Entrepreneurship Interface* – Proceedings of the UIC Symposium on Marketing and Entrepreneurship, Chicago 1995, pp. 205–225.

Ricardo, D.: *Principles of political economy and taxation.* London 1817.

Roberts, E.B.: Strategic transformation and the success of high-technology companies, *International Journal of Technology Management.* 1991, pp. 59–80.

Romanelli, E.: Environments and Strategies of Organization Start-up: Effects on Early Survival, in: *Administrative Science Quarterly.* 1989, pp. 369–387.

Schoonhoven, C.B., Eisenhardt, K.M., Lyman, K.: Speeding products to markets: waiting time to first product introductions in new firms, in: *Administrative Science Quarterly.* 1990, pp.177–207.

Schumpeter, J.A.: Der Unternehmer in der Volkswirtschaft von heute, in: Harms, B. (Hrsg.): *Strukturwandlungen der deutschen Volkswirtschaft (I).* Berlin 1929, pp.303–326.

Schwaninger, M.: *Managementsysteme.* Frankfurt/Main 1994.

Small Business Administration: *The state of small business: A report of the president.* Washington D.C. 1983.

Stinchcombe, A.L.: Social structure and organizations, in: March, J.G. (Ed.), *Handbook of Organizations.* Chicago 1965, pp. 153–193.

Szulanski, G., Winter, S.: Getting it right the second time, in: *Harvard Business Review.* January 2002, pp. 62–69.

Teece, D.J., Pisano, G., Shuen, A.: Dynamic capabilities and strategic management, in: *Strategic Management Journal.* 1997, pp. 509–533.

Timmons, J.A.: *New Venture Creation – entrepreneurship for the 21st Century.* New York 1999.

Tushman, M.L., Anderson, P.: Technological discontinuities and organizational environments, in: *Administrative Science Quarterly.* 1986, pp. 439–465.

Ulrich, H., Krieg, W.: *St. Galler Management-Modell.* Bern 1974.

Williams, J.R.: How sustainable is your competitive advantage? in: *California Management Review.* Spring 1992, pp. 29–51.

Zirger, B.J., Maidique, M.A.: A Model of New Product Development: An Empirical Test, in: *Management Science.* 1990, pp. 867–883.