Modeling the effects of new venture strategy on the environment

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ABSTRACT

The resurgence of new venture creations and failures has led practioners and researchers to identify the factors that impact new venture performance. One major research stream in the strategic management literature suggests that new venture strategic decisions are critical to their success. Research on new venture strategies has experienced limited success and beckons the call for more substantive studies. Given the recent rise of technology ventures in transitional economies it represents an opportunity to examine the new venture strategy impact on the environment-performance relationship. The model presented in this paper is designed with the transitional economies in mind as the backdrop for testing the model. The paper is a response to a call to further exploratory research in new venture strategies and their performance implications. A model framing the environment, new venture strategy and performance is offered. Propositions describing the relationships of the variables in the model are developed. Finally, conclusions and implications for future research are discussed.

Keywords: venture strategy, performance, venture environment

INTRODUCTION

The recent surgence of new venture creations and failures has led practioners and researchers to identify the factors that impact new venture performance. New ventures are often identified as newly established firms or those with less than seven years of existence. One major research stream in the strategic management literature suggests that new venture strategic decisions are critical to their success. The new venture must determine the manner they align their strengths and weaknesses with the opportunities and threats in the task environment representative of the specific industry where their venture conducts business. Some researchers have discovered that new ventures that enter the marketplace with aggressive marketing strategies and broad targeted markets are more successful than those with narrow target markets (Miller and Camp, 1985; Tsai, MacMillan and Low, 1991).

New ventures tend to have limited resources and a lack of legitimacy compared to the large more established firms who have been in existence for a longer term. Stinchcombe (1965) characterized new ventures as a 'liability of newness' with a high propensity to fail because of their limited resource capabilities. Others have noted that new ventures are highly dependent on environments for resources critical to their success (Eisenhardt and Schoonhoven, 1990; Pfeffer and Salancik, 1978). However, it is also obvious that new ventures have capabilities that are niche specific possessing speed and flexibility to exploit certain industry opportunities more readily than large, established firms (Dean, Brown, and Bamford, 1998). The Internet has been filled with new ventures exploiting niches that large firms deem unprofitable or time consuming. Regardless, the strategies new ventures adopt to manage and influence their environments will impact the overall performance of the firm.

The literature has offered two primary competing perspectives on the environment and strategies firms choose to adopt. The two perspectives are environmental determinism and environmental management. The environmental determinism supporters tend to view the environment as a deterministic influence and firms make strategic choices by adapting to opportunities and threats in the environment (Hannan and Freemand, 1977; Scherer, 1980). Porter (1980) points out that innovative and differentiation strategies are often found in dynamic and uncertain environments. Similarly, industrial organization and population ecology researchers claim that environmental determinism conditions influence a firm's strategic choices (Scherer, 1980; Hannan and Freeman, 1977).

In contrast, environmental management researchers suggest that firms' craft and implement strategies to best manage their environments for critical resources and gain a competitive advantage (Clark, Varadarajan and Pride, 1994; Zeithaml and Zeithaml, 1984). Lenz (1981) points out that as firms' craft strategies specific to customers that prove successful competitors will often imitate them as a retaliatory strategy and thereby changing market competition within the industry. Although there has been past research on the environment-strategy-performance relationship, there has been limited research examining the impact of new venture strategy on the environment and how it affects venture performance. More specifically examining new venture strategy as a moderator variable.

Research on new venture strategies has experienced limited success and beckons the call for more substantive studies. Failures of new ventures are often linked to their limited resources or ability to attract the needed resources. Peng and Heath (1996) point out that the problem is more prevalent for new ventures in transitional economies than in market economies. They suggest that new ventures in transitional economies like Russia, China, and Brazil are more constrained by limited technical, managerial and marketing capabilities than those in market economies like the U.S. Bruton and Rubanik (1997) suggest new research in the context of new ventures in transitional economies is an opportunity to advance new venture theory. The model presented in this paper is designed with the transitional economies in mind as the backdrop for testing the model.

The paper is a response to a call to further exploratory research in new venture strategies and their performance implications (Carter, et. al., 1994; McDougall and Robinson, 1990). A brief literature review on environments and new venture strategies will be developed. A model framing the environment, new venture strategy and performance is next offered. Propositions describing the relationships of the variables in the model are presented. Finally, conclusions and implications for future research are discussed.

LITERATURE BACKGROUND

As previously noted firms depend on resources and information from their environments critical to their success. New ventures face many potential hazards in terms of limited resources, lack of environmental knowledge, industry data, vendor support, and customer preferences. Because new ventures have limited or no performance records their potential for success is also limited. Thus, environments have a major impact on new venture performance. New ventures tend to examine their environments in terms of opportunities and threats. Dutton and Jackson (1987) identify opportunities and threats as two strategic categories confronting firms. These two categories seem especially critical for new ventures because of their limited track records.

ENVIRONMENT-OPPORTUNITY

Prior research suggests that the environment plays a critical role in shaping the resource opportunities of new ventures (Eisenhardt and Schoonhoven, 1990). Gartner (1985) points out that the creation and exploitation of the environment by a new venture is pursuing an opportunity. The creation and exploitation of the environment depends on new ventures assessing market discrepancies or niches and then pursuing the essential resources to leverage the opportunities (Savitt, 1998).

Industry growth has been identified as a key element of market attractiveness. Generally the more attractive the industry growth then the more likely new ventures enter the industry and grow. Porter (1980) suggests that new ventures entering high growth industries will provoke less response or retaliatory strategies from incumbent firms and have more potential for succeeding. Miller and Camp (1985) even suggest that new venture entrepreneurs seek high growth markets to minimize the effects of competitive pressures. Chandler and Hanks (1994) found that market attractiveness is positively related to new venture growth.

Pfeffer and Salancik (1978) point out that industry growth also indicates environmental munificence. Environmental munificence represents the extent critical resources required by new ventures are available in the environment. New ventures are more likely to obtain critical resources in high growth industries than they could otherwise in low growth industries. The opportunity for growth minimizes some of the competitive pressures. Research shows that venture capitalists prefer to invest in new ventures in high growth industries (MacMillan, Siegel and Narasimha, 1985; Sandberg, 1986). Other researchers point out that high growth industries do have some limitations. Many firms may be entering the industry simultaneously thereby diminishing the luster for venture capitalists and the success for new ventures (McDougall et. al., 1994; Tsai et. al., 1991). Regardless industry growth represents an important environmental dimension that typifies an opportunity for new ventures.

ENVIRONMENT-THREAT

Threats represent the second environmental dimension critical for new ventures. Stinchcombe (1965) referred to special difficulties that new ventures face in acquiring critical resources as ‘liabilities of newness’. Liabilities of newness pose threats to new venture success if they are not managed well. Threats come in many different forms to new ventures. For example, new technology ventures often require substantial financial resources in the early stages while developing their technology. The ‘cash burn’ rate or rate that cash is spent will often exceed their revenues. In fact, there may be no revenues for extended periods imposing questions of firm survivability. Technologies that are rapidly changing in industries may bring unanticipated consequences that derail the new venture and its potential for success (Tushman and Rosenkopf, 1992). Also, because new ventures often lack industry and environmental knowledge as well as not having strong relationships with customers and suppliers their legitimacy is weakened (Stinchcombe, 1965). Consequently, new ventures are in a risky and vulnerable market position. They are susceptible to many threats from multiple stakeholders that threaten the new venture’s performance. A key challenge for new ventures is to minimize these threats and position their firm for success in the marketplace. These conditions are often described as environmental hostility by researchers (Covin and Slevin, 1989; Tsai et. al., 1991). Thus, environmental hostility is one way of examining the industry and stakeholder threats confronting the new venture viability and performance.

NEW VENTURE STRATEGY

New venture strategies have been described and examined by researchers in various ways (Eisenhardt and Schoonhoven, 1990; McDougall and Robinson, 1990; Romanelli, 1989). Some researchers use product innovation as a means of examining new venture strategy (Chandler and Hanks, 1994; Eisenhardt and Schoonhoven, 1990). They define product innovation as the degree new ventures develop and introduce new products and services into the marketplace. Zahra and Covin (1993) measured product innovation by new product development, rate of change of products, and speed and variations in new products developed. The product innovation strategy reflects a venture’s proactive approach to entering the industry and minimizing competitive pressures.

Market differentiation is another dimension of examining new venture strategy. Market differentiation refers to the extent a firm pursues a strategy based on unique venture attributes matched to the market opportunities (Miller, 1987). Unique marketing efforts extend to personal networks that the entrepreneur brings to the marketplace that distinguishes or improves the venture performance (Ostgaard and Birley, 1994).

Market breadth is a third dimension of examining new venture strategy. Market breadth refers to the scope of the market that new ventures are attempting to capture or serve. McDougall and Robinson (1990) measured breadth by the variety of customers, geographic range, and the number of products offered. They suggest that providing a broad range of products to a large customer base is an important component of new venture strategy. McCann (1991) lends further support by suggesting that market breadth is an important variable for inclusion in any new venture research.

Finally, marketing alliance is another dimension for identifying new venture strategy. Bucklin and Sengupta (1993) refer to marketing alliance as the lateral working relationship between a venture and its competitors in one or more aspects of marketing. They measure marketing alliance by the new venture's emphasis on marketing complementary products, designing and manufacturing of new products, introducing new products, promoting new products, providing support services and pricing collaboration with other firms. Their study demonstrates the importance of marketing alliances and how those alliances allow a new venture to manage critical resources or lack of them in changing markets. Other researchers suggest marketing alliances enable new ventures to obtain concrete and abstract resources that improve the venture's market position (Eisenhardt and Schoonhoven, 1996). The concrete resources include specific skills and finances to manage the venture while abstract resources include firm legitimacy and market acceptance.

These four dimensions represent the conceptualization of the new venture strategy to be included in the model. They represent the fundamental strategic choices for new ventures in a variety of environmental settings. They also have prominence in the strategic management literature that fits equally well in the new venture field of study. The four dimensions should be equally useful in examining new venture strategy in transitional economies.

PROPOSED MODEL

Figure 1 (Appendix) contains the proposed model that offers a framework for examining the role of new venture strategy in the relationship between its environment and venture performance. The primary dimensions of the environment are industry growth and environmental hostility. The model integrates the environmental determinism and environmental management perspectives as a means of examining how entrepreneurs adapt to their environments and be proactive to exploit opportunities available. It is proposed that environmental determinism will play a mediating role for new venture strategy while environmental management perspective will play a moderating role for new venture strategy. In the model industry growth hostility is representative of the environmental determinism perspective while environmental hostility represents the environmental management perspective.

The environmental determinism perspective assumes that new venture strategy takes an adaptive response to the environment. More importantly it will mediate the impact of the environment on the new venture performance. Assuming there are niche opportunities in the environment affordable to viable ventures then the new venture will need to adapt certain strategies to transform these opportunities into achievable performance. Having the right venture attributes matched with the industry opportunity will enhance the venture's acceptance in the marketplace. Tsai et. al. (1991) noted the mediating impact that new venture strategies may have on performance. They state that new venture strategies will mediate a positive impact for return on investment of environmental munificence in terms of product life cycle. Contrastingly, the new venture strategies will mediate a negative impact on market share of environmental hostility. They concluded that environment and strategy separately affect new venture performance.

The environmental management perspective offers an alternative view about the impact of new venture strategy on the environment affecting venture performance. A hostile environment may have adverse effects on the new venture and give cause for developing different strategies to cope. New venture strategies will seek options and risk minimizing alternatives to absorb uncertainties in the environment that may adversely impact the new venture's performance. New venture strategies are developed that proactively reduce the negative impacts and enhance the positive elements of the environment. Thus, the environmental perspective suggests that new venture strategies play a moderating role in the environment that affects venture performance.

PROPOSITIONS

Based on the literature background several propositions are offered that address the different roles of new venture strategy in the environment affecting venture performance. The propositions are developed focusing on the transitional economies as the backdrop for testing the model.

1. There is a positive relationship between environmental determinism and performance when new venture strategy is a mediating variable in transitional economies.
2. There is a positive relationship between environmental management and performance when new venture strategy is a moderating variable in transitional economies.
3. There is a positive relationship between industry growth and venture performance when mediated by new venture strategies.
4. Product innovation will positively mediate the relationship between industry growth and venture performance.
    a. The higher the degree of product innovation the more positive the relationship between industry growth and venture performance.
    b. The lower the degree of product innovation the less positive the relationship between industry growth and venture performance.
5. Market differentiation strategy will positively mediate the relationship between industry growth and venture performance.
    a. The higher the degree of market differentiation the more positive the relationship between industry growth and venture performance
    b. The lower the degree of market differentiation the less positive the relationship between industry growth and venture performance.
6. Market breadth strategy will positively mediate the relationship between industry growth and venture performance.
    a. The higher the degree of market breadth the more positive the relationship between industry growth and venture performance.
    b. The lower the degree of market breadth the less positive the relationship between industry growth and venture performance.
7. Market alliance strategy will positively mediate the relationship between industry and venture performance.
    a. The higher the degree of market alliance the more positive the relationship between industry growth and venture performance.
    b. The lower the degree of market breadth the less positive the relationship between industry growth and venture performance.

8. The negative relationship between environmental hostility and venture performance will be mediated by new venture strategies in transitional economies.
9. Product innovation will moderate the negative relationship between environmental hostility and venture performance.
    a. The higher the degree of product innovation the weaker the relationship between environmental hostility and venture performance.
10. Market differentiation will moderate the negative relationship between environmental hostility and venture performance.
    a. The higher the degree of market differentiation the weaker the relationship between environmental hostility and venture performance.
11. Market breadth will moderate the negative relationship between environmental hostility and venture performance.
    a. The higher the degree of market breadth the weaker the relationship between environmental hostility and venture performance.
12. Market alliance will moderate the negative relationship between environmental hostility and venture performance.
    a. The higher the degree of market breadth the weaker the relationship between environmental hostility and venture performance.

The propositions developed reflect the possible relationships and their impact for examining the role of new venture strategy in the context of the environment. The new venture strategy is treated as a means of mediating or moderating the environment for best performance by the new venture.

CONCLUSION AND FUTURE RESEARCH IMPLICATIONS

The model proposed offers a framework for examining the role of new venture strategy and its relationship with the environment. More specifically, the mediating and moderating roles of new venture strategies that interact with environments to impact venture performance are examined. The mediating role of new venture strategy is developed in the context of industry growth as one environment that new venture strategy can mediate. It is further suggested that product innovation, market differentiation, market breadth and market alliance strategies mediate a positive effect on new venture performance in an environment with industry growth. McDougall et. al. (1994) suggest that aggressive venture strategies are necessary to achieve better venture performance in a rapidly growing industry.

However, new venture strategy can also play a moderating role in the context of environmental hostility. The model suggests that when new venture strategies are emphasized and are the strongest then the negative impact of environmental hostility on new venture performance is weaker than otherwise can be expected. Romanelli’s (1989) study reaffirms the proposition that new ventures with aggressive strategies are more likely to improve or enhance their survivability in a hostile environment.

The literature is replete with research suggesting how industry and market conditions lead new ventures to adopt different strategies for best performance (Carter, et. al. 1994). The literature is not firm on how these strategies deal with environments to best manage them or the best matches for success. The model proposed offers a framework to consider and test new venture strategies that deal with environments to impact venture performance. By examining the environment from two different perspectives new venture strategies are offered to generate the best venture performance. Each of the two perspectives shapes the way firms deal with environments. In one case, new ventures adapt to their environments as their entrepreneurs assess and respond to the environment or industry conditions. In the other case, new ventures have the capacity to enact their environments or industry and can be more proactive in managing their environments.

The proposed model is an attempt to advance new venture theory. Primarily, the model suggests that the two environmental perspectives be integrated to better understand the impact of new venture strategies on performance. In addition, the model suggests there are more ideal matches of new venture strategies with the environment that may lead to the best venture performance. The model offers a framework for testing these matches and their relationships among the new venture strategies and different environmental perspectives.

Transitional economies offer an ideal setting for testing the model because of their underdeveloped institutional frameworks. Transitional economies have been ignored in past research and offer a rich environment for testing new venture theory. Further, new technology is being developed in the transitional economies that provide industries representative of industry growth and potential. Finally, the richness of transitional economies offers researchers an opportunity to examine new venture activity in an environment other than market based economies where so much research has been conducted in the past.

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Figure 1