Journal of Business Research 69 (2016) 4815–4819

Contents lists available at ScienceDirect

Journal of Business Research

Influence of subjective interpretation, causation, and effectuation on initial venture sale☆

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ARTICLE INFO

Article history:
Received 1 February 2016
Received in revised form 1 March 2016
Accepted 1 April 2016
Available online 20 May 2016

Keywords:
Entrepreneurship
Start-up
Decision marking
Strategic approach

ABSTRACT

This study investigates the influence of subjective interpretations of strategy-relevant cues, specifically, perceived control/uncontrol and perceived gain/loss, on the relationship between causation or effectuation approach and the likelihood of initial venture sales. The results support the greater likelihood of initial sales when the entrepreneur increasingly relies on causation (albeit at low to medium levels) and has a greater perception of control. Similarly, perceived gains (instead of losses) strengthen the positive relationship between effectuation and initial sales. These results extend previous research on influence of the perceptions of control/uncontrol and gain/loss by supporting the influence of such subjective interpretations for strategic decision making. Furthermore, this study responds to recent calls for research on the different interpretations of the same environmental conditions and the resulting consequences for entrepreneurs.

1. Introduction

Few studies to date have examined the influence of differences in subjective strategic interpretations of environmental conditions on venture performance (Krueger, 2000; McMullen & Shepherd, 2006). Larger and older firms generally rely on established information-processing processes, whereas among entrepreneurs in the same industry, interpretations of the environment may differ according to their beliefs, knowledge, or previous experience, which then provide different frameworks for such interpretations (Dutton & Jackson, 1987). Top management team (TMT) studies have researched how such interpretations trigger and sustain belief structures, as well as facilitate sense-making processes, involved in validating the relationship between environmental interpretation and reality (Sims & Gioia, 1986). This perspective may be particularly relevant to understanding the strategic decision-making approach that entrepreneurs use at venture founding to realize early sales.

Strategic issue theory states that even when exposed to the same industry conditions, individuals often construct radically different beliefs regarding how potential trends and events will influence a company's strategic situation (Daft & Weick, 1984). Specifically, this study integrates Daft and Weick's theory regarding differences in subjective interpretations when making strategic decisions with Sarasvathy's (2001a) framework of causation and effectuation strategic approach. In this integration, this study focuses on the moderating role of two major strategic interpretations: strategic environment as either leading to 1) gain/loss or 2) being controllable/uncontrollable (Dutton & Jackson, 1987). Causation strategy is part of planning, which promotes entrepreneurs to better understand the value of a possibility when they have relevant knowledge, whereas effectuation logic highlights that entrepreneurs and stakeholders create and exploit unanticipated opportunities (Sarasvathy, 2001a). Thus, subjective interpretations, in turn, will provide direction toward a set of boundaries for how influential causation and effectuation are in leading to initial sales.

In the past, researchers have heavily debated the use and influence of causation or effectuation for entrepreneurs establishing new ventures (Dew, Sarasvathy, Read, & Wiltbank, 2009b; Sarasvathy, 2001a). According to Sarasvathy (1998), causation and effectuation can be considered the two foundational approaches that entrepreneurs use to make decisions in establishing a venture. The present study examines in what way an entrepreneur's subjective interpretation (control/uncontrol or gain-loss) of strategically relevant cues in the venture environment influence the likelihood of applying causation or effectuation to influence initial venture sales. Seemingly, no prior study has focused on how differences in founders' subjective strategic interpretations influence the effects of distinct strategy approaches in decision making. Building on recent studies of causation and effectuation, scholars have just begun to "determine the circumstances under which each approach

☆ The authors thank Assistant Professor Rana Mostaghel, Linnaeus University, and Assistant Professor, David Rönnberg Sjödin, Luleå University of Technology, for their careful reading and suggestions on revising this essay.

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http://dx.doi.org/10.1016/j.jbusres.2016.04.036
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is more appropriate for a particular individual" (Chandler, DeTienne, McKelvie, & Mumford, 2011, p. 376).

Growing evidence supports that reaching the initial sale is a challenging process because not even half of founders who register a venture succeed (Reynolds, 2007). Venture capitalists refer to this early stage as "death valley" because few ventures are able to generate initial revenue. In the formation stage of a venture, entrepreneurs have historically followed the advice of relying on causation strategic approach. However, many believe that this approach is unrealistic because entrepreneurs need to regularly act outside their predetermined plans (Fisher, 2012; Sarasvathy, 2001a). Entrepreneurs may benefit from applying effectuation strategic approach when they decide to start a venture by relying on experimentation and a step-by-step approach to change course as they move ahead (Chandler et al., 2011; Kalinic, Sarasvathy, & Forza, 2014; Sarasvathy & Kotha, 2001). Despite these discussions, scholars have yet to empirically examine whether causation or effectuation strategic approach is more effective for initial venture sales success. This is an important contribution to entrepreneurship literature (Fayolle & Liñán, 2014) because considerable research suggests that the success of a venture depends on initial actions and an understanding of whether the environment is control/uncontrol or presents an opportunity for gains/losses (Marion, Eddleston, Friar, & Deeds, 2015; Reynolds & Miller, 1992).

2. Theory and hypotheses

2.1. Role of subjective interpretation in strategic decision making

Entrepreneurs often take strategic actions in response to a subjective interpretation of an uncertain and complex environment. According to Dutton and Jackson (1987), individuals give meaning to ambiguous situations by categorizing them using strategic issue labels. The labels then serve as an address for a cognitive category. Such category-consistent information is easier to recall, and when individuals have incomplete information about situations or events, category-consistent information can fill these gaps. Categorization using strategic labels is useful in situations, such as new ventures, where information may have multiple and conflicting meanings. The interpretation of this information shapes the strategic response to the environment.

The present study posits that strategic issues research is of particular relevance for entrepreneurship because entrepreneurs typically face extensive ambiguity and uncertainty (i.e. reflected in incomplete and equivocal information) in pursuing their operations and tend to rely on cognitive biases and heuristics when interpreting their external environment (Alvarez & Busenitz, 2001). From such a perspective, categorizing situations provides a heuristic (a cue) that entrepreneurs can use to simplify information. Entrepreneurs tend to compare stimuli with prototypes that are idealized representations of the most typical member of a category and thus represent attributes with high cue validity (Baron, 2006).

Dutton and Jackson note that decision makers at the highest levels tend to interpret ambiguous environments as either opportunities or threats. According to this research, attributes with high cue validity for issues categorized as opportunities are "gains" and "controllable." Similarly, attributes with high cue validity for issues categorized as threats are "losses" and "uncontrollable." Interpreting the external environment as being controllable/uncontrollable and as gains/losses is relevant to how entrepreneurs execute and act using causation and effectuation logic. Controllable situations increase confidence in strategic actions, and greater perceptions of discretion in managing resources or resolving strategic actions. Conversely, uncontrollable situations relate to perceptions of less control of one's actions and greater perceptions of strategic challenges (Jackson & Dutton, 1988). An issue labeled as a potential gain has an association with more risk-averse actions than one labeled as a potential loss (Chattopadhyay, Glick, & Huber, 2001). The argument claims that individuals subjectively value avoiding losses more than experiencing gains. In other words, people risk more to avoid a loss of a particular amount than they risk to gain the same amount (Dutton & Jackson, 1987).

The following section integrates the theories on strategic interpretations with entrepreneurial strategic approaches, that is, causation and effectuation. The premise is that certain strategic interpretations work better with certain entrepreneurial decision making to increase the likelihood of initial sales. An entrepreneur's perception of control/uncontrol moderates the relationship between causation and the likelihood of venture success. Similarly, the extent to which an entrepreneur labels an environment as representing gain/loss moderates the relationship between effectuation and the likelihood of venture success.

2.2. Perceived gain moderates the influence of effectuation on initial venture sales

Effectuation highlights that entrepreneurs and stakeholders create and exploit unanticipated opportunities (Dew, Read, Sarasvathy, & Wiltbank, 2011; Read, Song, & Smit, 2009a; Sarasvathy, 2001a). Effectuation supposes that neither demand nor supply exists and that both must be the result of entrepreneurial intervention in the marketplace (Dew, Read, Sarasvathy, & Wiltbank, 2009a; Sarasvathy, Dew, Read, & Wiltbank, 2003). Effectuation requires flexibility because conditions may suffer alterations owing to extensive uncertainty. In accordance with the principle of leveraging environmental contingencies, entrepreneurs using effectuation are also less likely to feel discouragement of the setbacks that unexpected contingencies cause (Read et al., 2009a; Wiltbank, Dew, Read, & Sarasvathy, 2006). Indeed, with effectuation, the success of a venture is endogenous to the entrepreneurs' actions and those of their stakeholders, rather than exogenous, relying on factors that require the perception of greater control through the lens of causation (Dew et al., 2009b; Sarasvathy, 1998). Building on the aforementioned arguments, this study suggests that the choice of effectuation approach increases the likelihood that an entrepreneur will achieve initial sales.

Entrepreneurs who are effectual thinkers begin by defining an affordable loss. Thereafter, they use their means and those of their key stakeholders to find creative ways to generate economic gains (Dew et al., 2009b; Sarasvathy, 2001a). This gain is contingent on their actions rather than on the environment. Entrepreneurs who follow effectuation principles are more likely to work effectively when they subjectively label the external environment as "an opportunity to gain" as opposed to "a potential to lose a great deal." As they focus on avoiding loss, these entrepreneurs can effectively mitigate downside risk (Dew et al., 2009a). Hence, they act on the principle that a potential loss should always be small in magnitude; thus, in the context of gain/loss perception, entrepreneurs perceive lower losses and higher gains—leading to the pursuit of creating and exploiting opportunities by perceiving higher gains. Furthermore, the effectual approach sometimes defines new ventures as experiments. Effectual entrepreneurs that perceive a situation as a potential gain might be better able to reject experiments with potential losses and choose the affordable ones (Chandler et al., 2011).

Drawing on insights in Krueger and Dickson (1994), this study poses that entrepreneurs that subjectively interpret a situation as a potential gain can leverage effectuation better than those who interpret the situation as a potential loss. Sarasvathy et al. (2003) highlight that effectuation presupposes that entrepreneurs have the required beliefs with regard to the tasks in starting a business and solving problems in the face of extensive environmental uncertainty and substantial ambiguity when bringing influential stakeholders on board. This idea implies that effectual entrepreneurs who interpret a situation as a potential gain are likely to leverage effectuation better in realizing favorable venture outcomes (Dew et al., 2009b; Read, Dew, Sarasvathy, & Song, 2009b). Following this reasoning, this study posits that entrepreneurs' propensity to interpret an environment as an opportunity for gain