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Value proposition evolution and the performance of internal corporate ventures☆

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ABSTRACT

The success of internal corporate ventures (ICVs) is contingent upon their ability to: (1) anticipate the bases on which their offerings appeal to their target markets, (2) adjust these value propositions as the venture develops, and (3) leverage their parent corporations' relevant knowledge stocks. Aimed at developing a deeper understanding of the process requirements of successful exploratory initiatives, we build and test a model of venture performance using data from 145 ICVs. We find that value proposition evolution is related to venture performance in a curvilinear manner. ICVs whose value propositions exhibit moderate evolution perform better than ICVs whose value propositions exhibit no evolution or extensive evolution. Furthermore, the value proposition evolution–performance relationship is moderated by the parent corporation's familiarity with the venture's target market.

1. Executive summary

Internal corporate ventures (ICVs) are new businesses that are founded and developed within a preexisting corporate structure. Substantial knowledge gaps exist regarding the effective management of exploratory vehicles, such as ICVs. Building on theories of organizational learning and the knowledge-based view (e.g., Cohen and Levinthal, 1990; Grant, 1996; Kogut and Zander, 1992), we explore the effect on venture performance of the extent to which the ICV's value proposition evolves over the course of the venture's development, and the effect the corporate parent's familiarity with the market targeted by the ICV has on this relationship. A venture's value proposition is the intended basis on which the ICV will appeal to its target market.

We develop a value proposition evolution model of ICV performance and test it on a sample of 145 ICVs nested within 72 parent corporations. We observe how the dynamics of *building* knowledge stocks among ventures targeting markets unfamiliar to their corporate parents and *leveraging* knowledge stocks among ventures targeting markets familiar to their corporate parents can influence the relationship between value proposition evolution and ICV performance. We theorize and find that the (curvilinear) relationship between value proposition evolution and venture performance is moderated by the extent to which the corporate parent is familiar with the market(s) targeted by the ICV. We demonstrate the relevance of an ICV's initial founding conditions to the specific shape of the adaptation–performance relationship, showing that initial market familiarity predicts both the extensiveness of venture value proposition evolution and how such evolution relates to ICV performance.

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Our study has three specific theoretical implications. First, consistent with an absorptive capacity view (Cohen and Levinthal, 1990), ICVs adapt their value propositions more successfully in markets familiar to their parents whereas ICVs targeting unfamiliar markets may simply need to experiment more in order to build a knowledge base. Thus, there may be a knowledge building-related dynamic inherent to the exploratory process which suggests that early lessons will not be as valuable as latter lessons that occur after a core knowledge base has been built. A second implication relates to the apparent diminishing returns to value proposition evolution under conditions of high market familiarity and the knowledge-leveraging challenges that seem to account for this effect. Our results suggest that an ICV's ability to learn after repeated or extensive value proposition miscalculations will diminish as a function of market familiarity. Thus, while knowledge acquisition success is contingent upon the presence of prior knowledge in similar knowledge domains, prior knowledge may hinder ICV managers' abilities to recognize why underperforming value propositions are not delivering expected venture performance. A final implication concerns the matter of how exploration and exploitation can interrelate across levels of analysis. We recognize that the knowledge gained through exploration becomes part of the knowledge stock that is exploited as the exploratory vehicle develops. More specifically, we observe that the increasing market familiarity gained as ICVs navigate their new business domains helps build the knowledge stock on which possible value proposition adjustments are made.

2. Introduction

Internal corporate ventures (ICVs) are exploratory initiatives that originate within a corporate structure and are intended from their inception as new businesses for the corporation (Burgelman, 1983; Sharma and Chrisman, 1999). Because ICVs are aimed at business domains that are, by definition, new to the corporation, they are necessarily exploratory vehicles, defined here as entities through which acts of new entry or new value creation are implemented and for which a paucity of contextual knowledge exists regarding the targeted operating domain. For highly exploratory vehicles, such as ICVs based on evolving technologies or those targeting new or emerging markets, the consequences of having scant contextual knowledge of the new operating domain can be quite severe from a management perspective. For example, the inherent novelty of ICVs can preclude parent corporations from accurately and fully anticipating the challenges that will be confronted as these entrepreneurial initiatives develop. Moreover, many of the assumptions on which ICVs are initially based will ultimately be proven incorrect (McGrath and MacMillan, 1995) and strategically important cause–effect relationships will often be unrecognized or poorly understood by venture managers at the time of the ICV's founding (Covin and Miles, 2007). Thus, the management of ICVs is a process fraught with uncertainty.

As noted by March (2006) and McGrath (2001), substantial knowledge gaps exist regarding the effective management of exploratory vehicles, such as ICVs. Much of the acknowledged knowledge void pertains to the relevance of initial knowledge stocks to subsequent learning and performance. Building on theories of organizational learning and the knowledge-based view (e.g., Cohen and Levinthal, 1990; Grant, 1996; Kogut and Zander, 1992), we explore the effect on venture performance of the extent to which the ICV's value proposition evolves over the course of the venture's development, and the effect of a particular knowledge stock – namely, the extent to which the corporate parent is familiar with the market targeted by the ICV – on this relationship. As defined in this research, a venture's value proposition is the intended basis on which the ICV will appeal to its target market. Value propositions represent “something offered by a party for consideration or acceptance by another party” (Gordijn and Akkermans, 2003: 114). A value proposition is developed after a review and analysis of the costs, benefits, and value that an organization can provide for its customers and other constituent groups, both internal and external to the organization (Barnes et al., 2009). For example, the Opera web browser appeals to its target market by describing itself as a “fast and free alternative web browser”. Its benefit (fast) and its cost (free) are readily apparent to customers and potential custumers, and they discern this as a value proposition. Similarly, Apple Computers promotes the value proposition of its iTunes software as an easy application on which to organize, experience, and share music and media across multiple devices.

The ability of businesses to identify and enact value propositions their target markets judged as desirable is widely regarded as a key to competitive success (Anderson et al., 1993; Lanning, 1998). All businesses have value propositions. As observed by Morris et al. (2005: 729), “There is no business without a defined value proposition, and the creation of value provides a justification for the business entity.” However, ICVs are challenged to identify and enact sound value propositions without the benefit of historical business operations that inform their choices. McGrath et al. (2006: 54) argued that exploratory ventures must “learn their way in” to new business domains. As such, value propositions will often evolve as ventures learn about both their businesses and markets. Given the exploratory nature of ICVs and the associated likelihood that key elements of venture strategy will change over time (Garvin and Levesque, 2006), relevant managerial concerns include knowing the extent to which, and under what circumstances, value proposition changes drive venture performance.

The current research develops a value proposition evolution model of ICV performance and tests our theoretical model on a sample of 145 ICVs nested within 72 parent corporations. We define value proposition evolution as the extent to which the intended basis on which the ICV will appeal to its target market changes over time. This research recognizes the role of the parent corporation's familiarity with the ICV's target market as a potential determinant of the success with which ICVs are able to adapt their value propositions. In particular, we observe how the dynamics of *building* knowledge stocks among ventures targeting markets unfamiliar to their corporate parents and *leveraging* knowledge stocks among ventures targeting markets familiar to their corporate parents can influence the relationship between value proposition evolution and ICV performance. Learning scholars have argued that organizational knowledge accumulates most efficiently in areas adjacent to existing knowledge structures (e.g., Cohen and Levinthal, 1990; Zahra and George, 2002). Complementing this observation, we theorize and find that the (curvilinear) relationship between value proposition