Journal of Business Research xxx (2012) xxx–xxx

Contents lists available at SciVerse ScienceDirect

Journal of Business Research

Founders' experiences for startups' fast break-even☆

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ARTICLE INFO

Article history:
Received 1 October 2010
Received in revised form 1 May 2011
Accepted 1 September 2011
Available online xxxx

Keywords:
Nascent entrepreneur
Organizational learning
Founders' experience
Startup growth
Knowledge management

ABSTRACT

While some previous studies have found that the role of founders' collective experiences is paramount in resolving problems inherent in startups, others have failed to substantiate this. This study claims that this incongruence is attributable to a failure to consider organizational processes in which founders' experiences translate into organizational assets through information distribution and interpretation. Using the data from the Panel Study of Entrepreneurial Dynamics, this study demonstrates that startups reach their break-even point faster when their founders have had work experience in the same industry, and that this effect becomes stronger when these firms commit more resources to information distribution and interpretation.

1. Introduction

The process of new venture growth has been a central research theme in the field of entrepreneurship (Aldrich, 1999; Brush, Manolova, & Edelman, 2008; Low & Abrahamson, 1997; Stearns & Hills, 1996). Because a majority of new startups are fated to fail (Kirchhoff, 1994), entrepreneurs, whether nascent or actual, need to invent strategies to overcome a number of challenges that they face. These include establishing the business environment, making legal arrangements, developing new organizational routines, and formulating business plans (Aldrich, 1999; Stinchcombe, 1965). Research has demonstrated the substantial impacts of initial organizational conditions, including the role of entrepreneurs' social skills (Baron & Markman, 2003) and startups' resource endowments (Davidsson & Honig, 2003; Ruef, Aldrich, & Carter, 2003), market opportunities, and environmental constraints (Low & Abrahamson, 1997). Because the tasks required for a successful startup are various and demanding and must be accomplished within a very short time frame (Brush, Greene, & Hart, 2001; Lichtenstein & Brush, 2001), to explore the mechanisms for alleviating the liabilities of newness is of particular importance from both the theoretical and practical perspectives.

Research has also indicated that founders' prior trial and error experience is a critical factor in accelerating the growth of startups because such knowledge represents rich, in-depth knowledge of successful launches and resolution of emerging problems (e.g., Beckman, Burton, & O'Reilly, 2007; Chandler, Honig, & Wiklund, 2005). This causal link has been substantiated in some studies, but not in others. For example, Jo and Lee (1996) find in their analysis of 48 new Korean startups that they are more profitable when the founders have business experience in related areas. However, Davidsson and Honig (2003) find that none of the managerial, work, and founding experiences have a significant influence on sales or profitability. In addition, Newbert (2005) also finds no effect of startup experience on revenues except in the limited samples in high-tech fields. Finally, Tornikoski and Newbert (2007) obtain mixed results. While founders' startup and managerial experiences cause significant negative and positive impacts on subsequent firm performance, respectively, their education levels and work experiences in the business sectors of their startups have no significant effect.

Because of the importance of unpacking mechanisms for successful processes of startup creation and launches, the inconsistency of findings in previous studies is lamentable and requires scholars' close attention to determine whether founders' prior experience is beneficial. The purpose of this study is to fill this gap by examining the conditions under which new startups can leverage the advantages of founders' experience to quickly reach the break-even point. This study argues that the vulnerability of positive links between prior experience and startup growth proposed in previous studies results from a restrictive assumption that founders' personal experiences automatically become organizational assets without systematic efforts.

☆ The authors thank the two anonymous reviewers and Akihiro Hashimoto, Seki Asano, and Shinichiro Watanabe in University of Tsukuba (Japan) for their excellent suggestions. A part of this research was supported by the Grants-in-Aid for Scientific Research, the Japanese Ministry of Education, Culture, Sports, Science and Technology (22530375).
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doi:10.1016/j.jbusres.2012.01.011

Given that organizations encode “inferences from history into routines that guide behavior” (Levitt & March, 1988: 320) and “make and update routines in response to experiences” (Schultz, 2002: 261), founders' personal knowledge should not be treated as equal to organizational knowledge of their firms, although the former certainly has a substantial impact on the latter. This study thus claims that founders' previous experience may be unproductive unless encoded into the organizational routines of startups and properly absorbed as organizational knowledge (Huber, 1991). This study therefore articulates the above-mentioned entanglement by drawing on insights from the literature on organizational learning and applying the concepts of information distribution and interpretation to the context of entrepreneurship. The results of the empirical analyses indicate that startups benefit most from founders' experience in the same industry when resources are allocated to sharing the experience with other members and collectively storing the experience as an organizational asset. This study contributes to literature on entrepreneurship and knowledge management by indicating the role of information distribution and interpretation activities in boosting the fast growth of startups subject to the liabilities of newness. One of the practical implications of this study is that through information distribution and interpretation, startups should selectively leverage specific types of founders' experience relevant to current contexts in which the firms are embedded.

2. Theory and hypotheses

The liabilities of newness suggest that new startups have a greater risk of failure for several reasons: the high cost of building ties with suppliers, establishing an organizational identity, determining the social roles of the organization, and formulating standard operating procedures and organizational routines (Stinchcombe, 1965). To save on the cost of routine development, new startups can rely on tried and trusted routines that founders have learned from earlier entrepreneurial and professional experiences. The expertise that startups need for rapid growth is in the areas of human resource management, operating procedure development, and gaining competitive advantage. Startups have no previous organization-level experience, but can benefit from the founders' earlier work experiences (i.e., pre-founding experience) or from what Huber (1991) terms congenital knowledge. The literature suggests three forms of pre-founding experience: (1) founders' previous experiences in launching startups, (2) job experience, and (3) experience in the same industry (West & Noel, 2009).

Startup experience increases with every firm launched and offers founders opportunities to acquire detailed knowledge of administrative procedures for registrations, corporate tax declarations, and social security. Dealing with such bureaucracies does not enhance startups' competitive advantage but is mandatory and requires significant time and effort from founders. Startup experiences thus help the firms to focus on strategic issues to alleviate the liabilities of newness, such as building supportive relationships with suppliers and distributors and formulating business strategies to gain competitive advantage (Lerner & Haber, 2001). In addition, research has demonstrated that founding experience yields advantages because founders, who learn by doing, develop ideas about business opportunities and enhance predictability of future technologies and customer demand (Helfat & Lieberman, 2002). Founders' previous job experience is also beneficial in accelerating the growth of startups (Flamholtz & Randle, 1990; Rubenson & Gupta, 1992). Job experience in particular functions such as marketing and finance facilitates experiential learning and develops their operational knowledge (Vesper, 1980). Furthermore, pre-founding knowledge can be easily transferred if founders have experience in business domains where new startups launch. This is because the significant overlaps in terms of regulations, norms, and standard practices reduce costs of search for adequate and legitimate actions.

Because the support for impacts of pre-founding experience on startup growth has been mixed, this study considers retesting of the causal links to be valuable and, in doing so, conceptualize organizational growth as the reach to break-even points. Break-even points, frequently used as an indicator of organizational health in literature on financial loans and initial public offerings (Timmons & Spinelli, 2003), refer to points where gains equal losses. Startup firms typically begin operations with no profit (Majurndar, 2010), so exceeding break-even points as a result of resource mobilization to boost revenues and enhance production efficiency is one of the critical milestones in the life of startups (Churchill & Lewis, 1983). The reach is not necessarily an ultimate objective of all startups but a tentative goal for most of the startups in the early stage of organizational growth (Scott & Bruce, 1987). Indeed, Lechner, Dowling, and Welpe (2006) used time-to-break-even as performance measures for new ventures.

H1a. A startup reaches the break-even point faster if the founders have more startup experience.

H1b. A startup reaches the break-even point faster if the founders have had more job experience.

H1c. A startup reaches the break-even point faster if the founders have had more experience in the same industry.

This study attributes the inconclusive findings in prior studies of links between previous experience and startup success to the assumption that personal knowledge is automatically transformed into an organizational asset without adequate organizational commitment to assimilate, share, and encode them as such (Huber, 1991). A founder's personal experience becomes a collective asset of an organization only when the experience is appropriately assimilated, encoded, distributed, and interpreted. Huber (1991) terms these processes information distribution and interpretation. The former refers to the process by which information from various sources is transmitted and shared among organizational members (Huber, 1991), while the latter is the process by which organizational members collectively encode and assimilate data to reach a shared understanding and develop a common store of knowledge (Daft & Weick, 1984).

Founders' previous experience is not assimilated unless the experience is transmitted through knowledge sharing opportunities. Such experiences can be either explicit and codified or implicit and shared only through direct interactions. Information distribution occurs when founders transmit their personal knowledge to solve problems, but this knowledge is not transformed into organizational routines unless all other members encode and assimilate the knowledge (i.e., information interpretation occurs). Because of their limited processing capabilities, founders do not transform all of their experiences into organizational assets but are selective in storing those that they believe to be relevant and valuable for the rapid growth of the startup. Their experiences are filtered in an efficient and timely manner through the processes of information distribution and interpretation. Because knowledge inherited from past entrepreneurial and professional activities may contain errors that are irrelevant to the current startup, the startup needs a process by which a founder's experience is distilled.

When information from multiple sources is inconsistent, the founders must supply missing data and resolve conflicts. Such information interpretation occurs when founders formulate formal routines to exchange experience-based knowledge or develop shared frames of reference through spillover of tacit knowledge. Without these activities, information transmitted by founders is difficult to assimilate and store as collective knowledge. Insights and lessons from founders' experience can be stored not only in formal manners (e.g., standard

Please cite this article as: Oe, A., & Mitsuhashi, H., Founders' experiences for startups' fast break-even, *Journal of Business Research* (2012), doi:10.1016/j.jbusres.2012.01.011