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How do new ventures grow? Firm capabilities, growth strategies and performance

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ABSTRACT

While new venture growth performance has been studied extensively, little work has been done to examine the complex strategic choices through which growth is pursued and attained. Building on the resource-based view and social capital perspective, this study develops a conceptual framework that links combinations of ventures' (1) technological, (2) financial, and (3) networking capabilities to different growth strategies in terms of organic growth, partnership, and acquisition. We further assess the mechanisms through which a new venture's growth choices affect firm performance. Using data from 238 new high-tech ventures in China, we find that new ventures with different resource combinations follow different growth strategies. While partnership growth leads to greater product diversity, and acquisition is more effective in realizing firm internationalization, both lead to a better chance of survival of new ventures. In addition, the study explicates the role of technological capability in moderating the relationship between growth strategies and new venture performance.

1. Introduction

New ventures are an engine for job creation, innovation, and regional development. Yet, it is commonly observed that new ventures exhibit a higher growth rate variance than established firms (Gilbert, McDougall, & Audretsch, 2006). Why do some new ventures grow more than others? Previous research has identified various predictors for new venture growth, such as entrepreneur characteristics, industry dynamics, organizational resources and structures (Baum, Locke, & Smith, 2001; Dean & Meyer, 1996). However, limited attention has been paid to the complex decision processes that produce different strategic choices for new venture growth (Gilbert et al., 2006). This gap in the literature is concerning, especially considering the multiple growth choices that confront new ventures. For example, young firms could focus on acquisition growth at an early stage or choose to pursue both organic (internal) and external growth. As different growth strategies may require different resources and have different performance implications, there is a compelling need to explore how entrepreneurs make strategic choices to achieve growth (Kor, Mahoney, & Michael, 2007).

One of the critical resource endowments for new venture growth is technological capability. Firms with technological strength are more easily accepted by the market through low cost (Covin, Slevin, & Heeley, 2000) or differentiated product offerings (Zahra, Sapienza, & Davidsson, 2006). However, technological capability alone is not sufficient to create a competitive advantage (Zahra & Bogner, 1999). New ventures need to combine their existing technologies with other complementary resources or capabilities to compete in the market (Danneels, 2007; Shelton, 2005). Therefore, a key premise of this study is that combinations of existing resources position new ventures on different developmental trajectories (Gilbert et al., 2006). We argue that a thoughtfully leveraged and carefully managed set of initial endowments that integrates technological capability, financial capital and networking capability can move a new venture far along the road to becoming an established firm. Specifically, technological capability shapes the basis of the growth strategies of new ventures, while the leveraging of technological capability through the use of financial capital and networking competencies further directs the way in which ventures grow.

This study also investigates the performance implications of different growth strategies. In general, growth contributes to a higher likelihood of survival because it helps new ventures to overcome liabilities of newness and smallness (Buederal, Preisendoerfer, & Ziegler, 1992). Yet, empirical results suggest that various growth strategies may influence performance differentially. External growth may have a stronger impact on product differentiation than organic growth, whereas the impact of organic growth is more constant but slower than that of external growth (Gilbert et al., 2006; Penrose, 1959). The lack of a systematic examination of the growth–performance linkage calls for a more fine-grained analysis of the processes and boundary conditions of new venture growth strategies.

Using data from 238 new high-tech ventures in China, this study aims to (1) explore how combinations of different capabilities drive the

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choices of growth strategies, (2) investigate the effects of different growth strategies on product diversity and internationalization, two important outcomes that eventually contribute to firm survival, and (3) assess the role of technological capability in moderating growth–performance linkages. Our focus on Chinese high-tech firms provides both theoretical and practical significance. Theoretically, the topic of new venture growth has been extensively studied in developed economies, but has received limited attention in transition economies (Bruton, Ahlstrom, & Obloj, 2008). Despite the critical role that technological capability plays in new venture growth, other critical factors, such as financial capital (Pissarides, 1999) and networks (Park & Luo, 2001), have yet to be explored in transition economies like China. Practically, as new high-tech ventures are booming in China, entrepreneurial managers must develop effective strategies to integrate their technological capabilities with appropriate resource bundles. The study thus contributes to both researchers and practitioners managing new venture growth in emerging economies.

2. Conceptual development and hypotheses

The choice of a growth strategy is a complex issue for new ventures because of the absence of certain resources (Penrose, 1959), environmental uncertainty (Ensley, Pearce, & Hmieleski, 2006) and the different perceptions of entrepreneurs (Acedo & Jones, 2007). Earlier studies focus on contextual influences, such as industry globalization, product/market life cycle stages, and government regulations, that affect new venture growth strategies and their different levels of success (Covin & Slevin, 1991). A growing body of research argues that the internal resources of the firm should be examined to explain firm strategies (Shelton, 2005). From the resource-based view, firms' tactical and strategic decisions are influenced by their specific resource endowments (Chandler & Hanks, 1994). The configuration of a new venture's resources and capabilities therefore enables the firm to efficiently and effectively pursue its growth objectives (Brush & Chaganti, 1999). In line with this resource-based view of firm growth, we construct our conceptual framework, which is displayed in Fig. 1.

Technological capability has long been regarded as the core competence for new ventures to gain market acceptance and achieve long-term competitive advantages. The possession of a strong technological capability enables ventures to achieve strategic growth through product breakthroughs (Zahra, 1996), opportunity discovery (Banbury & Mitchell, 1995), and new product introduction (Siegel, Siegel, & Macmillan, 1993). The role of technological capability has become even more important as high-tech industries are increasingly characterized by incessant innovations and intense competition.

Financial capital and networking capability also attract a lot of attention from researchers (Gemünden, Ritter, & Heydebreck, 1996; Shane & Stuart, 2002). These two capabilities help new ventures overcome resource deficiencies and enable them to undertake more ambitious growth strategies. Brush, Greene, and Hart (2001) describe financial capital as an instrumental resource valued primarily for the access it provides to other key resources required by new ventures. With sufficient financial support, new ventures can more effectively utilize their existing technological capabilities to continuously improve, upgrade, and develop advanced products and processes. An abundance of financial capital also allows them to acquire resources from outside to strengthen their existing knowledge pool, which provides the basis for sustainable competitive advantages (Barney, 1991; Shelton, 2005).

Networking capability refers to the capacity of new ventures to identify, establish, coordinate and develop relationships with different players in the market. Social capital theory places a great emphasis on interpersonal relations because these relations provide a focal person with access to external resources embedded in the relationship (Burt, 1997). When properly utilized, these interpersonal relations can become intangible resources of the firm because they are difficult-to-replicate and advantage-enhancing assets (Gu, Hung, & Tse, 2008). A firm's networking capability also helps generate new resource configurations as the firm can integrate its own resources with those obtained from the outside to respond to environmental changes (Gemünden et al., 1996).

We classify high-tech ventures into eight groups based on their positions with regard to the above three capabilities: (i) technological capability (high versus low), (ii) financial capital (large versus small), and (iii) networking capability (high versus low). Unlike previous research that focused on the relationships between resources or capabilities and levels of growth achieved, we explore how ventures pick from among different growth strategies based on their relative positions with regard to different capabilities. In particular, given the importance of technological capability in new venture growth, we first classify firms into two categories: technology-seeking and technology-leveraging. Firms with inferior technological capabilities seek technology while they pursue growth strategies, whereas firms with superior technological capabilities leverage their strong position to follow more proactive growth strategies.

Three categories of growth strategies emerge from the literature: organic growth, external growth through partnership and external growth through acquisition (Gilbert et al., 2006; Lu & Beamish, 2006). Organic growth originates internally and focuses on internal R&D and product development (McCann, 1991). New ventures that adopt this growth strategy mainly rely on their own resources to expand. Growth through partnership refers to growth through licensing technology from other firms or through partnerships with other firms (Rothaermel & Boeker, 2008). The third growth strategy, namely, growth through acquisition, refers to acquiring other companies in related or unrelated business areas. High-tech ventures can pursue one or more growth strategies depending on their capability combinations.

2.1. Growth strategies of technology-seeking ventures

Growth is a process of overcoming resource deficiencies resulting from the liabilities of newness and smallness (Shelton, 2005). Resource endowments of the firm constrain its strategic decision making. New ventures with different resource combinations will be set on different developmental trajectories (Shane & Stuart, 2002).

Because of their inferior technologies, ventures are less likely to grow internally and more likely to seek technology through external growth. If new ventures are low on all three capabilities, the lack of resources forces them to stay with current customers and puts them into an inferior competitive position (Shelton, 2005). Hence, these ventures are largely incapable of pursuing any growth strategy because of the lack of both an internal engine and an external platform or linkage.

However, growth is the route to survival, especially in the context of an emerging economy with intense competition (Bruton et al.,

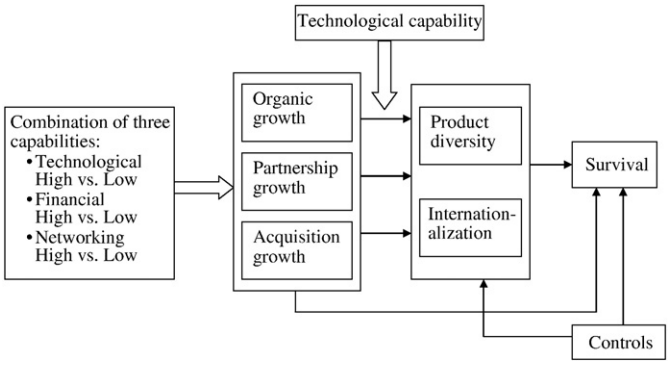

Fig. 1. Conceptual model.