

FAILURE TO LAUNCH: WHY AND WHEN SOME VENTURES LOSE THEIR WAY ON THE PATH TO SUCCESS

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Abstract

New ventures have an important role in economic growth. However, how these firms develop in the early stages, has not received adequate attention in the literature. This paper examines the launch trajectories of embryonic ventures. We propose a theoretical model of these trajectories based on the resources and processes required to establish a viable commercial entity. Potential launching paths are identified, from the inception of a new product/service idea through to success outcomes including rapid, independent sales growth, stabilized profit, acquisition or IPO. In our model, we argue that different resources and processes may affect a firm's ability to successfully complete one stage of development and move to the next, with important implications for the venture's long-term growth trajectory as well. The implications of this model are discussed.

Introduction

The importance of new ventures has been widely recognised due to their role in economic growth (Acs & Audretsch, 2003). However, how these firms develop in the early stages, especially before they become established and profitable, has not received adequate attention in the literature (Gartner & Carter, 2003). This paper examines the launch trajectories of embryonic ventures. We propose a theoretical model of these trajectories based on the resources and processes required to establish a viable commercial entity. Potential launching paths are identified, from the inception of a new product/service idea through to success outcomes including rapid, independent sales growth, stabilized profit, acquisition or IPO (Initial Public Offering).

Previous research such as work by Cooper and colleagues (e.g. Cooper, Dunkelberg & Woo, 1988; see also Baum, Locke & Smith, 2001) has enhanced our understanding of the factors associated with new venture performance. This research has focused on outcomes such as survival and growth of firms younger than seven years (e.g. Lyles, Saxton & Watson, 2004). Few attempts have been made, however, to recognize discrete episodes of development between idea formation and the seven-year time horizon, and to relate success factors to the specific stage of development that a new venture is going through. We argue that different resources and processes may affect a firm's ability to successfully complete one stage of development and move to the next, with important implications for the venture's long-term growth trajectory as well. Indeed, the definition of performance itself may vary in each of these stages of growth. By incorporating punctuated equilibrium (Gersick, 1991) explicitly into the model, we explore how bundles of resources are incorporated into the emergent venture in waves that allow for further development but limit flexibility and contribute to path dependence.

Our paper thus focuses on a process model of firm growth *from inception of the idea through the establishment of the viable enterprise and early growth*. The launching trajectories are divided into stages as new ventures bring together the critical components of ideas, people and funding. Part of our thesis is that firms progress through these development stages through co-evolution of the human, financial, and product components. Furthermore, different skills and combinations of tangible and intangible resources affect this progression. The individual founder may have a good idea and a credit card or second mortgage to fund early iterations of the venture; a founding team with a more fully developed plan and seed funding may require a different combination of assets. Our model of launching trajectories highlights when and how these critical components progress into a new stage for the venture.

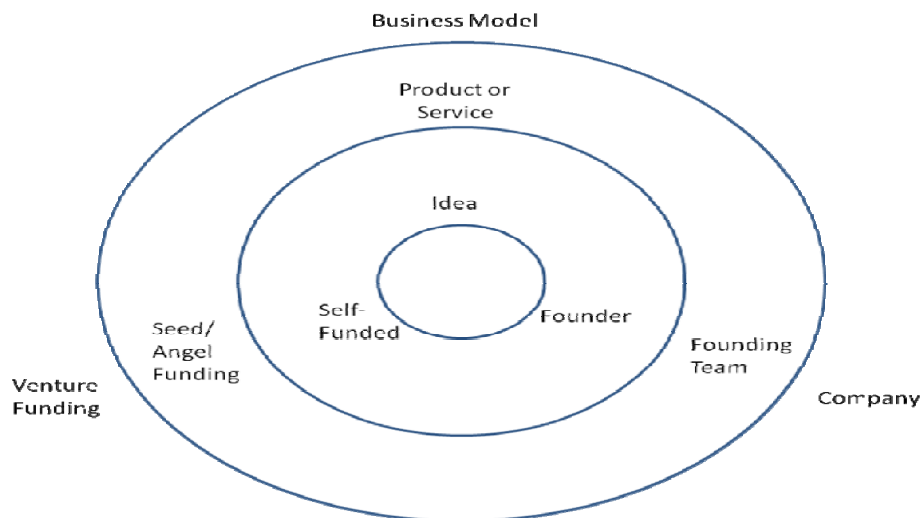
There are a variety of factors identified in different streams of the extant entrepreneurship research that can enhance or hinder a new venture's ability to migrate through the early stages of becoming a viable commercial entity. These factors can be categorized as founder/venture (internal) resources, network/external resources, and venture processes or characteristics that help convert external to internal resources. Our paper articulates these factors and develops a framework for positioning when and how these combinations of resources allows the firm to move through stages of development, and the subsequent impact on growth trajectories.

Scope: Embryonic ventures

Before discussing the theoretical background for the model, a prefatory note is in order regarding embryonic ventures as the focus of our paper. We are addressing here the de-novo independent venture; corporate ventures such as spin-offs may have some similar resource and evolutionary challenges, but face a different set of circumstances we do not address. Similarly, our model primarily applies to and is developed from research on and discussions with founders that aspire to grow their ventures rapidly; thus, "lifestyle" ventures are not the focus of our development.

An important element of our model is that these fledgling ventures progress through an evolutionary process during which three components of the venture grow simultaneously: the people involved, the product/service idea itself, and the money required to launch. The initial idea of one individual with limited associated funds typically progress to a founding team and more developed product or service concept and early stage or seed funding to move to launch. Finally, a business model or even fully articulated business plan and venture funding typically are required to launch the product as a company with employees and legal status. These concentric rings of growth are captured in Figure 1.

Figure 1: Concentric circles of venture development



Stylized Exemplars

Before delving into the theoretical background, we would like to set up three exemplars that represent different aspects of the evolution of the embryonic venture. The three prototypes are based on real ventures. The names and specifics of the situation have been slightly changed to protect the identity of the ventures and founders.

Exemplar 1: Aptus. The core idea for Aptus was developed by a consultant in the Outplacement service industry. He identified an opportunity created by the convergence of broadband internet access and digital video capture combined with high recruitment costs and inefficiencies in the typical face-to-face interview process. He connected with an IT (Information Technology) professional with entrepreneurial experience to further develop the idea. They brought an accountant and business consultant with experience in business development and strategic alliance formation to the founding team. Over two years the team invested \$50,000 of their own money, undertook significant market research, developed a business plan, and built a prototype kiosk as the key node in capturing digital video of job candidates. The embryonic company, named Aptus (for our purposes), would deploy a network of kiosks for video capture and incorporation of personal video into an electronic portfolio—kind of like Monster.com with more features. The kiosks would be initially be deployed regionally on a test market basis in partnership with a national copying and business service company.

Before deployment, the chain involved in the partnership was acquired and all business development activities put on hold. Without a launch site and partner, Aptus needed either a new partner or money to further develop the concept. While several potential angel investors liked the prototype and concept, none were willing to invest until “proof of concept” had been established by a sale to an actual customer (a company that would incorporate the electronic portfolio into its recruiting process). The IT member and original founder were unwilling to deploy a small number of kiosks on a test basis without further software development and a more robust system, which would require about \$100,000 and three to six months of work. In the absence of a beta site customer, sales experience from any team member, and through lack of funds, Aptus was put permanently on the back burner about four years after idea conception.

Exemplar 2: Buzzsaw. Buzzsaw was the brainchild of an IT guru with significant internet experience. He joined up with a consumer electronics product development engineer to develop a program to monitor web chatter including blogs and other internet resources to provide a sort of electronic clipping service for clients. From a modest original service of such electronic clippings, the team envisioned developing significant intellectual property around internet data collection, interpretation, and display to help clients interpret how “buzz” and internet chatter could be interpreted to predict changes in market position, reactions to ad campaigns, product defects, and other reputation enhancing or damaging events. The two co-founders sought significant outside guidance and feedback in the development of their plan. An information-based consulting service was discontinued based on advisor feedback that it distracted the founders and their clients from understanding the long-term focus of the embryonic venture.

Over two years and after multiple iterations, the prototype service was launched with 8 test clients (non-paying). Based on their feedback and positive reaction, the venture landed \$300,000 in angel funding and an additional \$200,000 in state SBIR-type grants. The influx of money is allowing the venture to expand its services considerably, develop new IP, and hire additional resources for product development and sales. While the company has certainly not reached high-growth or gazelle status, it is well on its way to having paying customers, enhanced product offerings, and full-time employees.

Exemplar 3: Cadence. Cadence was founded by a health care service provider with software experience in response to a specific hospital customer request. Specifically, the hospital wanted a better system for managing and monitoring the doctors’ appointments and calendars. While outside his typical job responsibilities, the founder decided to engineer a PDA (personal digital assistant) based solution coupling the device with new software to have a custom solution to the hospital’s request. He teamed up with a software developer as cofounder, and Cadence was launched.

After six months of debugging and development, Cadence was able to provide the hospital with a functional solution. The founder quickly became intrigued with the idea of marketing the system to more hospitals and health care settings. While he had a product and a paying client, he had never investigated the competition, researched the market, consulted with outside advisors, or developed a business plan. He is currently in the process of determining if he can adapt the developed system to a wider audience, continue to develop custom solutions for each client, or start from scratch with a different device/software configuration that will better serve a broader market.

These three vignettes emphasise the movement through the circles of venture development illustrated in Figure 1. It identifies several key themes that will be explored in the rest of the paper, namely: new ventures move through different stages of idea development, funding and business development; these stages take place in different combinations of these factors for different firms; and some ventures pass successfully through these stages while others fail. The emphasis of our analysis is which resources are critical at the different stages of the concentric rings of growth. The following literature review provides a backdrop for a theoretical model which attempts to explain this.

Theoretical Background

Our model of firm growth builds on several established theoretical streams of literature as well as empirical findings regarding new venture growth and performance. As mentioned, punctuated equilibrium serves as a backdrop for how ventures grow in episodes of accumulation of resources followed by longer periods of “digestion.” We also explore how the resource-based view relates to embryonic ventures. Finally, we introduce actor-network theory as a means to better understand the means founders employ to collect and configure resources, yet how those configurations can then constrain venture flexibility. Each of these streams is briefly summarized below.

Punctuated Equilibrium

Gersick (1991) perhaps best captures the theory of punctuated equilibrium and how it applies to organizations. Rather than a Darwinian model of evolution whereby organisms evolve through a slow gradual process over time, models of punctuated equilibrium propose that change occurs in revolutionary and often violent ways. These changes cause significant upheaval, but are then followed by longer periods of relative stability. Gersick notes that punctuated equilibrium or its equivalent is becoming a more common perspective for understanding change in individuals, groups, organizations, and institutions, as well as physical sciences and biological evolution. The different model begs several questions, including what trigger points lead to revolutionary change, how organisms survive this change, and what factors affect relative amounts of time in upheaval versus stability.

While some models of organizational change and development do acknowledge these issues (Gersick, 1994; Greiner, 1972; Tushman and Romanelli, 1985), punctuated equilibrium is relatively undeveloped in the context of the development of embryonic ventures. As the Buzzsaw example above suggests, evolving ventures progress through periods of idea development with relatively limited financial resources and a small founding team, to sudden influxes of capital which trigger changes in staffing and rapid progression of the business model. We therefore believe that this theoretical framework has much to offer our exploration of venture evolution.

Resource-Based View of the Firm

The resource-based view of the firm has a rich history and associated stream of research (Barney, 1986; Penrose, 1959). Fundamentally, this field of theory suggests that the main reasons for growth and competitive advantage can be attributed to the set of factors, called resources that exist within the firm (Penrose, 1959; Foss 1997; Barney, Wright and Ketchen, 2001). The resource-based view’s relationship with the literatures of both strategic management and entrepreneurship is well known (Alvarez and Busenitz, 2001; Barney, Wright and Ketchen, 2001). However, few authors consider how new resources are created, and combined with other resources to form the capabilities that will create economic value for

the new venture (Foss, 1997; Bromiley and Flemming, 2002).

One key point of difference in our approach to this process model of new firm growth is that we start with the premise that resources must be created by entrepreneurs. We argue that a resource-based view that does not account for the reconfiguring and creation of new resources is ultimately incompatible with a process theory that endeavours to explain the longitudinal patterns of success and failure in new ventures. To overcome these problems, we return to some of Penrose's original ideas on the dynamics of resources, and the formation of organisational components, that have largely been lost in the development of resource-based theory (Garnsey 1995; Garnsey, 2002; Gautam and Riitta, 2004; Baker and Nelson, 2005; Steen and Liesch, 2007).

Actor-Network Theory

One literature that can be used to conceptualize the strengthening of connections needed to create resources, and the relationship between resources and agents, is the part of science and technology studies (STS) known as actor-network theory (Law, 1992; Latour 2005). While this is a complex area of theory, we take two ideas that are compatible with our evolutionary approach to new ventures. The first of these is that entrepreneurs as agents are not analytically separable from the resources that they use (Steen, Coopmans and Whyte, 2006). This is important for understanding how the changing resource base will also change the opportunity set of the new venture. The other key idea is that connections between components that make resources can be strengthened to be made more durable, but also less reversible. An example of this is how an entrepreneur's idea to apply technology to an industry problem gets solidified into a network of business plans, partners and financial contracts, which may then get further solidified into hardwired resources of plant, product design and legal obligations to shareholders. Resource creation is therefore about the strengthening and lengthening of associations so that they can be held in place and counted as economically valuable resources (Law, 1992; Steen, Coopmans and Whyte, 2006; Steen, 2007). However, this process also enables and limits further opportunities.

New Venture Performance

The extant research on new venture performance incorporates a variety of models and a wealth of empirical evidence. A key research issue in entrepreneurship is to explain the performance differences between firms as well as what new ventures do in an attempt to improve performance (Kuratko, Ireland & Hornsby, 2001). The word 'performance' is used widely across management disciplines, yet the meaning is seldom defined and varies widely. Performance has been understood to mean effectiveness and efficiency, lean production competitiveness, cost reduction, value creation, growth, survival and job creation (Lebas & Euske, 2002). Lebas and Euske discuss various definitions of performance and then define it as "the sum of all processes that will lead managers to taking appropriate actions in the present that will create a performing [firm] in the future' in other words, 'doing today what will lead to measured value outcome tomorrow" (2002, p. 68).

As alluded to earlier, the definition of new venture performance may differ during the different stages of growth. Whereas entrepreneurial success in existing firms are generally measured against profit, market share, employee numbers or growth in these measures, embryonic firms often do not have sales income and use other measures of success. These can vary from proofing a concept, getting positive results on market research, attracting angel or venture capital, finding alliance partners, entering into sales agreements and making a first sale.

Theoretical Model

Baker and Nelson (2005), in a rare longitudinal study comparing the growth of numerous new ventures, draw upon theories of problem solving and taking advantage of transient opportunity to discuss new venture growth. They use the term *bricolage* (French for 'tinkering') to capture the way that entrepreneurs creatively use the resources at hand to achieve growth. While this *bricolage* process accounts well for the non-linear processes that create resource systems, we also take this a step further by recognising the

instability of these new venture resource systems. In other words, stability is the exception rather than the rule, and entrepreneurs must endeavor to hold the system in place, as well as expand into more advanced stages of venture creation. The strategies that entrepreneur use to ‘lock down’ these systems, while allowing enough flexibility for growth and adaptation, is vital to understand why some ventures succeed, and others fail. Conceptualizing growth as a process of bricolage and resource stabilization could also account for failure of regression models to explain new venture success as details in process may have enormous implications for the future of the venture as the feedback loop between learning, resource creation and opportunity recognition proceeds. Entrepreneurship is intrinsically related to the capacity for purposive agency and “the key to grasping the dynamic possibilities of human agency is to view it as composed of variable and changing orientations within the flow of time” (Emirbayer and Mische, 1998, p. 964).

As previously mentioned, following from Penrose (1959) we see new venture creation as a process of assembly and ‘engineering’ of resources that is underpinned by learning about these resources and external opportunities. Creating economically-valuable resources means arranging people, technologies, documents and capital into a stabilized “system” (Steen, Coopmans and Whyte, 2006). We agree with the suggestion from McKelvey (2004, p. 337) that “entrepreneurship is about order creation, rather than equilibrium.” Creating and recombining resources also changes the firm’s opportunity set, and this will further drive entrepreneurs to change the resource-base of the new venture (Steen and Liesch, 2007). Furthermore, because resources are available in uneven multiples, there will always be a mismatch between resources and opportunities, creating “...resource shortages and surpluses resulting from earlier activity” (Garnsey, 2002, p. 108). In reality, ventures accumulate resources in waves; each round of funding, for example, allows for accelerated product development and employment growth. Founders may celebrate the signing of a term sheet with angel investors bringing a relative wealth of money; this munificence, however, is quickly drained as prototypes are developed and first employees hired.

Our model incorporates three categories or “buckets” of resources: Internal, external and enablers. Internal resources are founder/venture resources including founder characteristics, top management team composition, initial funding levels and sources, and venture strategy. External resources include the business relationships and social networks the founder can draw on to launch, the advocate behaviors of members of the venture community, and the government, university, and other venture community support systems in place to help founders. Venture processes and characteristics that allow for transfer from external to internal resources include the extent to which the venture has a selling versus a marketing orientation, the stewardship orientation of the founder, and the new venture’s decision making processes. These variables will be referred to as *enablers*, as they enable the founder to use external resources to develop, configure and convert them to internal resources. One of these resources, namely enablers, includes one of the important concepts on which we focus in our model and is developed further next.

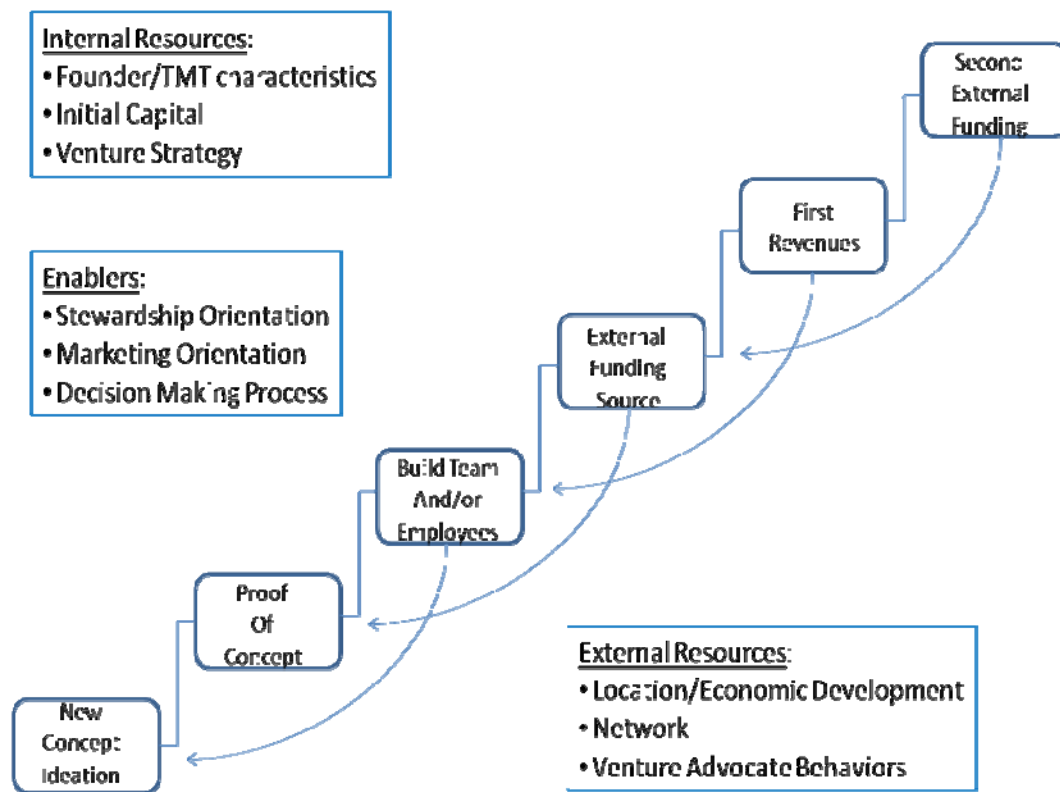
Marketing orientation

There has been much discussion in the marketing literature about how companies establish competitive advantage via specific orientations and strategies (Day 1990; Day & Wensley 1988; Houston 1986; Treacy & Wiersema 1993). Some have argued that firms should be marketing oriented such that they understand what customers need so well that their products sell themselves (Drucker 1973). Others recognize that firms can develop advantage through the use of several different orientations: selling, marketing, product/technology or even the production process itself (Houston 1986; Kotler & Keller 2007; Stevens et al 2006). A selling orientation is described as aggressively seeking out purchasers for an existing product, while a marketing orientation seeks to understand customers’ needs and then develop products that meet these needs. The first stresses finding the right customers for products. The latter finds the right products for its customers. The key difference in these orientations is the focus on the activities of the firm. A marketing orientation requires deeply analyzing markets, including both customers and competitors, and strategically developing products that fit a gap in the market where customers’ needs are unfulfilled and competitors are absent. A selling orientation, on the other hand, requires identifying potential product purchasers, and strategically developing a plan to stimulate their purchase interest in the firm’s offerings. In truth, most firms have some balance of these two orientations.

Kotler, Rackham and Krishnaswamy (2006) suggest that the relative importance of these two orientations changes over time as the firm gets bigger. Initially, the firm’s focus is on selling, primarily as a means of survival. Over time, the organization has more resources, adds marketing personnel who take on higher level functions and eventually transform the organization into a “marketing-led” company. We likewise suggest that embryonic ventures struggle to balance the need to be selling oriented with the need to be marketing oriented. Some firms, for example Cadence, get started by finding an initial customer for their offering. Later, they try to become more marketing oriented as they seek to get new customers. Others, like Aptus, spend so much time and energy in perfecting an offering to meet customers’ unmet needs that they struggle to actually sell their products to any customers. Like Kotler et al (2006), we suggest that embryonic firms must evolve their selling and marketing skills in order to grow. Initially, a selling orientation is more likely to lead to that first sale, a key developmental stage. But, they must become marketing oriented in order to grow sales and become a fully evolved venture.

The combination of above is captured in Figure 2, which juxtaposes the different categories with the progression of an embryonic venture from idea to launch.

Figure 2: Stages of Venture Evolution



Discussion and Implications for Future Research

As the high failure rate would indicate, fledgling ventures have a number of opportunities to fall off the path to launch. If the product idea and strategy is not well formulated prior to seeking funding, the venture will not launch for lack of financial resources. If the management team and funding are not in place prior to pitching customers, the emergent firm may not be able to deliver on promises--this may create market problems that are insurmountable in subsequent growth efforts. All of this creates a simultaneity problem: What resources are critical in these concentric rings of growth, and how should they most effectively be

assembled and employed? Subsequent empirical research must not only provide support for the elements of this model, but explore alternative paths and variables that help the embryonic venture get to launch.

In a review of the firm growth literature, Wiklund (1998) categorises studies according to their underlying theoretical assumptions and units of analysis (Davidsson and Wiklund, 2000). One of these groupings is identified as the *resource-based perspective* where the unit of analysis is the business activity or related set of business activities rather than the entrepreneur. The second of these groupings is labelled the *strategic adaptation perspective* that focuses on governance and ownership as the main unit of analysis and is based upon theories of agency and transactions-costs. This perspective downplays the importance of individuals. However, the *motivation perspective*, with its grounding in psychological studies, uses the individual as the unit of analysis to discover what business activities expand or do not as a result of the entrepreneur's orientation and motivation. These motivations also may affect the choice of governance structures. Davidsson and Wiklund (2000) classify these three perspectives as seeking factors that can explain the growth of firms. In other words, they search for antecedents of growth which is analysed as a dependent variable. Our model attempts to incorporate variables from each of these perspectives.

In contrast to these factor studies, the *configuration perspective* deals with the process of growth itself and the organisational changes that occur as a consequence. Managerial problems will appear and structures must be put in place to address these problems. This configuration perspective brings into light some important methodological issues for studying new venture development. If venture growth is indeed characterized by problem solving, improvisation and *bricolage*, then the details of events in the process matter because small changes can affect the future development of the business through the recursive interaction between opportunity recognition and business development (McKelvey, 2004; Chiasson and Saunders, 2005). In other words, as suggested by Van de Ven, (1992) the temporal sequence of events matters immensely, and this is not necessarily well captured in regression studies that ignore processes. This is reflected in the observation that the 'error term' in these regression studies which endeavour to explain new venture performance is in the vicinity of 70 - 80 per cent (Woo, Daellenbach and Nicholls-Nixon, 1994; Garnsey, Stam and Heffernan, 2006).

While a model of venture evolution must incorporate factors or variables that explain performance, they must also be structured in a way to capture processes and small differences that have large consequences. Any study of firm development necessitates the longitudinal examination of processes. This is true for the classic studies of growth within large firms that have been the platform for current understandings of business strategy (e.g. Chandler, 1962; Penrose, 1959; Chandler, 1990), but it is particularly true for the complex and idiosyncratic process of new venture creation and growth (Woo, Daellenbach and Nicholls-Nixon, 1994; Chiasson and Saunders, 2005, Garnsey, Stam and Heffernan, 2006).

Despite this axiom, truly longitudinal studies of new ventures are rare (Van de Ven and Engleman, 2004) even though several prominent authors have called for more entrepreneurship studies that focus on processes and events (Van de Ven, 1992; Shane and Venkataraman, 2000; Davidsson and Wiklund, 2001). In a review of the entrepreneurship literature, Chandler and Lyon (2001) examine 291 empirical research studies and found that only 19 of these were genuinely longitudinal in the sense that they involved the collection of data over time, including the retrospective use of archival sources. Furthermore, only eight of these longitudinal studies involved real-time observation of event-driven processes. We encourage further development in this stream use a combination of qualitative as well as longitudinal large sample or hybrid methodologies to further our understanding of these complex processes.

Our paper makes important contributions to both research and practice. For research, we take a more evolutionary, process-based view of the development of the new venture and shed light on the void between idea and successful launch often referred to as "Death Valley." In terms of practice, founders face overwhelming odds in attempting to launch a venture. By recognizing the appropriate focus of activity for stage-specific resource development, our work will help founders use limited time and money in the best way to move through stages of development and realize long-term objectives.

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