EVALUATING THE IMPACT OF “TOP MANAGEMENT TEAM” FOCUS ON LARGE COMPANY CORPORATE ENTREPRENEURSHIP

Stephen Spring and L. Murray Gillin
Australian Graduate School of Entrepreneurship, Swinburne University of Technology

CONTACT: Stephen Spring, AGSE Po Box 218, Hawthorn, Australia 3122, sspring@swin.edu.au

ABSTRACT

The field of corporate entrepreneurship has evolved in response to increasing competitive pressure on companies to innovate and regenerate in order to survive.

Corporate entrepreneurship research has focused on the processes involved and in particular how the behaviours of independent entrepreneurs can be adapted to the corporate environment.

The role of the top management team, which we define as the board/senior management team, in corporate entrepreneurship has largely been ignored.

We are exploring how the focus of the board/senior management team influences a company’s corporate entrepreneurship.

This paper summarizes theoretical underpinnings for our work and the observations made over the course of a series of pilot interviews involving non-executive directors at two large banks. We observed that the bank with a board that saw itself as entrepreneurial and innovative and comprised a majority former CEOs, followed an entrepreneurial strategy and enjoyed high but volatile long-term growth. In contrast, a second bank with a board that saw itself as operationally focused and was comprised primarily of functional experts, followed a strategy where it sought operational excellence and risk minimisation. The second bank’s performance was not as volatile as the first banks and produced lower returns over the long term.

The next stage of the project will seek to confirm and expand on these findings by increasing the size of the sample. It will also seek to expand the validity of the study by including companies from other industry sectors in the sample.

INTRODUCTION

Around 1730, Richard Cantillon (1959 p.74) was the first to describe the “entrepreneur,” as someone who accepts the risk associated with starting a new venture in anticipation of future returns. Since that time, other authors have broadened the role of the entrepreneur to include the innovation, securing of resources and execution required to start a new business and have recognised entrepreneurship as one of the main drivers of economic growth (Say 1855; Schumpeter 2000).
The need for business organizations, commonly described as firms, developed during the industrial revolution as the scale of production facilities grew beyond what individuals could finance via direct ownership (Mokyr 1999). Since that time, firms have grown in complexity and size, and have come to be dominant vehicle for large business ownership.

Large firms commonly rely on the capital markets to provide the funds required to finance their growth. These markets provide funds on expectation that their investments will generate income and capital gains. The cost of such funding reflects the risk associated with the proposed investment.

Over time, it has become clear that if firms do not innovate and regenerate, competitors will invade their markets, their revenues will shrink, and the returns to their shareholders will fall and possibly disappear (Foster and Kaplan 2001b). As a result, many firms are searching for ways to promote innovation and regeneration within a corporate environment. This search has led firms to explore how the tools and techniques used by start-up entrepreneurs can be applied to the corporate environment. The term Corporate Entrepreneurship (CE) is used in various ways to describe the adaptation of these tools and techniques for use in the corporate environment (Sharma and Chrisman 1999).

However, although it is recognised that innovation and regeneration is required for long-term survival, the reality is that while there are examples of religious and educational institutions that have survived for multiple centuries, there are very few examples of corporate institutions that have done so (Konz and Katz 1996).

The success of efforts by firms to innovate and regenerate has been mixed. While we can identify examples of firms that have enjoyed long-term corporate entrepreneurial success, we can also identify a large number of firms that have been unsuccessful in their efforts.

O’Reilly and Tushman observed “Most successful enterprises are adept at refining their current offerings, but they falter when it comes to pioneering radically new products and services. Kodak and Boeing are just two of the more recent examples of companies that failed to adapt to market changes” (O’Reilly III and Tushman 2004 p.74).

There is not a clear reason why corporate entrepreneurship is successful at some firms and unsuccessful at others. Many researchers have suggested the conditions required for CE to be successful. While they have established links between a range of conditions and success, their prescriptions are insufficient to ensure a high probability of such success. The absence of widespread corporate entrepreneurial success indicates that their understanding of the drivers of success is incomplete.

One area that has received little attention is how the actions of the top management team impacts CE. Whereas many authors have tended to limit its role (for example, to deciding who to trust as front-line corporate entrepreneurs (Pinchot 1985)), we are exploring whether their role may be more significant. This paper reports on the early progress of research that is exploring the role and impact of the top management team in corporate entrepreneurship.
Section 1 – Entrepreneurship

Richard Cantillon first described the concept of the entrepreneur in 1730 (Cantillon 1959). Cantillon referred to entrepreneurs as those who would undertake ventures with uncertain returns. He wrote as an economist and as such his focus was on how markets worked and the role of the entrepreneur within those markets. Cantillon’s entrepreneur is essentially an individual who works for uncertain returns.

Jean-Baptise Say (1855) described a broader role for the entrepreneur as someone would source the funds required to establish a new venture, and then manage and administer its establishment.

Joseph Schumpeter (2000) added that the entrepreneur has to innovate, and that this innovation was an essential part of a venture’s success. He wrote from the perspective an economist, that is, he recognised that the exploitation of new opportunities by entrepreneurs was a key driver of economic growth.

Academic interest in has grown over the past 25 years in part driven by change in the ruling economic-political ideology that took place with the coming to power in 1979-80 of Thatcher and Reagan – from Keynesianism to a radical pro-market ideology, and the combination of the deep concern with unemployment and the general insight that only the creation of new business can provide jobs on a sufficient scale in a society with a shrinking industrial labour force (Swedberg 2000).

Bruyat and Julien (2001) suggest this interest has led to an expansion of research that can be described as aiming to understand or forecast the entrepreneurial act and its success or failure, and to define more accurately the environmental conditions favourable to that act.

Section 2 – The Firm and its Management

While organizations have existed for thousands of years, the modern firm is a consequence of the scale of funds required for the large production facilities that became economically and technically viable with the advances of the industrial revolution (Mokyr 1999).

Up until the industrial revolution, organizations were formed, to allow groups of like-minded individuals (governments, trade guilds, religious orders) to formalise the basis of their common relationship. Individuals generally carried on business. They owned the assets required for production, and used profits to repay any loans they required to establish the business, and to fund any expansion of the business. If the scale of a business was too large for an individual to fund, it could generally still be funded by a partnership of individuals who could do so collectively.

English law did provide for the establishment of companies to raise equity funds at the start of the eighteenth century. While the most famous of these, the South Sea Company was successful at raising funds to pay for government concessions, the subsequent boom and crash in its share value led to laws being made that meant that an act of parliament was required before similar companies could be established (Mokyr 1999).
The development of powered machinery and the resulting advantages provided by large factories meant that a business’s need for capital often exceeded that which could be provided by a single or group of individuals. This demand for capital led to new laws for the establishment of companies and the birth of the modern firm.

The key to the success of the early firm appears to have been execution. Firms were unlikely to be competing with a comparable business for the same customers. Hence, their challenge was to meet unmet demand as opposed to raising capital.

The development of capital markets led to increased availability of funding for new opportunities, provided returns are promised that reflect the risk of the proposed investment. Management is then judged and rewarded by its ability to grow profits. If profits decline, shareholders suffer and management is likely to be penalised.

Over time these pressures have led to an increased pace of change and increased competitive pressure on the management of companies. Research published by Foster and Kaplan (2001a) observed that whereas companies that were on the Standard and Poor’s index of major US companies in the 1920s stayed there for an average of 65 years, by 1998, the average anticipated tenure of a company on the expanded S&P 500 was 10 years. Their research suggested that a majority of companies will under-perform the financial markets and less than a third are likely to survive 25 years in an economically important way.

Foster and Kaplan observed “the fundamental concepts of operational excellence are inappropriate for a firm seeking to evolve at the pace and scale of the markets.” The challenge for management is how to provide returns that exceed those earned by the market as a whole. They argue that “management philosophies and control processes based on the assumption of continuity only deaden corporations to the vital and constant need to embrace the forces of what Joseph Schumpeter called “creative destruction” and to change at the pace and scale of the capital markets” (Foster and Kaplan 2001a, p.41).

Section 3 – Corporate Entrepreneurship

The search for strategies to achieve innovation and regeneration has led firms to adopt the techniques used by independent entrepreneurs to achieve growth including innovation and risk taking to the corporate environment.

However, the established firm represents a very different environment to the start-up enterprise. Its culture, systems and controls are designed to ensure that ongoing operations are efficient and controlled as opposed to innovative and uncertain. Hence corporate entrepreneurship operates in a different environment to independent entrepreneurship.

Sharma and Chrisman (1999, p.18) provided a differentiation between independent entrepreneurship and corporate entrepreneurship thus:

Independent entrepreneurship is the process whereby an individual or group of individuals, acting independently of any association with an existing organization create a new organization.
Corporate entrepreneurship is the process whereby an individual or a group of individuals, in association with an existing organization, create a new organization or instigate renewal or innovation within that organization.

In the entrepreneurship literature, a range of behaviours leading to growth from innovation has been identified as corporate entrepreneurship. These can be classified into four schools (Birkinshaw 2003). Two schools focus on the organisational front line – the encouragement of individuals to act in an entrepreneurial way, described as Intrapreneurship by Pinchot (Pinchot 1985) and the managing of new businesses ventures as distinct units, commonly described as corporate venturing (Sykes and Block 1989). Intrapreneurship starts with the basic assumption that large firms put in place systems and structures that inhibit initiative, and that individuals have to be prepared to actively challenge those systems. Corporate venturing involves the establishment of a pluralistic management style to avoid the application of mature company practices to the management of new corporate ventures.

The other two schools require top management involvement. The first of these is identified by Birkinshaw (2003) as Entrepreneurial Transformation whereby a firm’s culture and systems are manipulated to induce employees to act in a more entrepreneurial way. The second Birkinshaw identified as Bringing the Market Inside whereby structural changes are made to encourage entrepreneurial behaviour and the development of an entrepreneurial culture.

While there is some clarity in the identification of these schools, there is less in the definition of the roles of the individuals associated with the various forms. We suggest that corporate entrepreneurs take one of four roles depending on whether they are front-line managers within a firm, managers of a stand-alone venture, middle managers or members of the top management team.

Corporate entrepreneurs who are frontline managers, within a corporate environment, have similar objectives to independent entrepreneurs, in that they seek to identify opportunities, secure resources and manage the establishment of a new business. These managers do this in a bureaucratic environment designed to optimise existing operations as opposed to an environment designed to foster entrepreneurship and innovation. In 1985, Gifford Pinchot labelled these managers ‘Intrapreneurs’ (Pinchot 1985).

Corporate venturing describes the establishment of a discrete structure that is designed to give its managers an operating environment similar to that enjoyed by an independent entrepreneur with the expectation that they will not be handicapped by the bureaucratic practices of a mature company while enjoying the advantages of a corporate parent (Sykes and Block 1989). In reality, the benefits of a corporate parent will only be enjoyed if close linkages are maintained. Such benefits will include access to corporate resources including skills, networks and funds. In reality, in many situations, the role of managing a corporate venture may be closer to that of the intrapreneur than that of the independent entrepreneur it seeks to replicate.

The role that the middle manager plays in facilitating corporate entrepreneurship has long been recognised as critical to the success of corporate entrepreneurship. In 1982, Rosabeth Moss Kanter observed
“Top leaders’ general directives to open a new market, improve quality, or cut costs mean nothing without efficient middle managers just below officer level able to design the systems, carry them out and redirect their staff’s activities accordingly. Furthermore, because middle managers have their fingers on the pulse of operations, they can also conceive, suggest and set in motion new ideas that top managers may not have thought of” (Kanter 1982 p.96).

Kuratko and Goldsby observed that

‘… middle managers create the social capital and trust needed to foster the corporate entrepreneurial process’ (Kuratko 2004 p.15).

The role of top management in facilitating corporate entrepreneurship is less clear. In simple terms, top management develops and commits to strategic objectives for the company, recruits key executives and provides direction. However, this is unlikely to be sufficient if top management wishes the company to be entrepreneurial and innovative.

**SECTION 4 – THE BOARD/SMT**

The structure of a firm’s top management team will vary from company to company as a consequence of many factors including its history, environment, culture and the people involved. Strategic decisions made by a firm’s team may be made by the chairman of the board, the board as a whole, sub-committees of the board, the chief executive or by committees of senior executives.

The decision maker for a specific decision maker, for example about whether to enter a new business, will vary from firm to firm. In some firms, (e.g. News Corp) the chairman appears to play a major role in such decisions. In others, (e.g. Amcor Limited) the chief executive appears to play the main role. In the United States, the same individual often occupies both roles. But as these are only external appearances, we may not know how specific decisions are made and who has been involved. We are conscious that firms approach different decisions, at different times in different ways.

While a member of the top management team, generally the chief executive, delivers a management decision, the recipients, middle managers and front-line employees, may not be aware who actually made the decision. In fact, who makes a decision may be irrelevant, as the focus of middle management and front line employees is likely to be on who delivers the message, and how that message is delivered,

The critical issue, from the perspective of this research, is how does top management focus affect the company as opposed to how are top management decisions made.

Accordingly, top management can be viewed as a “Black Box” comprising members of the board and senior management team that produces decisions that are relayed to middle management and front line employees.
SECTION 5 – MANAGEMENT OF CE

Ultimately it is the responsibility of the Board/SMT to make decisions about how a firm will be managed. These decisions, which may be specific or general, will influence the development of a firm’s culture and the behaviour of the members of the firm.

The Board/SMT may establish parameters or targets for the growth of the firm and is likely to approve a strategy for achieving that growth.

The Board/SMT may incorporate corporate entrepreneurship as part of its strategy. If so, it will take actions to encourage its incorporation. These actions will in turn depend on the specific school of entrepreneurship being followed.

• **Intrapreneurship** requires the fostering of an environment where individuals are encouraged to act entrepreneurially. Ideally, this will require that employees are confident that they are authorised to so, will see benefits following success and will not be punished for failures.

• **Corporate venturing** requires the establishment of ventures that reside outside the core bureaucracy with the independence required to operate entrepreneurially.

• **Entrepreneurial transformation** requires top management to manipulate the firm’s culture and systems to induce employees to act in a more entrepreneurial way.

• **Bringing the market inside** requires structural changes to encourage entrepreneurial behaviour and the development of an entrepreneurial culture.

In each case, the Board/SMT can either makes a decision to influence the extent of corporate entrepreneurship or can take a hands-off approach whereby the extent of corporate entrepreneurship will be determined by the historic culture of the firm.

While the literature relating to each of the schools of entrepreneurship presents examples of success enjoyed by firms following that prescription, the Foster and Kaplan’s analysis (2001b) shows that despite the existence of such prescriptions, the number of firms enjoying long term entrepreneurial success is small.

The aim of the current research is to explore the role of the Board/Senior Management Team in determining the success of a firm’s corporate entrepreneurship. It loosely seeks to replicate a McKinsey 1975 study (As cited by Trench and Stockpot 2001) of large mining companies that identified links between board leadership and management style and exploration success. In particular, the study observed that firms that answered yes to the following questions were more successful in exploration than those answering no.

• Does the board take a significant leadership in exploration rather than treat it as a ‘down-the-line’ technical function?

• Does the board develop and communicate a powerful and believable rationale for exploration?

• Do the board evidence strong commitment to exploration through spending patterns and organisational relationships?
• Are few, thoughtful targets set at board level for exploration outcomes?
• Does the exploration management team believe that ‘small’ organisational character is essential?
• Do exploration managers aid and abet the process of idea generation?
• Does the company assimilate new technologies quickly?
• Is the operation of the exploration team best described as ‘structured chaos’?
• Is technical risk-taking encouraged within a regime of tight scientific discipline?
• Does the exploration team abhor administration?
• Are projects managed in bite-sized pieces?
• Does the company take the view that good explorers are made rather than born?
• Is the exploration budget used as a means to create opportunity rather than as a control device?

While exploration is different in many ways to entrepreneurship, there are a number of similarities:

• Creativity and innovation is required to identify opportunities.
• Opportunities must be evaluated to determine value of exploration success.
• Exploration is risky and often leads to dry holes.
• Exploration is not managed in the same way as ongoing operations.
• Exploration is required to maintain and grow the business.

These similarities have led us to explore how the Board/Senior Management Team impacts corporate entrepreneurship.

**Methodology**

Grounded theory methodologies (Hindle 2004) are used to identify the relationship between board/senior management team focus and the corporate entrepreneurship of large publicly listed firms.

The researchers are initially focusing on the Australian banking sector. This sector has been chosen because the members of it are similar in term of scale, business focus, profitability and growth. As well, the researchers are able to arrange to interview members of the boards and the senior management teams of many companies in the sector.

Interviews will be arranged with chairman and three to four board members and/or senior managers at each participating company who are identified by their peers as being contributors to the company’s strategic thinking. This selection process is adopted as only a small sample can be interviewed at each company.
The interviews will follow a standard protocol that explores the extent of each company’s corporate entrepreneurship and innovation, and the nature of board/senior management team’s involvement in its management.

The content of these interviews will be analysed using computer assisted coding. This analysis will be used to develop theories about the linkages between board/senior management team focus and corporate entrepreneurship and innovation.

Results and Analysis

We have completed the first stage of interviewee recruitment and pilot interviews. As the number of interviews is small from a research perspective, our observations are preliminary and are shared on a ‘for discussion’ basis.

Recruitment

Our first interview of a multi-company director revealed a reluctance to discuss topics related to the actions and behaviour of a specific board without the approval of the chairman of that board. This finding led us to adopt a protocol whereby we first approach the chairman of a company, and then its present and former directors and senior managers.

We approached the chairmen of three of the five largest banks in Australia. These approaches led to the chairman of one bank and the former chairman of another being interviewed and ongoing discussions with a third.

We concluded each interview with a request for a recommendation as to who else we should interview. In each case, the interviewee was prepared to suggest other present and former directors, or senior managers who they considered would be willing to participate and who would make a ‘meaningful’ contribution. When we suggested possible candidates, their response ranged from positive to suggestions that particular directors would not make a useful contribution. Where possible, we will minimize the impact of this bias by interviewing directors and senior managers who can be accessed via alternate channels.

One chairman, who was reluctant to speak with us, was prepared to authorise our approaching a former chairman, who in turn was prepared to talk about the role of the board as it related to his tenure as chairman and to suggest interviews with directors and executives from that time.

We have conducted four pilot interviews with one non-executive, two former non-executive directors and one executive director. Two of the non-executive directors were or had been on the board of a major bank, one of the non-executive directors had been on the board of a second bank and the executive director was chief executive of a high growth company.

Observations – General

In the interviews we have examined the relationship between the cultures of the board and senior management group, and the extent of entrepreneurship at a bank.
While the two banks represented in the sample are similar in terms of business mix, scale and financial success, our research shows them to have very different cultures producing different levels of entrepreneurship as reflected by their long-term earnings growth and earnings volatility.

Observations – First Bank

The board of the first bank seeks incremental improvements through good management. The core values of the board reflect this objective, it believes that its shareholders are looking for solid performance and franked dividends and that this will be achieved by focusing on what the bank is good at.

The company has had earnings setbacks in its recent history that were the result of what the board believed to be poor management decisions. This has led to the board acting to reduce the possibility of future errors by improved risk management and tight corporate focus. Innovation and entrepreneurship are not believed to be important to the bank’s strategy. Rather the bank seeks to be a rapid follower of other bank’s technologies.

The board’s membership reflect its objectives, many of the members bring particular expertise and few have chief executive experience. The board is heavily involved in such decisions as the strategy for the replacement of the core IT systems,

Over time, the bank on occasions has experimented with more aggressive strategies, generally, in response to advances by its competitors. On these occasions, the underlying culture of the bank has hindered implementation of these strategies. This has led to a subsequent retreat from those strategies and a reconfirmation of the bank’s focus on its core business.

The board is conscious of the bank’s inherent culture and the skill of its management and the limitations that these imply to the adoption of a new strategy. The board is reluctant to introduce any strategy that requires cultural change

Observations – Second Bank

The board of the second bank considers itself to be aggressive in seeking innovation and entrepreneurship. The board’s financial objective is for the company’s earnings per share to grow at a rate comparable with companies at the upper end of the market. During the 90s, this implied an EPS growth rate of about 10% per annum. The board was conscious that this target would not be met by organic growth in its domestic market and would require entry into new products and markets.

The board and top management team is constantly looking for opportunities to grow the business.

The company has out-performed its peers over the long term. However, over some periods it has under-performed its peers as a result of unsuccessful initiatives. The board’s reaction to these periods of underperformance is to recognise mistakes and take appropriate action.

The second bank’s board is dominated by former CEOs who have successfully grown companies and have, as individuals, had experience across a range of industries. The board’s aim when recruiting CEOs is to employ experienced bankers with reputations for credit and risk management, and utilization of the bank’s capital base.
The board is conscious of the bank’s inherent culture and the skill of its management and the limitations that these imply to the adoption of a new strategy. The board is encouraging the recruitment and integration into the company’s executive ranks of new managers to increase the overall skill level of the management team and encourage the evolution of the bank’s culture.

Observations – Board/Senior Management Team Dynamics

One of the non-executives, and one of the executive directors described board experiences where the relationship between the board and the chief executive was not close, in that case the chief executive chose to minimise the involvement of the board. In this situation, the board was not involved in decision-making or strategy development. The response of one of the directors to this situation was to retire from that board when other demands necessitated a reduction in board memberships.

In contrast, the relationship between the board and the management team in both of the banks being discussed could be described as constructive.

Emerging Hypothesis

The pilot interviews have led to our development of the following hypotheses that will be further tested as the research progresses:

H1 – That boards have cultures that reflect the culture of the companies they govern.
H2 – That boards with entrepreneurial cultures are likely to govern entrepreneurial companies.
H3 – That board/SMT cultures evolve slowly in response to the environment in which the firm operates.
H4 – That boards on which a majority of members are former CEOs are likely to have a more entrepreneurial culture.
H5 – That boards with an entrepreneurial culture are more likely to seek to grow managerial skills and encourage cultural change than boards without an entrepreneurial culture.

Discussion

This paper presents the early stages of a research project, with the aim of receiving peer feedback as to the proposed approach to data collection and interpretation.

The work to date leads us to believe that we will be able to describe linkages between board culture and a company’s entrepreneurship. We have already found strong evidence for such a link, which we anticipate will be strengthened by further work.

We have not shown the basis for these linkages. Whereas, with an independent start-up, the values of the foundation board/senior management team will drive the development of the organisation’s corporate culture, this is not necessarily the case for an established organisation. While we have identified a situation where the board has set out to change the culture of the organisation, it is clearly conceivable that in some cases the culture of the board evolves to match the culture of the organisation.
We recognise that the research by its nature has several inherent limitations:

- We are seeking to develop general theory about social phenomenon that by their nature are inexact and will vary from population to population. While our initial work is focusing on a discreet population, we intend to test our findings more widely to determine their broader applicability.

- The research is based on a small sample. The selection of interviewees is largely driven by the scale of the study and our ability to access potential interviewees. Our strategy of using existing relationships to gain access to initial interviewees and then leveraging off those interviews to gain access to other interviewees has allowed us to enter what is essentially a closed community. We recognise the biases this recruitment strategy introduces.

- The research and the analysis is qualitative and will be influenced by the biases of the researcher and interviewees. While we have used a standard interview protocol to reduce this bias, our experience has been that interviewees, who are typically senior executives and community leaders, will seek to drive the course of the interview and will only loosely follow the standard protocol.

These theories will be tested by following the same process with the board/senior management teams of entrepreneurial companies in other segments.

**Conclusions**

Although our research is still in its pilot phase, we believe it shows, that with further work, we will be able to develop theories as to the basis of the relationship between the board/senior management team and a company’s corporate entrepreneurship.

Our pilot interviews suggest that there is a strong relationship and have provided the basis for additional research. Future interviews will allow us to test this relationship and strengthen our conclusions.

In particular, our work to date suggests that

- a strong relationship between the culture of a bank’s board/senior management team and a firm’s corporate entrepreneurship exists,

- a bank’s board/senior management team can have an entrepreneurial culture.

- a bank managed by board/senior management team with an entrepreneurial culture is more likely to be entrepreneurial, and

- these conclusions may be applicable to other sectors.

The next stage of our work will involve interviews with other members of bank board/senior management teams and, assuming that these interviews strengthen our findings, with members of board/senior management teams of firms in other industry segments.
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