Theoretical Legitimacy of 'Strategic Entrepreneurship': How does a firm engage in entrepreneurial exploration as well as strategic consolidation?

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Abstract

Theoretical legitimacy of 'strategic management' has not yet been established. This exploratory theoretical paper revisits the connection between entrepreneurship and strategy. Examining data of decisions in two firms across their initial years, one of which sold to a larger buyer and the other did not, this paper attempts to trace the firms' path in navigating the tension between entrepreneurial exploration necessary for initial growth on the one hand, and strategic direction, on the other, through building efficiency routines necessary for profitable exploitation. Preliminary results and implications are discussed.

Introduction

Strategy scholarship, Jerry Katz reminds us in prefacing Meyer and Heppard's (2000) book, is the parent of entrepreneurship as a field of study and that the child, having grown up, now informs the parent field. This exploratory theoretical paper revisits the relationship between entrepreneurship and strategy in order to understand the new field of 'strategic entrepreneurship' the legitimacy of which has been claimed but not yet established. To do so it examines empirical longitudinal data in two/three firms during their initial growth phase. It is pertinent that start-up and established businesses environments respectively contextualise the entrepreneurship and strategy literatures. Opportunity formation characterises entrepreneurial behaviour (Venkataraman, 1997) in the context of 'start-up' exploration, and dominant logic characterises strategic behaviour of firms (Prahalad & Bettis, 1986) in the context of exploiting efficiencies. How do the two meet in 'strategic entrepreneurship'?

The emphasis in strategic management literature of the need to retain entrepreneurial exploration aspects in large firms and in the entrepreneurship literature of developing strategic direction in entrepreneurial firms are important for firm growth (Hitt, Ireland, Camp, & Sexton, 2002; Ireland, Hitt, & Sirmon, 2003; Venkataraman & Sarasvathy, 2001). However, the change from an entrepreneurial character to a strategic character in the growth path of an entrepreneurial firm is yet to be properly understood. This paper argues that this change defines a chasm in a firm's development path, when the firm learns to engage in exploration and introduce routines of efficiency for profitable exploitation. This often may define and a fundamental 'DNA change' the firm may need to undergo as it learns this.

Theoretical considerations and proposition building

Successful entrepreneurial firms in their growth path, crossing over from being fleet-footed small entities to larger entities with established organisational routines, undergo a trade-off from opportunity seeking to advantage seeking behaviour (Ireland et al., 2003). During this phase a lessening of the entrepreneurial exploration propensities of the firm is to be expected as it routinises efficient processes that builds dominant logic of the firm but also erects blinders (Prahalad, 2004). This process demands a fundamental change in logic and script of the firm that has so far mainly been pursuing entrepreneurial exploration, and a firm has to learn to manage such crucial DNA change in its growth path and initial success. Often entrepreneurs sell out to large companies without attempting that cathartic DNA change. As the firm grows it has to bring in systems and processes that continually enhance efficiency, reduce waste of trial and error exploration action. In this respect it also needs to have the efficiency driven thinking in the TMT and perhaps even a change in the decision making structure or TMT structure. Managing this process is therefore critical learning for the firm, and understanding this cross-over point is of interest and perhaps critical for the validation of the field of strategic entrepreneurship. It is therefore proposed that:

> Proposition 1: A growing entrepreneurial firm will initiate and establish routines in its various functions that will build its dominant logic internally with the propensity to reduce effectual exploration.

With changes required in the operating ethos and the TMT thinking, this transition period for a growing entrepreneurial firm is expected to be a phase of discontinuity, and thus a period of difficult changes that would often accompany a change in decision maker composition of exploring effectuators and routine builders. However, an entrepreneurial firm has a small TMT with the entrepreneur as the greatest influence on the firm's initial decision making. A small management team of a growing entrepreneurial firm that is guided predominantly by the individual entrepreneur's decisions, would usually find it difficult to simultaneously direct effectual venturing and exploitation routines building dominant logic. Therefore, during early phase, the entrepreneurial firm will alternate between the two different logics. However, success during the growth phase of an entrepreneurial firm which is dependent on the simultaneous pursuit of exploration and exploitation or effectual experimentation and routinisation of efficient processes. Thus, it is proposed as follows.

> Proposition 2: The management of growth phase efficiencies and the longer term success of the firm will depend upon how a firm can synchronise its pursuit of the two logics, ie, effectual action in an exploration logic, and routinisation engendering dominant logic.

The above propositions require longitudinal data of firms through their growth phase transition and may show how firms reconcile the fundamentally necessary but opposing aspects of growth, ie, adventurous entrepreneurial exploration and best-practice driven efficiency routinisation.

In a small firm, particularly at start-up, the variations in cash flow turn out to be a large percentage of the funds in business and hence impact the firm's operations dramatically, and therefore the pain points for a small firm are most reflected by its cash flow situation, as convincingly demonstrated by Welsh and White (1981). Therefore, the cash flow (rather than profits) crisis points in a start-up firm's initial years of limited resources should reveal a pressure on it to focus on routinisation rather than on exploration. Tracking the firm's focus on the two demands of routinisation and exploration and relating them to cash flow crisis points should reveal the dynamic process of balancing between the two where routinisation processes undertaken to achieve desired cash flows can support the exploration needed for the firm to ensure uniqueness in its market offerings or bring new offerings to market.

Methodology

An exploratory longitudinal study is being undertaken in a technology firm where the effectual exploration events and the routine establishment events are identified and examined. The results are expected to enhance understanding of how a firm manages the opposing logic of routinising for efficiency while keeping its exploration ethos alive during growth. Events over three years are tracked to examine the firm expending resources in process efficiencies while effectuating new opportunities.

Case selection

A technology based firm was selected for this exploratory study. The firm was set up over 1995 to 2002. The entrepreneur left his salaried job taking a partner in 1995, and counts the start-up phase to have extended to 2002 when they got their first large client. In the interim the firm underwent a major change in their strategy, deciding to start product development, alternating between development that and their more routinized consulting, and charting their growth path through a bootstrapped and rocky period of over seven years. The firm started with consulting in data warehousing, and in the next three years started product development. While their own data warehousing product did not represent disruptive technology, it was sufficiently innovative in that it allowed the user to build their own data marting solutions. This change from consulting to product business represented incorporation of major innovation in the firm that was thus far working with routine consulting mandates. It represented an extended exploration event within the routine events already occurring. Data on the firm's working over that exploration event is therefore tracked to examine how the firm coped with the demands of exploration and routinisation and, in this case, came out successfully.

A qualitative case study approach was suitable to examine the 'how' and 'why' questions through information-rich data (Yin, 2003) and was necessary to probe the details of the internal workings of the business during the initial period of survival and growth. This particular case was selected for several reasons but mainly because the firm faced the exploitation-exploration tension in a big way early in its life, and secondly also because the chief executive officer B was willing to give sufficient time for the study through in-depth interviewing and access to company archives and historical data. This had the potential a strong case that was rich in information about the research issue or purpose (Patton, 1990) and providing 'theoretical sampling' (Eisenhardt & Graebner, 2007). A qualitative approach was considered suitable to gather the rich information needed.

Event points selection; Longitudinal non-realtime design

The data gathering was done around the main processes that surrounded exploration events (product, process, etc) and routinisation events. Exploration events identified in the verbal protocol were characterised by everything the firm did that was aimed at attempting new initiatives, both big and small, whether in process innovation, product R&D or customer relationship, etc. Routinisation events were identified in the protocol by spotting all events aimed at increasing efficiency of operations and marketing including, hiring staff, installing systems at the firm, routine consulting with clients, or even fixing a consulting client's system problem that was unrelated to the firm's work with the client company. The verbal protocol, coded for events, gives a clearer picture of the separation of the two kinds of event data. These events were then tracked in time with the firm's archival data including historical books of accounts and email correspondence with the aim to relate the events to specific financial situation the firm experienced at the time of the events. This enabled the pressure on the firm to routinize for efficiency to be gauged at different points in time by juxtaposing the routinisation and exploration events with crisis moments identified by in its cash flow changes over the seven year period. These historical data gathered thus constituted a longitudinal, non-realtime design of the study empirics.

Data, results and analysis

The firm had done consulting mandates from early start-up stage in 1995 to about the mid-1997 when they decided to use their expertise for product development. The coded verbal data was combined with the archival data from August 1997, when the exploration event of new product development started, to first sale of version-1 of the full product complete with the first set of manuals in early 2000. To keep it confidential the cash balance is mentioned divided by an undisclosed factor.

In the consulting business the entrepreneur and his colleagues knew from their experience of the local / domestic market the potential clients that would have data warehousing needs. Their routine was straightforward, ie, they would make calls on such companies, identify and define the client problems or aspirations, negotiate terms of the mandate, deploy the right person for the job on site, and give any technical support to the client post job execution. When there was an additional part in the mandate beyond what was negotiated, as often happened, there would be subsidiary discussions to modify or enhance the mandate and redraw the schedule.

In early 1997 the entrepreneur team took stock of their capabilities and their market activity, and decided to use their skills and knowledge to develop the software for the potential data warehousing user market ("we knew how to build warehouses from our work at (ex-employer company) – but we always thought there had to be a better smarter way. And the idea behind that.. the better smarter way was what we embodied in our software"). Thus the disruptions to the consulting routine were not unexpected – and were anticipated by the entrepreneurial team. The sequence of events thereafter, selected for relevance to the firm's action that showed exploration-routinisation events are set out below.

1996-97

- Consulting business has been rising (from 1995)
- hiring their first senior employee so the technical partner in the entrepreneurial team could leave much of the consulting responsibility and devote himself to product development
- an early prototype version of the product idea, ie, the core of their envisaged product was developed(Jan 97)
- firm started using this early version in their consulting jobs and interested clients started asking for it to use it themselves (Nov-Dec 97)
- good growth in consulting business (ten clients in Dec 97)

End 1997 to end 1998

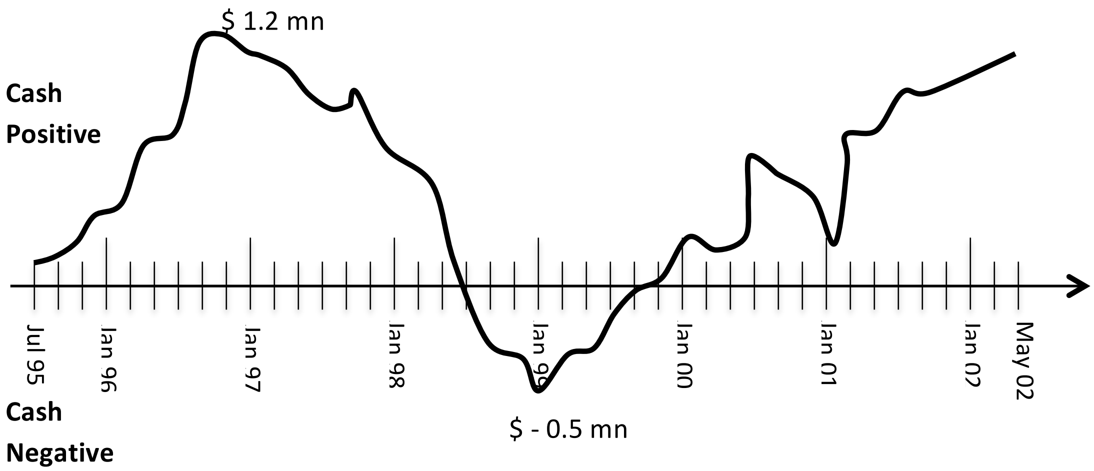
- started looking for market feedback on their product idea from users/ potential users
- went overseas to get market feedback through contacts in Hong Kong, US
- successful first meeting with mid-sized bank in the US (May 98)
- series of meetings over two months follow
- US bank gives all feedback except price it could fetch as they want to buy it: January 1998; firm refuses to sell as product not ready and ask for time (Sep 98)
- Over the next few months the development work intensifies, product manuals work started
- Consulting clients eleven (Dec 98)

January to December 1999

- major consulting client dissatisfied with training on product (Jan 99)
- senior technical employee leaves, partner CTO takes more consulting responsibility (Feb 99)
- Entrepreneur CEO partner also makes new consulting calls (over January to May 99)
- Charge consulting clients for the prototype version on demand
- Occasional contact with US bank ("keeping the seat warm")
- CEO and CTO write / check new product manuals at night
- firm recruits more technical hands at junior levels (May-Jul 99)
- Engagement with US bank intensified with feedback cycles for product development; one employee stationed in the US
- Product v-1 sold to US bank (Oct 99) with 500-page user manual and 1500-page installation guide.

The firm's cash position changes through all this is juxtaposed with the events below in Figure1, graphically showing the stress points in time. The net cash position in the business activity is taken.

Figure 1: Firm's cash position from start-up through first innovation cycle to May 2002



The firm went through a major convulsion in its attempt to pursue exploration between 1997 and 1999 reflected in Figure 1 as it went through events described above. The following section connects these events to what steps the firm took in order to manage the financial stresses and survive through a strategic exploration cycle.

Concluding discussions

The dataset represents a successful case of strategic direction setting and a successful management of the exploration-routinisation interplay as depicted by the fact that in 2006, apart from direct purchase by companies, every singe one of the 29 major consulting clients was a customer of the proprietary software product of the firm. The firm had made a successful transition to a product software firm, a strategic success in its entrepreneurial start-up stage.

Alongside an increasing client base in its consulting business, a slackening of debt collection in the 1997-98-99 product development period was a direct cause of worsening cash situation. The average debtor outstanding (of final (or penultimate) and major portion of the mandate payment rose from 20 days to 41 days in October 1998. This critical slippage reflected the failure of important routinisation effort at start-up that occurred at the same time as exploration focus increased. Other symptoms of slackening of effort in building efficient routines were found in records of consultants attending to ordinary machine problems in individual members' computers at client site that were outside the firm's mandates with the client. While these were done as a goodwill gesture, they reflected a lack of attempt to develop routines like periodic time and cost sheets to control consulting mandate budgeting. An attempt to rectify this is seen in the hiring of office administrator in March 1999 and the introduction of budget reporting.

All the personnel in the firm, except the office administrator, were technical personnel. The exploration-routinisation tension was apparent not only in their lack of discipline in the routine aspects of their work but also in their unquestioned tendency to do the product development as against consulting ("all of us find development work technically challenging and exciting"). Appreciation of the importance of the routine aspect of the business is reflected in the entrepreneur's own words that consulting was a "poisoned chalice" as the firm decided to self fund all development work. They realised this meant keeping up a strong consulting dealflow. With the limited technical hands in the small firm, the drive to pick back the high calibre consulting deliverables through the first half of most of 1999 when the firm neglected the product development work it started with the prospective client, as in Proposition 1, at a high risk. According to the entrepreneur "We kept the seat warm"; however the US bank "was hardly waiting with bated breath…. And we feared we would lose them".

While consulting has funded their product development, the firm has thus managed to blend the routine and exploration aspects of their business. This is most evident in their using their product development prototype in their consulting mandates, as much as in their decision to fund their product development through consulting income. The management of exploration-routinisation tension was also evident in their not agreeing to 'white-label' their product even sacrificing short term revenue for long term brand development, and also in their decision to develop the product with the potential client's feedback over a year. Even after the technical aspects of the product along with attendant documentation of manuals and guides had settled, the market routine of price-point discovery would take several years alongside future version updates of the product. The discipline of the market making routines was learnt over time as seen in the entrepreneur's remark: "We sold our first version very low – it was part of development. We did not know what we had. I feel we have only now made the price-point discovery journey". This was in 2006.

By forging a close relationship between the routinisation needs of the consulting business and the product development exploration the firm ensured entrepreneurial survival as well as charted its growth strategy, as suggested in Proposition 2. In this case they evolved a co-dependent logic between efficiency routinisation and effectual exploration at start-up. Recognising consulting as "the poisoned chalice" helped in awareness and resistance to establishing a dominant logic with blinders in routine consulting. By ensuring the ability to fund, through consulting mandates, the effectual exploration of product development with the potential client's feedback the firm developed the discipline of efficient routines.

Implications, limitations, further research

The successful management of the exploration-routinisation tension at start-up throws up several pointers to how the firm can manage the 'phase-change' as it grows into a large company where, on the one hand, establishing efficiency routines are critical for growth and, on the other, exploration of new direction critical in the long term.

A single case in this study is its major limitation. However the data in this study, itself an exploratory enquiry, examines a start-up entrepreneurial firm at the micro level and extends understanding of the black box of entrepreneurial firm growth dynamic. Two other cases are presently at the final stages of data collection and are expected to strengthen the study. Studies with larger micro data are definitely needed.

Several entrepreneurial firms do not make the transition across this “phase change” barrier well. Longitudinal data in the study indicate how the stages of effectual action and emergence of dominant logic occur during initial growth. How a firm’s small team can manage entrepreneurial action and consolidation of strategic direction needed for successful growth as ‘strategic entrepreneurship’ recommends, may help clarify the theoretical legitimacy of the field of ‘strategic entrepreneurship’.

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