

Firm Emergence: The Importance of Embeddedness to Firm Founders in Resource-Poor Situations

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Firm founding is a process characterized by a series of organizing activities, performed prior to actual emergence. This period is referred to as the gestation period. Our study investigated how one dimension of embeddedness – relational embeddedness affects the execution of these gestation activities and how this, in turn, affects progress to firm emergence. We report results from a broad survey of nascent entrepreneurs that supply chain relational embeddedness is associated with legitimating, operational, and marketing-related gestation activities. We also report that the execution of these activities mediates the relationship between supply chain relational embeddedness and progress to firm emergence. Our study contributes to recent research efforts targeted at a more comprehensive understanding of the important implications of embeddedness for entrepreneurial success.

INTRODUCTION

Emerging entrepreneurship literature conceptualizes firm founding as a process characterized by a series of organizing activities (Carter, Gartner, & Reynolds, 2004; Aldrich, 1999; Delmar & Shane, 2002; Aldrich & Ruef, 2006). This is also acknowledged in the more frequently cited academic definitions of entrepreneurship (e.g. Stevenson & Jarillo, 1990; Shane & Venkataraman, 2000) in which firm founding is described as a process. It is the successful execution of the organizing activities, in what has been labeled the gestation period, which results in the event of firm establishment.

In the last few years, researchers have taken keen interest in the nature and implications of gestation activities (Davidsson, 2006). However, one area that is yet to receive substantial empirical research attention is the sourcing of the resources necessary to perform these activities (Baker, 2006). The present study contributes to the emerging research stream (Carter, Gartner, & Reynolds, 1996; Delmer & Shane, 2003; Newbert, 2005; Baker, 2006; 2007) by investigating the efficacy of using different forms of relational embeddedness by nascent entrepreneurial firms to access the resources necessary to execute different types of gestation activities. The study also explores the effect of the execution of these activities on nascent firms' progress to emergence. We test related hypotheses using data from a broad survey of nascent entrepreneurs ($n= 289$). To preempt our findings, we found support for the positive effect of supply chain embeddedness, a dimension of relational embeddedness, on legitimizing, operational, and market-oriented gestation activities and support for the mediating influence of gestation activities on the relationship between relational embeddedness and progress to firm emergence. Our findings have important implications for progression to firm emergence through the cultivation of dyadic relationships with resource controlling partners. We outline these implications and directions for future research in the discussion section.

THEORETICAL BACKGROUND AND HYPOTHESES

The Liability of Newness and the Performance of Gestation Activities

Liability of Newness

Stinchcombe's (1965) concept of liability of newness has, for the last four decades, been used as a key factor in appreciating the problems associated with the emergence of new ventures (Morse, 2007; Shepherd, Douglas, & Shanley, 2000). At the risk of appearing to oversimplify the argument, Stinchcombe (1965) posited that new firms fail to perform satisfactorily because they lack specific resources and capabilities – a situation engendered by insufficient operational time to accrue these

resources and capabilities. This deficiency results in new firms suffering higher rates of failure than the more established firms (Hannan & Freeman, 1984). According to Stinchcombe (1965) as well as more contemporary sources (e.g. Goldberg, Cohen, & Fiegenbaum, 2003; Morse, 2007), there are four mechanisms that underlie the liability of newness argument. These are: (1) the lack of trust among potential employees and suppliers, (2) the lack of social capital that comes with embeddedness in other organizations, (3) the lack of economic capital that accrues over time, and (4) the underdeveloped internal organizational systems including the capacity to learn and create new roles.

All the four mechanisms have been used in the literature to explain the disproportionate rates of performance between new businesses and their longer established counterparts. Logically, any improvement of the nascent entrepreneurs' resource position remedies their inferior performance. In its contribution, this study investigated possibilities of improving nascent firms' resource position from two relatively uncommon perspectives: (1) nascent as opposed to new firms and consequently the focus on the execution of gestation activities; and (2) relational embeddedness as a resource; segregated from the broader concepts of social capital and social embeddedness. Relational embeddedness is in turn decomposed into component parts labeled as familial, supply chain, and institutional relational embeddedness.

Gestation Activities

Gestation activities have been defined as "events, behaviors, and other accomplishments of individuals [including founders and their start-up teams] that lead to the emergence of a new business" (Gartner et al., 2004, p.285). The gestation period is generally considered to consist of two sub-processes: the discovery and the exploitation processes although the boundary between the two is fluid and still a subject of debate. By and large, the two sub-processes are distinguished by their temporal order of occurrence and the tangibility of activities undertaken. Broadly conceptualized, the exploitation activities operationalize opportunities identified through the discovery window (Davidsson, 2006). The focus of this paper is largely on the exploitation activities.

The extant research on gestation activities during firm founding has centered on determining the number of gestation activities that need to be performed to signal emergence, the order or sequence in which the activities are performed, categorization of the activities, and the pace of activity execution. There has been a fair amount of academic discourse about the number of activities (e.g. Carter, et al., 1996; Gartner, et al., 2004; Newbert, 2005), the sequencing of activities (e.g. Vesper, 1990; Carter, et al., 1996; Delmar & Shane, 2003; Newbert, 2005), categorization of activities (Davidson, 2006), and pace of activity execution (Byabashaija & Schwab, 2007; Lichtenstein et al., 2006; Samuelsson, 2004). However, not as much empirical research has focused on nascent entrepreneurs' acknowledged poor resource position in the face of the need to efficiently perform these activities.

In general, the successful execution of gestation activities should have a positive effect on firm emergence, differences in the conceptualization of these activities notwithstanding. This is so because such performance builds legitimacy, develops production processes, and creates demand for the firm's outputs. The emergent research in this area (e.g. Byabashaija, 2007) affirms this effect. Accordingly, this paper does not center on this relationship but rather on the possibility of relational embeddedness to ease nascent entrepreneurs' resource woes; thereby enabling better execution of the different types of gestation activities.

The literature subdivides the organizing activities into three categories (e.g., Delmar & Shane, 2002; Newbert, 2005). First, there are legitimating activities which are aimed at improving the perceived legitimacy of the emerging firm to internal and external stakeholders. The legitimating activities prepare the nascent firm for legal establishment and enhance prospects of resource mobilization (c.f. Ruef, 2001). Second are operational activities or resource transforming activities which are aimed at making "the

business tangible to others” (Weick, 1979; Delmar & Shane, 2002) and to prepare the ground for production or service delivery. The operational activities work toward production operations readiness. This progress toward tangibility should increase the level of relational trust of resource suppliers. Lastly, there are marketing activities aimed at increasing the visibility of the new firm’s outputs in potential markets. The market oriented activities prepare the nascent firm for exchange relationships (c.f. Ruef, 2001; see also Carter et al., 2004).

Relational Social Embeddedness

The embeddedness argument, derived from social capital theory, is that [new] firms improve their chances of survival by connecting more with the population in which they operate (Uzzi, 2000; Hager, et al., 2004). The argument is that social connections with higher status firms, resource suppliers, state agencies, and customers will help to overcome many of the problems associated with newness and accord the new firms the legitimacy needed to operate (Burt, 1992). This viewpoint is supported by Larson (1992) who argued that resource-poor firms will improve their chances of survival by “building network exchange structures with [stakeholders] identified as critical resource suppliers” (p. 100). Embeddedness arises out of social exchange theory and is inextricably entwined with the social capital resource. However, whereas social capital refers to the outcome of social relations, embeddedness captures the mechanism through which these outcomes are achieved (Granovetter, 1985; Uzzi, 1996; Adler & Kwon, 2002). The social capital of individual actors is determined by the extent of their exploitation of their social networks and the maze of interrelationships among actors in the networks (Granovetter, 1973; Burt, 1992; Scott, 2000) but embeddedness is the conduit through which these outcomes are achieved. Social capital is the outcome of the relationships and is the object that attracts firms to be embedded in their environment.

It seems logical to assume that access to the social capital resource would enable firm founders to reduce the odds imposed by liability of newness, since the resource comes with a wide range of benefits related to both social recognition and material support (Aldrich, 1999). Accordingly, this study argued that to the extent that firm founders can initiate the development of social relations and exploit their value, their nascent firms may be able to overcome the constraining institutional theory problem of lack of legitimacy and enhance their prospects of successful emergence. The social embeddedness literature makes a distinction between structural and relational embeddedness (Adler & Kwon, 2002; Hanlon, 2007). Relational embeddedness refers to the quality of a single dyadic relationship (Moran, 2005). In contrast, structural embeddedness refers to the extent to which the mutual contacts of the dyad are interconnected (Granovetter, 1992). In other words, structural embeddedness is impersonal; representing the aggregate configuration of the network ties and/or lack of ties (Nahapiet & Ghoshal, 1998; Moran, 2005). On the other hand, relational embeddedness represents pair-wise connections that have been developed over time (Nahapiet & Ghoshal, 1998; see also Granovetter, 1985). This paper discusses relational embeddedness and borrows from the research approaches used by Uzzi (1996) and Moran (2005). The focus of the paper is on the inclination of selected organizational field units and individuals to avail resources to nascent firms, based on the quality of the dyadic relationship between them. Recall that conceptually, relational embeddedness emphasizes the contribution of personal relationships to economic exchanges (Zaheer and Venkataraman, 1995; Hite, 2003).

Relational Embeddedness and the Execution of Gestation Activities

Left to their own devices, firm founders are characteristically resource poor. Due to the liabilities of newness and smallness, their nascent firms rarely have sufficient internal capacity to sustain firm development (Hite, 2003; Baum, 1996). Consequently they have to take recourse to external resource bases (Pfeffer & Salancik, 1978). To the extent that dyadic ties embedded in social relationships influence economic activities (Uzzi, 1996; De Clercq, 2008), they exemplify an external resource base and may, according to Hite (2003), represent a strategic form of organizing for [nascent] firms to execute gestation activities. As discussed earlier, relationally embedded ties have the potential to influence the economic

behavior of strategic partners thereby enabling greater access to requisite resources and, ultimately, performance. For resource poor nascent entrepreneurs, the chances of success are likely to be boosted by the support from others (Hanlon, 2007). Since the forms of the gestation activities and the purpose for which they are executed differ, it is logical to assume that there will be variation in the effect of dyadic network ties on the execution of the different types of gestation activities. We therefore derive multiple hypotheses as follows:

H1a: Relational embeddedness has a positive effect on the execution of legitimating gestation activities.

H1b: Relational embeddedness has a positive effect on the execution of operational gestation activities.

H1c: Relational embeddedness has a positive effect on the execution of market-oriented gestation activities.

The Mediating Role of Gestation Activity Execution

The ultimate purpose of executing gestation activities is to get a nascent firm up and running. The literature, although not yet quite definitive, holds that progress to emergence is a function of the number of activities performed (Gatewood et al., 1995; Carter, et al., 1996; Gartner et al., 2004), the sequencing of the activities (Delmar & Shane, 2003; Newbert, 2005), and the pace at which activities are undertaken (Samuelson, 2001; Lichteinstein et al., 2004; Byabashaija & Schwab, 2008). By and large, the quantum and speed of execution of gestation activities depends on the entrepreneur's ability to marshal the resources necessary to carry out the execution. Developing and cultivating network ties is such ability. In themselves, network relationships do not create a business. This only happens when the relationships enable the nascent entrepreneur to execute start-up activities. We therefore hypothesize that:

H2: Gestation activities execution will mediate the relationship between relational embeddedness and progress to firm emergence.

METHOD

Data: The study employed data collected in 2007 for a similar nascent entrepreneurship study. The data were collected from a bank of volunteer respondents maintained by a project run at Syracuse University. The response rate was 48%.

Analyses: In response to the nature of the study hypotheses, the study used regression analysis and Kenny's (2006) technique for testing for moderation.

RESULTS

Relational Embeddedness and Types of Gestation Activities (H1)

Legitimizing activities (H1a): Hypothesis 1a proposed a positive effect of relational embeddedness on legitimating gestation activities execution. Table 1 shows that the addition of the variables capturing familial, operational, and supply chain relational embeddedness dimensions significantly improved model fit ($\Delta R^2 = .10$; $p < .01$). This finding supports H1a. Clearly, the association is driven by supply chain relational embeddedness ($B = .13$, $p < .01$).

Operational activities (H1b): Hypothesis 1b predicted a positive effect of relational embeddedness on operational gestation activities execution. Table 1 displays part of the results of this analysis. In this case, the control variables (Industry type $B = .20$, $p < .01$; Idea novelty $B = .14$, $p < .01$) explain much of the variation. However, relational embeddedness dimensions (specifically, supply chain embeddedness $B = .10$, $p < .01$) add a 5% explanatory power to the model ($\Delta R^2 = .05$; $p < .01$). This finding lends support to hypothesis 1b.

Market-oriented activities (H1c): Hypothesis 1c proposed a positive effect of relational embeddedness to market-oriented gestation activities execution. The results in Table 1 show a 7% increase in the models explanatory power with the introduction of the relational embeddedness dimensions. The result supports hypothesis 1c. Once again the driving dimension was supply chain embeddedness ($B = .13$; $p < .01$)

The mediating role of Gestation Activities Execution

The results of the first two steps of the Kenny (2006) procedure for testing for mediation show that familial relational embeddedness, has a non significant coefficient ($B = .06, p > 0.1$) when the other two dimensions are in the regression model (progress to emergence as the criterion variable) and institutional relational embeddedness is significant only at 10% level ($B = .13, p < 0.1$). These two dimensions are therefore dropped from subsequent mediation analysis.

Table 1: Regression of Execution of Gestation Activities on Relational Embeddedness¹

Variable	Legitimizing		Operational		Market-Oriented	
	B	SE	B	SE	B	SE
Intercept	-.13	.09	-.14	.09	-.12	.13
Industry Type	.03	.04	.19**	.04	-.05	.05
Founding Experience	.03	.02	.01	.02	-.01	.03
Idea Novelty	.03	.03	.14**	.03	.01	.04
Education Level	.03*	.01	.01	.01	.03*	.02
Gender	.00	.03	-.01	.03	-.04	.04
Age	.01	.01	.02	.01	.04*	.02
Embed - Familial	-.02	.02	-.05*	.02	.04	.03
Embed - Institutional	-.03 [†]	.02	-.02	.02	-.06*	.03
Embed - Supply Chain	.13**	.02	.10**	.03	.13**	.03
R ²	.16		.22		.10	
Δ R ²	.10**		.05**		.05**	
Adjusted R ²	.14		.19		.07	
Model F	5.99**		8.53**		3.46**	
n	289		289		289	

Significance (two-tailed): ** $p < .01$ * $p < .05$ [†] $p < .10$; ¹ For lack of space, only the final regression model is shown

Supply chain relational embeddedness on the other hand satisfies all the Kenny (2006) conditions. It is significantly correlated with both progress to emergence ($B = .27, p < .01$) and gestation activities execution ($B = .10, p < .01$). Table 2 displays the results of stage 3 analysis and confirms that gestation activity execution mediates the relationship between progress to firm emergence and supply chain relational embeddedness.

Table 2: Testing for Mediation (Step 3)²

Variable	Model 1		Model 2		Model 3	
	B	SE	B	SE	B	SE
Intercept	2.98**	.30	2.24**	.34	2.44**	.33
Industry Type	.01	.14	-.08	.14	-.13	.14
Founding Experience	.10	.07	.06	.07	.05	.07
Idea Novelty	.06	.11	.01	.11	-.04	.11
Education Level	.02	.05	.00	.05	-.02	.05
Gender	-.13	.11	-.17	.11	-.16	.11
Age	.08	.05	.09 [†]	.05	.07	.05
Embed Supply Chain			.35**	.08	.24**	.09
GAE					1.33**	.37
R ²	.02		.08		.13	
Δ R ²			.06**		.05**	
Adjusted R ²	.00		.06		.10	
Model F	1.10		3.57**		4.94**	

Significance (two-tailed): ** $p < .01$ * $p < .05$ [†] $p < .10$; ² Only Step 3 of the procedure is shown.

The gestation activities execution variable affects progress to emergence with both the mediator and the independent variable as predictors ($B = .1334$, $p < .01$). The effect of supply chain relational embeddedness on progress to emergence is less in Model 3 ($B = .24$, $p < .01$) than in Model 2 ($B = .35$, $p < .01$) but does not reduce to zero. Gestation activities execution therefore only partially mediates the relationship. Hypothesis two (H2) is therefore only partly supported.

DISCUSSION

Relational Embeddedness

There have been some recent studies done that address resource disadvantages in entrepreneurial firms (e.g. Baker, 2006; Baker & Nelson, 2003; Baker, Miner, & Eesley, 2003; Mosakowski, 2002; Sarasvathy, 2001; Miner, Bassoff & Moorman, 2001). The findings of this study add to this body of work by specifically addressing resource disadvantages of nascent firms. The results of our broad survey of nascent entrepreneurs show that the more relationally embedded nascent firms are the more gestation activities they will execute and the closer they will get to emergence. This confirms the findings in prior empirical studies by Carter, et al., (1996), Diochon, et al., (2006); Gartner, et al., (2004) relating to the execution of gestation activities and nascent firm emergence. Specifically, we learn from the results of this study that relational embeddedness has the capacity to lessen nascent firms' liability of newness by: (1) increasing the level of trust among partners; (2) building social capital; (3) exploiting capital resources accumulated by dyadic partners; and (4) providing access to older partner firm's information and experiences about structures and systems.

The focus on relational embeddedness extends current studies relating the social capital resource to firm performance (e.g. Arenius & Minniti, 2005; Wagner, 2004; de Clecq & Arenius, 2003; Davidsson & Honig, 2003; Delmar & Davidsson, 2000). Segregating different dimensions of social capital is important since firms establish network ties for different purposes. There is therefore bound to be variation in outcomes as Hite (2007) observes. Our study singles out ties with partners along the supply chain as the most important to lead to effective gestation activities execution and, subsequently, to firm emergence. Equally significantly, the study fails to find support for the importance of family, friends, and acquaintances (familial embeddedness) in providing resource or market support for nascent firms. This lack of a significant positive effect was an unexpected and counterintuitive finding. It calls for further study. Similarly, relationships with institutions like local or state agencies did not have a consistent significant positive effect. The focus of these institutions is advice, training, and trade information. Rarely do they extend physical resource support. This probably explains the weak relationship with gestation activities execution. This notwithstanding, the more fine-grained study of the dimensions of embeddedness represents an important extension of prior social capital research and identifies an important direction for future research.

Limitations and Future Research

The main limitation of our study is the cross-sectional nature of the data that we used. The character of same point in time data creates challenges for establishing temporal order of effects and the determination of causal direction. The fact that some activities may be more important at the beginning or closer to the end of the venture and less so at other times could not be factored in the study when we tested for association. Future research designs intended to capture gestation behavior, progress to emergence and the effect of resource availability in these processes need to include the timing and sequencing of activities in their models. It is entirely likely that relationships with family and friends as well as state agencies is important in the early stages but diminishes as the venture takes hold.

CONCLUSIONS

This study contributes to the emergent research on nascent entrepreneurship. Specifically, it contributes to research efforts by initiating a search for better understanding of how different types of relational

embeddedness affect the execution of gestation activities and, ultimately, firm emergence. The empirical results indicate that supply chain embeddedness has a positive effect legitimating, operational, and market-oriented gestation activities. The other two dimensions – familial and institutional – failed to show consistent effects as hypothesized despite having moderate positive correlations. Our view regarding the lack of significant effect in the two dimensions is that there are dynamics both in the performance of gestation activities and in the combination of the dimensions of embeddedness that are still ill-understood. The counterintuitive findings notwithstanding, we found strong influence of supply chain embeddedness on gestation activities execution and progress to firm emergence. This and the other findings provide encouragement for future research. The research in respect of nascent entrepreneurs' resource disadvantages is important to the field's better understanding of new venture emergence, a topic of current interest to both academics and practitioners.

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