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Founding Matters: Initial Choices Predict Future Start-Up Success

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Founding Matters: Initial Choices Predict Future Start-Up Success

Abstract

KEY FINDINGS

* The career experiences of start-up founders, and the initial organizational structure they create, matter for a new venture's future success.

* Firms with little organizational structure and inexperienced founders—"engineers in a garage"—are disadvantaged on all fronts and are the least likely path to success.

* Organizational structure (i.e., positions) and career experience are not interchangeable—having one does not compensate for lacking the other.

* Deliberate planning for the future—including decisions about which positions and experience are needed for success—should be done at the very beginning of a new venture. Don't assume it will be easy to add more experienced talent later.

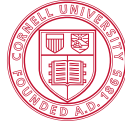
Keywords

talent management, employee engagement, recruitment, selection, retention, turnover, entrepreneurial firms, start-ups

Comments

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Founding Matters: Initial Choices Predict Future Start-Up Success

THE TOPIC: HOW FOUNDING TEAMS MUST EVOLVE TO SUCCEED

The popular media love the image of the brilliant scientist or engineer starting a successful company—often in a garage. Later, more experienced executives step in to formalize the company and take the firm to the next level.

While a few start-ups have grown this way, research shows that it's actually the least effective method. Instead, there's abundant evidence that the most successful firms are led by seasoned professional managers with a full range of skills (Roberts 1991, Copper et al. 1994, Burton et al. 2002), who create an organizational structure with clear roles and accountability (Ancona and Caldwell 1992, Keck 1997, Roure And Keeley 1990, Jensen and Zajac 2004, Sine et al. 2006).

How then are new companies—often founded by narrowly experienced technical gurus and lacking in structure—able to attract a deeply experienced management team and develop the portfolio of organizational roles necessary for success?

In this study, researchers explored the founding team's influence on the types of executives later attracted to the firm (the top management team or TMT), the subsequent organizational structures they put into place, and how these interact to affect firm success.

KEY FINDINGS

- ◆ The career experiences of start-up founders, and the initial organizational structure they create, matter for a new venture's future success.
- ◆ Firms with little organizational structure and inexperienced founders—"engineers in a garage"—are disadvantaged on all fronts and are the least likely path to success.
- ◆ Organizational structure (i.e., positions) and career experience are not interchangeable—having one does not compensate for lacking the other.
- ◆ Deliberate planning for the future—including decisions about which positions and experience are needed for success—should be done at the very beginning of a new venture. Don't assume it will be easy to add more experienced talent later.

Specifically, this study examined two key aspects of founding teams—their prior experiences, and the breadth and depth of position assignments they create in the new enterprise. The results show that founders influence the firm not only through directly influencing firm outcomes, but also by leaving a lasting organizational imprint—for good or bad.

For the purposes of this study, *prior functional experience* is a measure of the founding team’s human capital (e.g., whether someone has prior sales or engineering experience), while position assignments are a measure of *organizational structure* distinct from the skills and qualifications of any specific incumbent (e.g., whether or not a firm has created a position for vice president of sales or engineering).

This research fills several important gaps in the understanding of how new companies grow and succeed. First, it details the relationship between the founding team and the top management team, an area where little research exists. Second, most previous studies focus on either functional experience or structure, treating them as interchangeable. This study is the first to examine both factors as distinct, and how they interact to affect firm performance. Finally, the study is one of the first to attempt a detailed look at career histories of executives in small firms over time.

THE STUDY QUESTIONS

In this study, researchers asked the following questions:

- How do founders’ career experiences shape their initial decisions about organizational structure (i.e. which positions/roles to create) and future executive hires?
- What effect does the initial organizational structure of a new venture have on both future organizational structures and future executive hires?
- How do the initial organizational structure of a new venture and the founders’ experiences interact to shape firm success?

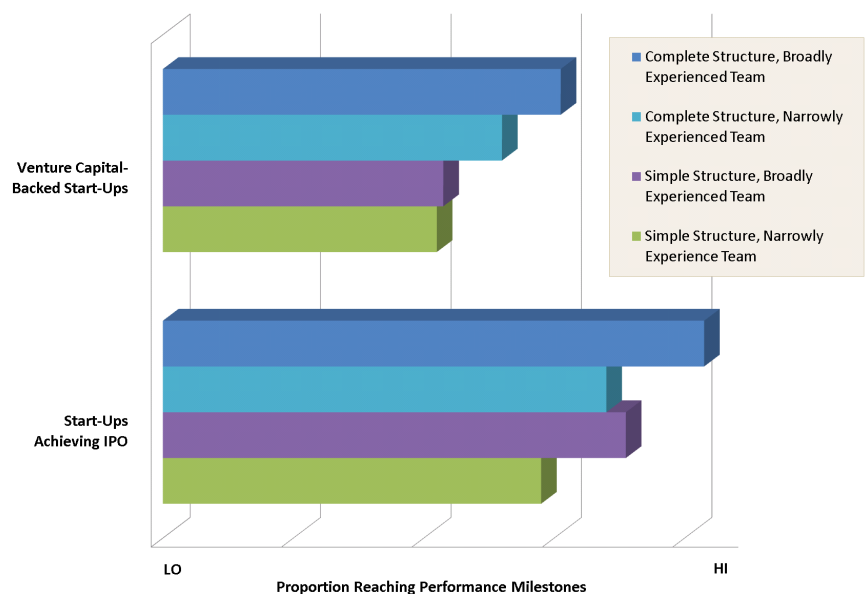
THE RESULTS

Having certain career experiences represented on the founding team significantly increases the rate at which those positions are added to the new firm’s top management team (TMT). For example, founding teams with sales experience are 69 percent more likely to add a sales position to the TMT. Those with science experience are 44 percent more likely to add a science position.

The initial organizational structure of a new venture strongly predicts its future organizational structure. This is true even after controlling for whether the founding team has experience in a given functional area (since, for example, founders with sales experience are already more likely to add sales positions to the TMT).

A new venture’s founding organizational structure and its founders’ career experiences have lasting consequences for subsequent growth, attracting talent, and success:

- Unstructured founding teams with broad experience can develop functional structure—but narrowly experienced founding teams that begin with a full structure never catch up in terms of attracting broadly experienced executives to their top management teams.
- Firms with little organizational structure and inexperienced founders—“engineers in a garage”—are disadvantaged on all fronts and are the least likely path to success. They start with smaller teams, do not grow as much, and are less likely to receive venture capital or go public than firms with the most broadly experienced teams and complete structures (see chart above).



New firms that start out with more initial organizational structure are likely to continue adding more structure (i.e., cover more functional areas) over time.

Contrary to what would be expected, the initial organizational structures (i.e., positions) created by founders do not predict the experience people later bring to the firm. This means that establishing positions and filling them with people who are “placeholders” appears to hamper the firm’s ability to ultimately attract broadly experienced executives.

The later top management team is very likely to have experience similar to the founding team—even when changes in team composition are taken into account.

Organizational structure and functional experience are not interchangeable—having one does not compensate for lacking the other. While both are related to firm outcomes, founders’ background experience trumps initial structure for predicting success.

Founding experience, structure confer cumulative advantage for start-ups

The results of this study show that the founding teams of new ventures strongly influence their later top management teams and future success. Founding teams made up of broadly experienced members are more likely to attract broadly experienced executives. New ventures that begin with a broader range of positions (i.e., organizational structures) are more likely to develop fuller functional structures. These initial conditions produce a cumulative advantage—as high-quality founding teams become high-quality top management teams, and less well-endowed founding teams never catch up.

that it needs and values that expertise—the company is limited in its ability to fill the position if it does not already have an executive in place with at least some experience in that function. This suggests that structure is a poor substitute for experience.

The myths of the “garage” entrepreneur and “placeholders”

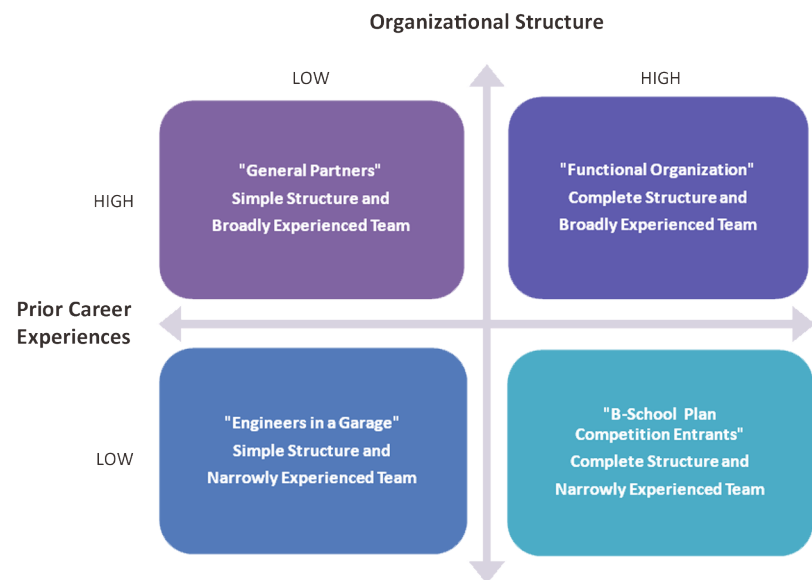
These results stand in sharp contrast to the dominant image of engineers in an unstructured budding venture, eventually replaced by broadly experienced professionals who then formalize the structures and evolve the firm into a professional bureaucracy. Instead, the results imply that the narrowly experienced “garage” entrepreneur is not likely to succeed (Audia and Rider 2005).

The researchers also found that the positions created by founders (i.e., functional structure) had little relationship to the talent and expertise of employees later brought into the firm. At least in entrepreneurial firms, the structure of the position does not predict the experience of those people who later fill it. In fact, establishing positions and filling them with people who are “placeholders” appears to impair the founders’ ability to later attract executives with broad functional experience.

The path to success is paved by predecessors

This study shows that the founding team of a new venture exerts an influence on the firm not only through directly influencing firm outcomes, but also by shaping the very nature of the organization. Examining the top management team of a new venture without taking into account its history will overstate its ability to change. In fact, future TMT teams may be best understood by taking a detailed look at teams that have come before. This finding means that taking actions later to change the nature of a new venture (from a structural or talent perspective) will have a limited effect on outcomes—and that sharp deviations from the initial path are unlikely (and probably risky).

The researchers found clear evidence of path dependence in their analysis—that is, that the future structure or experience in a new venture is limited by what came before—and these effects remained even after accounting for firm changes and growth. Yet, the results also show the significant influence of new hires on future success.



But why exactly do firms founded by narrowly experienced people have difficulty attracting broadly experienced executives? It does not seem to be the case that narrowly experienced founders simply fail to recognize the importance of other types of functional expertise. Instead, even when the firm has created an executive level position for a given function—a strong statement

While growth through hiring experienced talent does allow firms to add both functional expertise and structure, the researchers emphasize that initial conditions do matter and not all firms easily professionalize and grow. Particularly in light of the finding that initial structure does not predict attracting functional experience to the firm—new ventures should be cautious about assuming they can add experience later. Instead, these findings suggest that founders should deliberately plan into the future from the beginning.

In sum, the researchers suggest that the relevance of founding teams to new venture success is more significant than has been acknowledged. Not only do founding teams directly impact firm outcomes, but, through path dependence, the founding team shapes the top management team's experience and structure.

Entrepreneurship research often focuses on the individual entrepreneur, but understanding the teams that come together and develop over time is essential to understanding the performance of entrepreneurial firms. This is also true for the success of many other new ventures—including new functional departments, project teams, or task forces.

THE TAKEAWAY

How can HR practitioners guide founders toward building a successful organization?

- **Encourage founders to consider what their ideal future organization** would look like and develop an appropriate staffing plan that anticipates future needs.
- **Help founders attract highly-experienced executives** for the initial top management team.
- **Recognize the benefits of having diverse career backgrounds** represented on the top management team for ensuring future success.
- **Resist the temptation to staff positions with less-experienced “placeholders”** with the intention of bringing on more experienced employees later. Doing so is more harmful than beneficial, as it limits the firm's ability to attract experienced talent to the position when it is most needed.

THE DATA SOURCE

The researchers studied 1,485 executives at 167 entrepreneurial high-tech firms in California's Silicon Valley. This sample is a subset of the [Stanford Project on Emerging Companies](#), but is enriched by additional career history data gathered by the researchers. The companies span industries including computer hardware/software, telecommunications, medical devices and biotechnology, semiconductors, manufacturing, and research. The sample includes firms less than ten years old with at least ten employees. The data was collected from 1994 to 1996, and includes both firms that did and didn't receive venture capital funding and/or go public.

The researchers determined each firm's functional organizational structure by looking to see if the firm had defined executive-level positions in the following areas: sales and marketing, general administration including human resources, science/R&D/engineering, operations, business development and strategic planning, and finance and accounting.

THE RESEARCHERS

This study was conducted by:

- M. Diane Burton, Associate Professor, Human Resource Studies, ILR School (Industrial and Labor Relations), Cornell University
- Christine M. Beckman, Associate Professor, Paul Merage School of Business, University of California, Irvine

For an in-depth discussion of this topic, see:

Beckman, Christine M. & Burton, M. Diane (2008). Founding the Future: Path Dependence in the Evolution of Top Management Teams from Founding to IPO. Organization Science, 19, 1, 3-24.

◇ Questions about this research should be directed to Diane Burton at burton@cornell.edu.