Corporate Venture Management in SMEs : evidence from the German IT consulting industry

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Chapter 2

Related Work and Theoretical Embedding

This chapter provides the literature review conducted for the research. Section 2.1 (Related Work) introduces the reader to the challenge of corporations to renew their business portfolio strategically by establishing corporate ventures alongside the mainstream business. Section 2.2 (Theoretical Embedding) reveals the complexity of corporation-venture relations. The dynamic capability-based view is discussed as an analytical framework that defines corporation-venture relations in the form of management routines.

2.1 THE CHALLENGE TO RENEW THE BUSINESS PORTFOLIO STRATEGICALLY

The strategic renewal of the business portfolio is a well-known challenge for corporations in innovation-driven industries where market parameters quickly change. The changing conditions erode and sometimes disrupt current businesses (cf. D'Aveni, 1994). Renewing the business portfolio strategically is therefore a core challenge for corporations confronted with changing environmental conditions (cf. Volberda, Baden-Fuller, & Van den Bosch, 2001). For this reason, corporations need simultaneously (1) to improve existing businesses and (2) to create new ones (see Phan, Wright, Ucbasaran, & Tan, 2009). Exploiting established businesses to ensure current profits and explore new businesses to ensure future incomes requires a dual capacity (see Raisch & Birkinshaw, 2008), which is described in 2.1.1. Dual capacity calls for a dual structure (see 2.1.2). In Subsection 2.1.3, the emergence of dual structures through corporate ventures are discussed.

2.1.1 DUAL CAPACITY

The term dual capacity refers to the ability of corporations (1) to engage concurrently in *exploitative* learning for improving existing businesses and (2) to invent new businesses by engaging in *explorative* learning (e.g., March, 1991a; McGrath, 1995). Corporations that achieve both simultaneously are characterized as ambidextrous organizations (see O'Reilly & Tushman, 2013). These organizations achieve a superior long-term performance as they are prepared for today's and tomorrow's business environments (cf. Burgers & Jansen, 2008; Raisch & Birkinshaw, 2008). However, ambidexterity is not easy to achieve because exploitative and explorative modes of learning are associated with negative externalities (Gupta, Smith, & Shalley, 2006). Exploitation is associated with levering the existing knowledge base (i.e., improve existing capabilities) whereas the purpose of exploration is to enlarge the current knowledge base (i.e., develop new capabilities) (see Raisch & Birkinshaw, 2008). They are mutually *incompatible* as exploitative learning modes involve refinement, selection and improvement, whereas explorative learning refers to modes of search, variation and experimentation (March, 1991). Both are associated with a self-reinforcing behavioral tendency that may cause corporations to be trapped into the overemphasis of either mode to the detriment of the other (cf. Levinthal & March, 1993). Overemphasis may have negative performance implications as it reflects the trade-off to generate short-term profits by focusing on the exploitation of established businesses instead of creating long-term benefits by focusing on the exploration of emerging alternatives (see March, 1991b; He & Wong, 2004). Corporations therefore face the challenge to balance both modes in order to achieve superior long-term performance (see Andriopoulos & Lewis, 2009).

2.1.2 DUAL STRUCTURES

For realizing the balance between the exploitation and exploration modes, dual structures are proposed (cf. Duncan, 1976: 167). Establishing such structures refers to "the subdivision of tasks into distinct organizational units that tend to develop appropriate contexts for exploitation and exploration" (Raisch, Birkinshaw, Probst, & Tushman, 2009: 686). The structural differentiation or separation of tasks into distinct subunits creates "pragmatic boundaries" (Carlile, 2004) that allow the two incompatible learning modes to coexist within one organization (Jansen, Tempelaar, Van den Bosch, & Volberda, 2009). The separation of exploitative and explorative tasks enables corporations to improve capabilities for the mainstream business and to develop new capabilities for entering novel business domains simultaneously (Raisch, 2008). Corporations may realize dual structures by establishing explorative subunits alongside the mainstream business (cf. Jansen et al., 2009).

The mainstream business is generally formalized in order to maximize efficiency and control through process management (Benner & Tushman, 2002; Benner & Tushman, 2003). Such a formalized organizational context is ill-suited for explorative subunits which are established typically as small teams with flexible routines that facilitate explorative learning modes such as experimentation or improvisation (Lavie, Stettner, & Tushman, 2010). Hence, explorative subunits are often separated from the mainstream business to avoid cultural and procedural spillovers that may constrain their explorative task (Christensen, 1997).

2.1.3 DUAL STRUCTURES THROUGH CORPORATE VENTURES

Large corporations generally establish explorative subunits such as corporate ventures as separated subunits (see Birkinshaw, van Basten Batenburg, & Murray, 2002). Corporate ventures are small entrepreneurial teams focused on the explorative task to develop new businesses for the corporation (Garrett & Covin, 2013). Separation protects the corporate ventures from the managerial cognitions (Gilbert, 2005), inertia (Simon & Houghton, 1999) and short-term pressure (McGrath, Keil, & Tukiainen, 2012) of the mainstream business (Kanter, 1985; Block & MacMillan, 1993; Jansen et al., 2009). The prevailing yet normative view is that the extent of separation thus increases the corporate venture's success as it enables ventures to mould their own "processes, structures, and cultures" (O'Reilly & Tushman, 2004: 3) that suit their new task environment (Dess, Lumpkin, & McGee, 1999; Simon & Houghton, 1999).

While common wisdom follows the normative assumption that corporate ventures should be separated from the mainstream business (Burgelman, 1983; Kanter, 1985; Schuler, 1986; Birkinshaw et al., 2002; Burgers et al., 2009), empirical evidence associating separation with corporate venture success is yet to be provided (e.g., Birkinshaw et al., 2002). Rather than that, empirical findings contradict the common wisdom and show that separation may also influence corporate venture success negatively (Johnson, 2012) or may have no impact at all (Kuratko et al., 2009; Garrett & Covin, 2013).

The evidence that separation may have negative performance implications shows that establishing corporate ventures as fully autonomous subunits may not be the optimal form. Instead, the relationship between corporations and their ventures is more complex (cf. Thornhill & Amit, 2000). For example, studies show that corporate ventures are subject to subtle control (Simon & Houghton, 1999). With subtle control, corporate management allows ambiguity for creative problem-solving. At the same time corporate management exercises sufficient control to ensure that product-market offerings fit corporate strategy and competences (Brown & Eisenhardt, 1995). Subtle control puts corporate ventures into a somewhat semi-autonomous position (Kuratko, 2010). Thus, corporation-venture relations are more complex than it may appear at first glance.

2.2 RESOLVING THE COMPLEXITY OF CORPORATION-VENTURE RELATIONS

Untangling the complexity of corporation-venture relations, Thornhill and Amit (2000) assume that corporate ventures are tight and loose coupled with their corporations. Tight and loose coupling mirror the challenge of corporate ventures (1) to benefit simultaneously from existing corporate strengths and (2) to develop something new. Tight coupling facilitates corporate ventures to exploit capabilities that already exist in the corporation (MacMillan, Block, & Narasimha, 1986; Dougherty, 1995). Loose coupling, in contrast, facilitates freedom and flexibility required to develop new capabilities (Burgelman, 1983; Simon & Houghton, 1999). Research acknowledges the relevance to resolve the complexity that is inherent in corporation-venture relations and have shed light from different viewpoints. The literature review highlights three different viewpoints by which we can manage this complexity. These are the resource-based view, the organizational design-based view and the dynamic capability-based view. They are discussed in the Subsections 2.2.1 to 2.2.3.

2.2.1 A RESOURCE-BASED VIEW

An organization seen from a *resource-based view* is considered as a bundle of resources (Penrose, 1959). Competitive advantage is explained based on the characteristics of the organization's resources and its ability to protect them from imitation, transfer and substitution (Barney, 1991). Resources include (a) tangible assets such as machinery, infrastructure or skilled personnel, (b) intangible assets such as knowledge of technologies, reputation or brand names and (c) financial assets such as capital (Wernerfelt, 1984). Following the resource-based view, corporation-venture relations may be regarded as being formed through the relatedness of corporations and their ventures (Sorrentino & Williams, 1995).

In theory, relatedness reflects the extent to which corporate ventures share corporate resources. The extent to which resources are shared defines how tight or loose corporate ventures are coupled with their corporations (MacMillan et al., 1986; Campbell, Goold, & Alexander, 1995a). Synergetic effects may emerge when ventures utilize corporate resources (MacMillan et al., 1986). It is believed that high levels of relatedness or tight coupling influence corporate venture success positively when the corporate and venture businesses are similar, for example, with respect to products, markets or technologies (see, e.g., Campbell, Goold, & Alexander, 1995b). In contrast, other studies find that tight coupling is antithetical to corporate venture success as the purpose of ventures is rather explorative. Thus, the proponents proposed to share a minimum of resources or low levels of relatedness (Burgelman, 1983; Ginsberg & Hay, 1994).

In practice, Sorrentino and Williams (1995) report however that (1) there is no significant association between relatedness and corporate venture success in either form. Garret and Neubaum (2013) find that (2) low levels of relatedness (referring to the venture's initial resource base) exhibit a positive association with corporate venture success. However, they further show that business similarity (referring to the product lines) has a negative impact on the positive association between low levels of relatedness and corporate venture success. The explanation for that may be that (3) the share of resources reduces "the venture's ability or willingness to think outside the box and pursue disruptive innovations" (Garrett & Neubaum, 2013: 911). In summary, the limited empirical evidence indicates that the impact of relatedness on corporate venture success remains discussed. In any case, the literature review shows that the resource-based view has not yet provided sound managerial implications for successful corporate venture management.

2.2.2 AN ORGANIZATIONAL DESIGN-BASED VIEW

The *organizational design-based view* assumes that diversified firms should match high levels of differentiation with high levels of integration in order to achieve superior performance (Lawrence & Lorsch, 1967; Thompson, 1967). Differentiation is defined as the subdivision of tasks (e.g., marketing and R&D) into distinct subunits. Integration includes mechanisms such as liaison roles, temporary teams or common goals (Galbraith, 1973; Gupta & Govindarajan, 2000). Independent of its form, it is agreed that integration facilitates the coordination of activities and resource in diversified organizations (Ghoshal & Nohria, 1989; Bartlett & Ghoshal, 1999; Gupta & Govindarajan, 2000). Proponents of the organizational design-based view allocate corporation-venture relations to design arrangements of differentiation and integration (Hill & Birkinshaw, 2012). Both design arrangements are seen as complementing. Tight relations are referred to integration whereas loose relations are associated with differentiation, which positions corporate ventures as loosely-coupled subunits (Burgers et al., 2009).

In theory, it is assumed that differentiation provides ventures with the freedom required to develop new knowledge and integration facilitates the transfer of knowledge already existing in the corporation which may stimulate cross-fertilization and enforce strategic coherence (Jansen et al., 2009; McGrath et al., 2012). Research suggests accordingly that differentiated corporate ventures should be integrated with the rest of the corporation (Hill & Birkinshaw, 2012). Integration may be achieved through formal and informal integration mechanisms (Gupta & Govindarajan, 2000).

In practice, a study confirms that informal integration mechanisms pursue "corporate venturing" (the extent to which corporations enter novel product/market domains by creating corporate ventures) whereas formal integration mechanisms are found to be ineffective (Burgers et al., 2009). While this study highlight the relevance to integrate corporate ventures informally, we do not know whether the matching of differentiation and integration is associated with corporate venture success (see Hill & Birkinshaw, 2012). Hence, the organizational design-based view has so far not provided insights into successful venture management practice.

2.2.3 A DYNAMIC CAPABILITY-BASED VIEW

The *dynamic capability-based view* evolved as an analytical framework in consequence of the paradigmatic change from stable to dynamic environmental conditions (D'Aveni, 1994) in which corporations compete today (Li & Liu, 2014). The analytical framework assumes that corporations accomplish competitive advantage by reconfiguring their resource base quickly in adaptation to the business environment (cf. Teece, 2012). The reconfiguration of resources is realized through routines (e.g., Eisenhardt & Martin, 2000). Routines are defined generally as the recurrent interaction patterns carried out by multiple actors (Becker, 2004). An organization's routines are embedded in individual processes and thus specific to the context (see Cohen et al., 1996). Below, management routines are defined in order to specify the context in which the term routine is used in this thesis.

Definition 2.1: **Management Routines** *are the regular and recurring meetings among corporate management and venture management.*

Building on this definition, the thesis assumes *in theory* that corporation-venture relations are formed through management routines. This assumption is reasonable as the interaction between corporate management and venture management is carried out through the management routines. Although it seems promising to investigate management routines to explain effective corporate venture management, it is not yet tested *in practice* whether this research attempt explains corporate venture success. One reason for the lacking evidence may be that it is difficult or even impossible to measure routines directly in order to quantify their effects on corporate venture success (see, e.g., Strehle et al., 2010).

Therefore, I focus on the interaction among corporate management and venture management which is carried out through the management routines. More specifically, I investigate a particular part of this interaction, namely, the oversight and control that corporate management exercises over venture management. Similar to prior studies, oversight and control is measured in this thesis through the degree and types of autonomy that corporate management disperses to venture management (Crockett, McGee, & Payne, 2013). Investigating the impact of autonomy on corporate venture success seems promising to explore effective venture management practice. However, the remainder of this section demonstrates that a construct to measure the autonomy of venture managers is not yet satisfactorily developed. Therefore, I propose a multidimensional autonomy construct.

A construct to measure autonomy is still to be developed

Prior research has measured the autonomy of venture managers based on two constructs (see Thornhill & Amit, 2000; Birkinshaw & Hill, 2005; Kuratko et al., 2009). The first construct gathers the extent to which venture managers operate independent from the rest of the corporation (Kuratko et al., 2009). The second construct measures the extent to which venture decision-making is separated from the corporation in the sense that corporate management disperses decision power to venture managers.

The first autonomy construct is known as venture planning autonomy and measures "the extent to which venture managers are responsible for establishing goals, timetables, event milestones, and strategy for the venture" (Kuratko et al., 2009: 465). However, studies aligning this type of autonomy with corporate venture success are inconclusive. Kuratko et al. (2009) find that venture planning autonomy exhibits a positive association with corporate venture success. Garret and Neubaum (2013) confirm these results reporting that venture planning autonomy exhibits a positive influence on corporate venture success. In contrast, Johnson (2012) reports a negative relation between venture planning autonomy and corporate venture success. The contradicting results of these studies demonstrate that the relevance of the first construct to explain corporate venture success is discussed controversially.

Studies applying the second autonomy construct for investigating the association between autonomy and corporate venture success are similarly inconclusive. Birkinshaw and Hill (2005) report that venture managers with increased decision authority concerning "investment and management matters" outperform their counterparts with low decision authority (Birkinshaw &

Hill, 2005: 251). Crockett et al. (2013) come to a similar conclusion and find that venture managers enjoying high decision authority are more likely to achieve strategic milestones. In contrast, Thornhill and Amit (2000) find that corporate venture success is influenced negatively when venture managers have the authority to make decisions. The contradicting findings of these studies illustrate that the relevance of the second autonomy construct for explaining corporate venture success may also be questioned.

A multidimensional autonomy construct is proposed

The ambiguous evidence concerning the relevance of both autonomy constructs supports the previous assumption that the construct reflecting the autonomy of venture managers is not yet well understood (see, e.g., Lumpkin, Cogliser, & Schneider, 2009; Johnson, 2012). The ambiguity of available autonomy constructs to explain corporate venture success suggests that it may be fruitful to establish a more detailed view on autonomy (Johnson, 2012). The suggestion to measure autonomy more precisely is consistent with the notion that further conceptual work is required to generate a more comprehensive understanding of the autonomy construct (see Birkinshaw & Hill, 2005; Lumpkin et al., 2009; Johnson, 2012; Crockett et al., 2013; Garrett & Covin, 2013).

All in all, we have shown that research suggests a multidimensional construct to measure the autonomy of venture managers more precisely (Johnson, 2012: 473). The autonomy that venture managers may enjoy, reflects many conditions such as loose versus tight corporate control (Crockett et al., 2013), centralized versus decentralized decision making (Birkinshaw & Hill, 2005), independent versus dependent venture operations (Garrett & Covin, 2013) or dependency versus independency on corporate resources (Sathe, 1985). The distinct conditions reflecting autonomy imply that different constructs are required to measure the full spectrum of autonomy. Johnson (2012) proposes accordingly that it might be best to measure autonomy based on a multidimensional construct, which is however missing so far. Following the recommendation to develop such a construct, a first multidimensional autonomy construct is developed and applied in this thesis.