

# Inducing strategic initiatives at a startup firm: Understanding the role of the co-founding team

## **Abstract**

I propose a study to understand the process of inducing strategic initiatives at a startup firm. Building on the model of strategy as a process of guided evolution (Lovas & Ghoshal, 2000), I seek to detail how co-founders at a startup firm induce strategic initiatives by orchestrating influence on variation, retention and selection of ideas, people and projects over time. Using a comparative case study of Paypal and Billpoint at around the turn of the 20th century, I hope to enrich the Lovas & Ghoshal (2000) model in the empirical context of the digital economy.

## **Keywords:**

co-founders, process model, strategic initiatives, variation selection retention

### Inducing strategic initiatives at a startup firm: Understanding the role of the co-founding team

*I disagree and commit all the time. We recently greenlit a particular Amazon Studios original. I told the team my view: debatable whether it would be interesting enough, complicated to produce, the business terms aren't that good, and we have lots of other opportunities. They had a completely different opinion and wanted to go ahead. I wrote back right away with **"I disagree and commit and hope it becomes the most watched thing we've ever made."** Consider how much slower this decision cycle would have been if the team had actually had to convince me rather than simply get my commitment.*

*Jeff Bezos*, reflecting on a recent *strategic initiative* at Amazon (Bezos, 2016).

One of the recent debates among scholars in the strategy process tradition is whether strategic initiatives in firms are induced, are autonomous or are both. In incorporating a "variation selection retention" framework into the process research tradition, Burgelman (1991) presents the strategic process as being either induced by management or being autonomous from across the organization. Lovas & Ghoshal (2000) on the other hand conceive of all strategies as being autonomous.

Lovas & Ghoshal (2000) define strategic initiatives as "a deliberate effort by a firm at creating or appropriating economic value from the environment, which is organized as an independent project with its own profit and loss responsibility". The focus on economic value leads to the additional recognition that not all strategic initiatives survive the initial stages to become a part of the firm's product line as the strategic initiative could be hampered by any number of internal, technical or market related issues. This definition lends itself into an evolutionary process model consisting of variation (the introduction of a new product or service), selection (appropriating resources from the environment), and retention (continued capacity to appropriate resources over time). Saliently, this maybe applied to internal as well as external market conditions of a firm. By treating the organization itself as the platform for ecological selection, Lovas & Ghoshal (2000) suggest that all strategic processes may either be considered autonomous or induced.

The management of strategic initiatives involves selecting and motivating talent, communicating the strategic intent, guiding resource allocation and providing sense and direction when things do not work out. The Lovas & Ghoshal (2000) model is particularly appropriate in the context of a startup firm, where traditional management is either absent or is manifested in a decentralized way. If we assume that all strategic initiatives are autonomous, it becomes interesting to understand how startup firms guide the strategic initiatives in the direction of the co-founders' strategic intent. As the quote from Jeff Bezos at the beginning of this section suggests, strategic initiatives at firms make take complex paths. This provides the motivation for the study proposed in this paper, to simplify and explain that process better.

In the following section, I review process theories of the past and present and suggest why the Lovas & Ghoshal (2000) framework may be the appropriate one to study strategic initiatives in a startup firm. In the section following the next, I then propose a comparative case study of PayPal and Billpoint to further our understanding of how strategic initiatives are induced at a startup firm.

## REVIEW OF THE EVOLUTION OF THE STRATEGY PROCESS LITERATURE

The tradition of process research applied to strategic initiatives goes at least as far back as Bower (1970). I briefly trace the evolution of this tradition in the following sections. A snapshot of the original models have been provided in Appendix A.

### Classical theories

Noda & Bower (1996) capture the ethos of strategy process researchers by drawing attention to various complexities inherent in organizations. They highlight “possible goal incongruence”, “information asymmetry”, “organizational politics” (Barnard, 1938; Cyert & March, 1963; Simon, 1997), and “unpredictable and uncontrollable environments” (Nelson & Winter, 1982; Pfeffer & Salancik, 1978; Schumpeter, 1934; Thompson, 1967) as having driven process researchers to describe how strategy is formed in practice rather than prescribing what it should be (Mintzberg et al., 2005).

Bower (1970)'s classic study demonstrated that the role of top managers is limited in that they do not necessarily have the appropriate knowledge or information to evaluate technical and economic aspects of the strategic initiatives, and tend to rely on the track records or credibility of proposing middle managers in making resource allocation decisions. Figure 5 in the appendix displays the original resource allocation process suggested by Bower (1970). Mintzberg (1978) suggested that strategy is, more or less, emergent from lower levels of organizations (see Figure 6). Quinn (1980) suggested strategy emerged incrementally with logical guidance from the top (see Figure 7 and Figure 8). The Bowerian model was further extended by Burgelman (1983) in his study on internal corporate venturing (ICV) in a large corporation. In summarizing the tradition, Noda & Bower (1996) suggest that the Bower-Burgelman (B-B) process model of strategy making in a large, complex firm depicts multiple, simultaneous, interlocking, and sequential managerial activities over three levels of organizational hierarchy (bottom, middle, and top managers) and conceptualizes intra-organizational strategy-making processes as consisting of four subprocesses: two interlocking bottom-up core processes of definition and impetus and two overlaying corporate processes of structural context determination and strategic context determination (see Figure 9).

### Including the Variation Selection Retention framework in the Burgelman (1991, 1994) Model

The intraorganizational perspective (see Figure 1) by Burgelman (1991) extended the frameworks presented by Mintzberg (1978) and Quinn (1980) by highlighting processes through which emergent strategies become part of realized strategies and by providing some evidence that logical incrementalism is likely to be variation reducing.

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Insert FIGURE 1 about here.

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Burgelman (through Burgelman (1991, 1994) introduced into this tradition the variation selection retention framework (see Figure 2) from the literature on organizational evolution and ecology (Campbell, 1965; Nelson & Winter, 1982). This model suggests that autonomous strategic initiatives serve to challenge the formal strategy of the firm. The key task of top management in this

model is to therefore resolve the tension between the autonomous and induced strategy processes by acting as the selection filter through resource allocation decisions.

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Insert FIGURE 2 about here.

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### **Treating all strategic processes as autonomous/induced in the Lovas & Ghoshal (2000) Model**

In contrast to the Burgelman view described above, Lovas & Ghoshal (2000) describe guided evolution as being based on the experiences of a firm that has attempted to replicate a natural selection environment within itself (see Figure 3). They argue therefore that all strategic initiatives may be seen as being autonomous in the sense that someone in the organization initiates them. Yet, they may all be seen as being induced in the sense that the process of variation selection retention is guided by a strategic intent that is defined by top management. As a result of this difference, guided evolution posits a role of top management that is very different from the role one can infer from Burgelman's model. Relative to the Burgelman (1991) model, the Lovas & Ghoshal (2000) model (see Figure 4) suggests that top management's role in shaping the strategic context maybe be retroactive rationalization and their influence on structural context severely constrained. The role of top management in this model to create an administrative systems to replicate the processes of natural selection within the organization and to guide those processes by defining the strategic intent, strategic initiatives and human and social capital.

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Insert FIGURE 3 about here.

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Insert FIGURE 4 about here.

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### **Applying the Lovas & Ghoshal (2000) model in a startup firm**

While all prior process theories discussed here focus their attention on traditional and typical large firms organized as hierarchies, I suggest here why they may remain quite relevant in the context of the entrepreneurial startup firm. First, the process theories lay their focus on the tasks of management, and it stands to reason that similar functions are performed in entrepreneurial firms even though not by a clearly designated management team. Second, the Lovas & Ghoshal (2000) model is particularly relevant to the startup firm because of the relaxing condition that all strategic initiatives maybe viewed as being either induced or as autonomous. This removes the requirement of a formal management team, and the concepts are now adaptable to the co-founding team that is traditionally vested with many of the functions of top management. Strategic initiatives may be induced in such a firm through a series of actions including those in recruitment, financing and spinning off of independent projects. Finally, evolutionary models require that there be sufficient variance selective system to operate on, a condition mated well to startup firms. I therefore propose to build on top of the Lovas & Ghoshal (2000) model in presenting my research proposal.

## RESEARCH PROPOSAL

Scholars have highlighted that the central problem of evolution in cultural and social systems is the tension between the creation of new variants (new strategic initiatives) versus the retention of previously selected variants (existing strategic initiatives). This may be particularly salient in startup firms that are constrained on managerial experience or talent. I therefore pose the following question: How do founders in a startup firm simultaneously balance variation, selection and retention of ideas, people and projects over time in the pursuit of their strategic intent?

### Theory

Drawing from the theories of the Carnegie school (problem-solving perspective, Cyert & March (1963); Simon (1997)), as well as from the findings of several process studies referenced in this article, we understand strategic initiatives to emerge primarily from managerial activities of front-line and middle managers. In the context of a startup firm, front-line and middle managers are adequately approximated by the group of all non-founder employees, and top management is partially approximated by the co-founding team. Drawing on Bower (1970), we may therefore conclude that the co-founding team may critical influences on strategic initiatives by setting up the structural context (organizational and administrative mechanisms and reward and punishing systems) to reflect their strategic intent, and thereby manipulating the context in which the decisions and actions of rest of employees are made.

***Creating slack for the future*** James March has noted elsewhere that the problem in attempting to engineer or guide evolutionary processes in social systems is to specify what part of the system one is to optimize (March, 1994). This is problematic because social systems are composed of interrelated components. In the language of evolutionary biology (Kauffman, 1993), the path to a position of greater system fitness may come from a lowering the fitness contribution of some of the components at the benefit of others. This then requires that a tradeoff be made about which aspects to optimize on at a point of time. Therefore, rather than control the retention of predefined strategies, co-founders at a startup firm must be seen to help manage the coevolution of strategic initiatives and human and social capital (Lovas & Ghoshal, 2000). This positive side in the role of management (Lovas & Ghoshal, 2000) leads me to my first hypothesis:

*Hypothesis 1: When strategic intent and execution of strategic initiatives converge, co-founders in successful firms are more likely to emphasize variation in human capital and deemphasize selection of projects than those in unsuccessful firms.*

***Failing fast*** Successful startup firms are more likely to avoid the negative side in the role of management (Lovas & Ghoshal, 2000) characterized either by a failure to act or the impulse to make frequent changes. When failures occur, good teams are likely to deemphasize the role of the individuals in the failure and instead search for alternative problems to solve. That leads me to my second hypothesis:

*Hypothesis 2: When the strategic intent and execution of strategic initiatives fail to converge, co-founders in successful firms are more likely to emphasize selection and retention in projects and deemphasize selection and retention of human capital than those in unsuccessful firms.*

## **Data and Method**

At around the turn of the century, PayPal found itself up against Billpoint. PayPal had been founded to enable secure digital payments between individuals, and had dedicated its strategic attention on its most important partner - eBay, an online auction marketplace. The vast majority of PayPal transactions at the time were happening on the eBay platform when eBay decided to partner with Wells Fargo Bank to launch its own payment system, Billpoint. PayPal faced competition from eBay (eBay would promote Billpoint to all its users) on its most valued platform. Yet, within a year PayPal triumphed over Billpoint and eBay was forced into purchasing PayPal for \$ 1.5 billion in August 2002 (the deal completed in 2003).

The setting described above is characterized by the following attributes. First, PayPal and Billpoint were clearly direct competitors operating in the same industry and therefore subject to similar external environmental forces. Second, both PayPal and Billpoint were building a solution to the same problem. Third, both firms were located in the same region and had access to the same talent pool. Despite such similarities, and a presumable advantage (through the eBay parentage), Billpoint failed and PayPal succeeded. A comparative case study of the co-founder decision making process between the two firms, can potentially give us causal answers to what processes adopted at PayPal vis-a-vis that adopted at Billpoint specifically lead to PayPal's success. The sample selection process described above is resilient to alternative explanations or endogenous factors to be proposed to weaken the findings. Indeed, given that PayPal had a natural disadvantage against Billpoint, the findings from my study are likely to understate the true effect of co-founder action not overstate it. While it maybe argued that retrospective studies may suffer from survivor bias, I contend that this maybe adequately countered by relying primarily on archival data including internal memos, emails and press reports from the period that were describing process occurring at the time.

Since neither PayPal nor Billpoint could have possibly known upfront which strategic initiatives would lead to success, it stands to reason that the evolutionary response of PayPal co-founders to the problems at hand were superior to those of Billpoint. By inspecting founders' communications, hiring decisions, and sense giving processes, I expect to tease out the differences in the processes of simultaneously manipulating the conditions for variation, selection and retention of ideas, people and projects at each of the two competing firms. The rich data, coupled with the quasi-experimental setup will lead us to provide causal explanations for PayPal's superior evolutionary and economic outcomes.

## **CONTRIBUTION**

Insights from the empirical study of the evolutionary processes in strategic initiatives at PayPal and Billpoint can potentially further the theory of strategy as guided evolution. In the least, I expect the

study to add significant empirical insight to the processes of inducing strategic initiatives in startup firms.

## SUMMARY

In this paper, I have used the Lovas & Ghoshal (2000) model of strategy as guided evolution as an anchor to first review the literature on strategy process research, and then suggested a study that will apply the Lovas & Ghoshal (2000) to an empirical setting that promises to provide a causal inference of the sources of superior evolutionary approaches to the inducing of strategic initiatives.

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## APPENDIX A: CLASSICAL PROCESS MODELS

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Insert FIGURE 6 about here.

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Insert FIGURE 7 about here.

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Insert FIGURE 8 about here.

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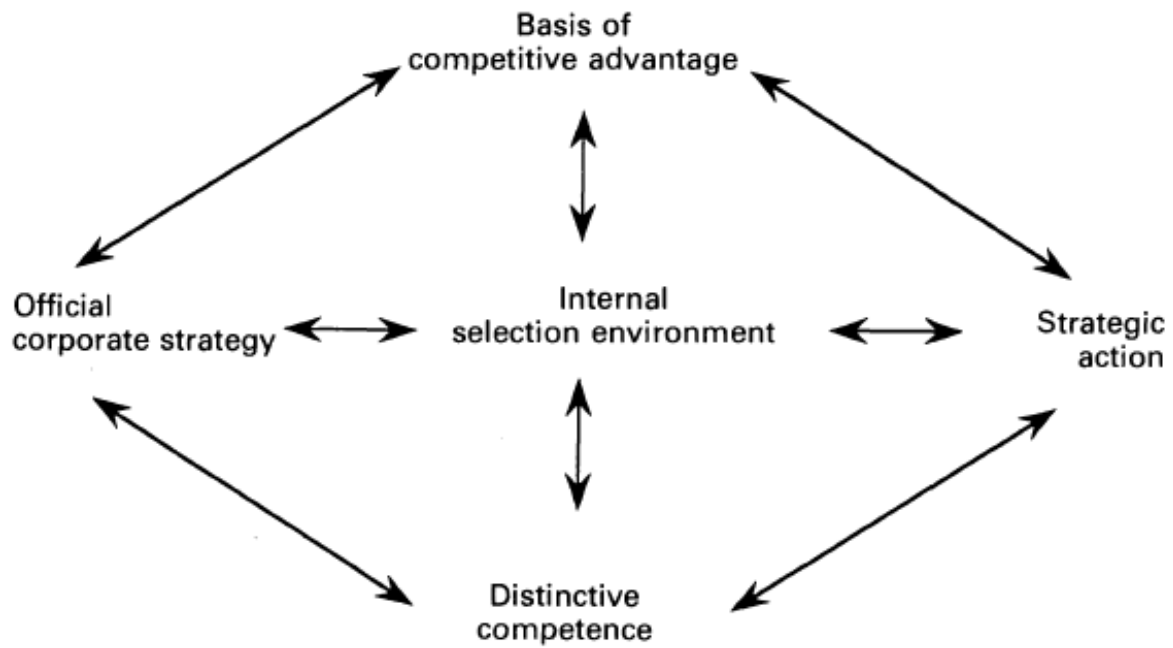
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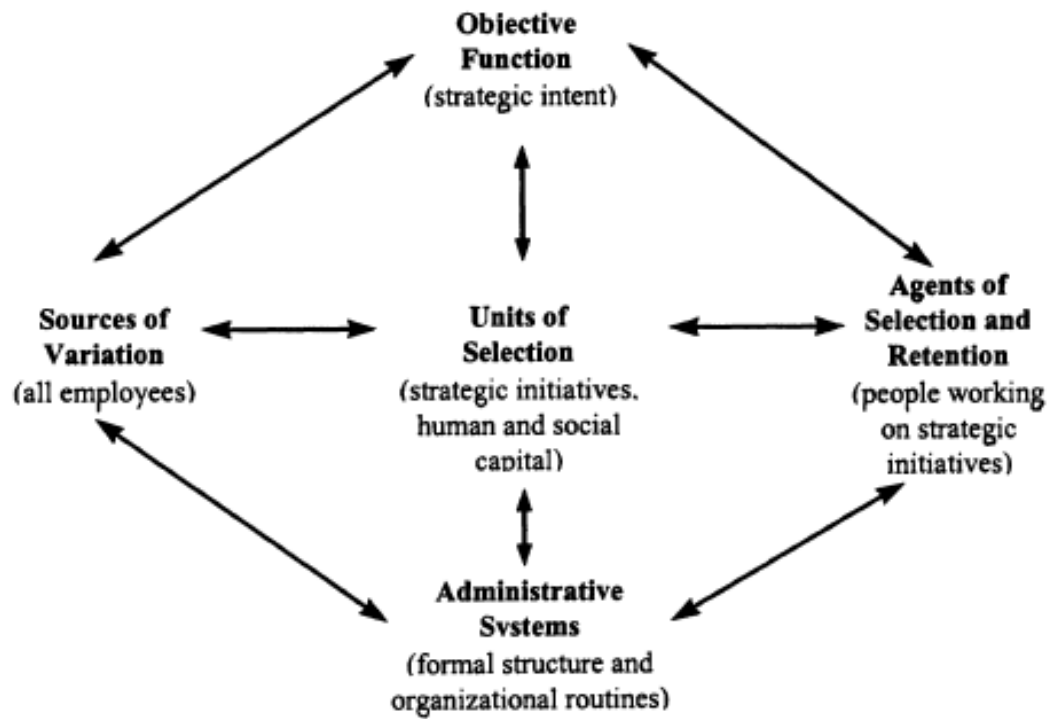
Insert FIGURE 9 about here.

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**FIGURE 1:** Intraorganizational Ecology of Strategy Making and Organizational Adaptation, adopted from Burgelman (1991)

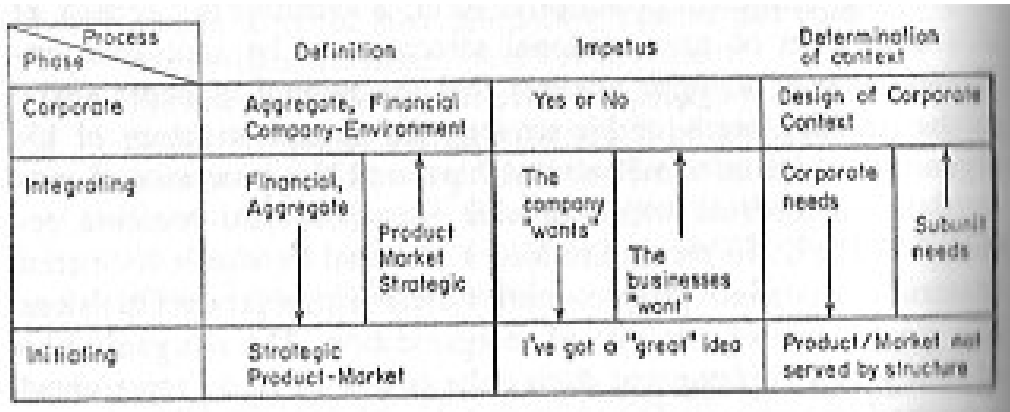
<i>Intraorganizational Ecological Processes</i>				
	Variation	Selection	Retention	Ties to Adaptation
Strategic Processes	<p><b>Induced</b></p> <p>Strategic initiatives seeking resources for projects that correspond to internal selection pressures of structural context, fit with the current organizational strategy, and offer access to regular opportunity structure for career advancement. Originate at operational-level but intended to be driven by top management's ex ante vision.</p> <p>Enhanced by availability of growth opportunities remaining in current action domain.</p> <p>Radically new induced initiatives initiated by top management.</p>	<p>Initiatives selected through administrative mechanisms (e.g., strategic planning) and/or cultural influencing (e.g., reference to key values). Differential allocation of resources to different areas of strategic initiative.</p> <p>Key is that internal selection reflects current external selection pressures.</p> <p>Major changes in structural context.</p>	<p>1. Organizational learning about bases for past/current survival (variously embodied).</p> <p>2. Distinctive competences (variously embodied).</p> <p>3. Organizational goals.</p> <p>4. Organizational action domain.</p> <p>5. Organizational character.</p> <p>All of these elements integrated in ex ante vision</p> <p>Major changes in the dimensions of organizational strategy.</p>	<p>1. <i>Relative inertia.</i> Organizational survival is due to a good fit of internal selection processes with the environment. Survival motivates conservatism on the part of top management and desire to leverage existing organizational learning through induced process. Reluctance to change organizational strategy.</p> <p>2. <i>Adjustment.</i> Relatively minor changes in strategy to accommodate environmental change.</p> <p>3. <i>Reorientation.</i> Major changes in strategy in response to major environmental change.</p>
	<p><b>Autonomous</b></p> <p>Strategic initiatives outside scope of current strategy. Driven by operational-level managers seeking to use their skills in new combinations with organization's distinctive competences and, in some cases, seeking career advancement through alternative opportunity structure.</p> <p>Enhanced by availability of unabsorbed slack</p>	<p>Defining strategic context for new initiatives through:</p> <ul style="list-style-type: none"> <li>finding resources outside regular resource allocation process;</li> <li>demonstrating viability in external environment through entrepreneurial activity;</li> <li>mobilizing internal support on the part of upper level managers;</li> <li>developing new competences/skills.</li> <li>setting stage for an amendment in the organizational strategy.</li> </ul>	<p>Changes in organizational learning, distinctive competence, and relative importance of new activities in total domain activity, which, cumulatively, lead top management to recognize that a major change in strategy is necessary and feasible. Lead to new, ex post vision. Once formally ratified, new vision becomes part of the basis for the induced process.</p>	<p>4. <i>Strategic renewal.</i> Major change in organizational strategy preceded by internal experimentation and selection offers organization possibilities for anticipatory adaptation to new environmental demands and/or to enter new niches.</p>

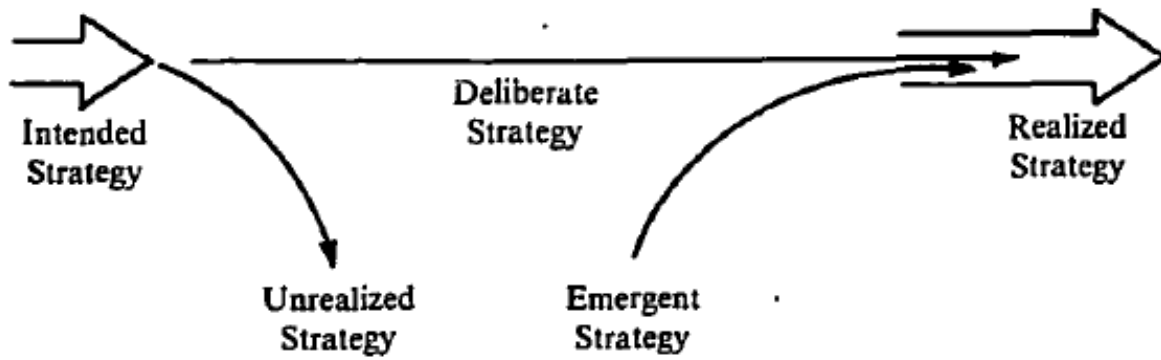
**FIGURE 2:** Forces driving the strategic business-exit process, adopted from Burgelman (1994)

**FIGURE 3:** The five elements of guided evolution, adopted from Lovas & Ghoshal (2000)

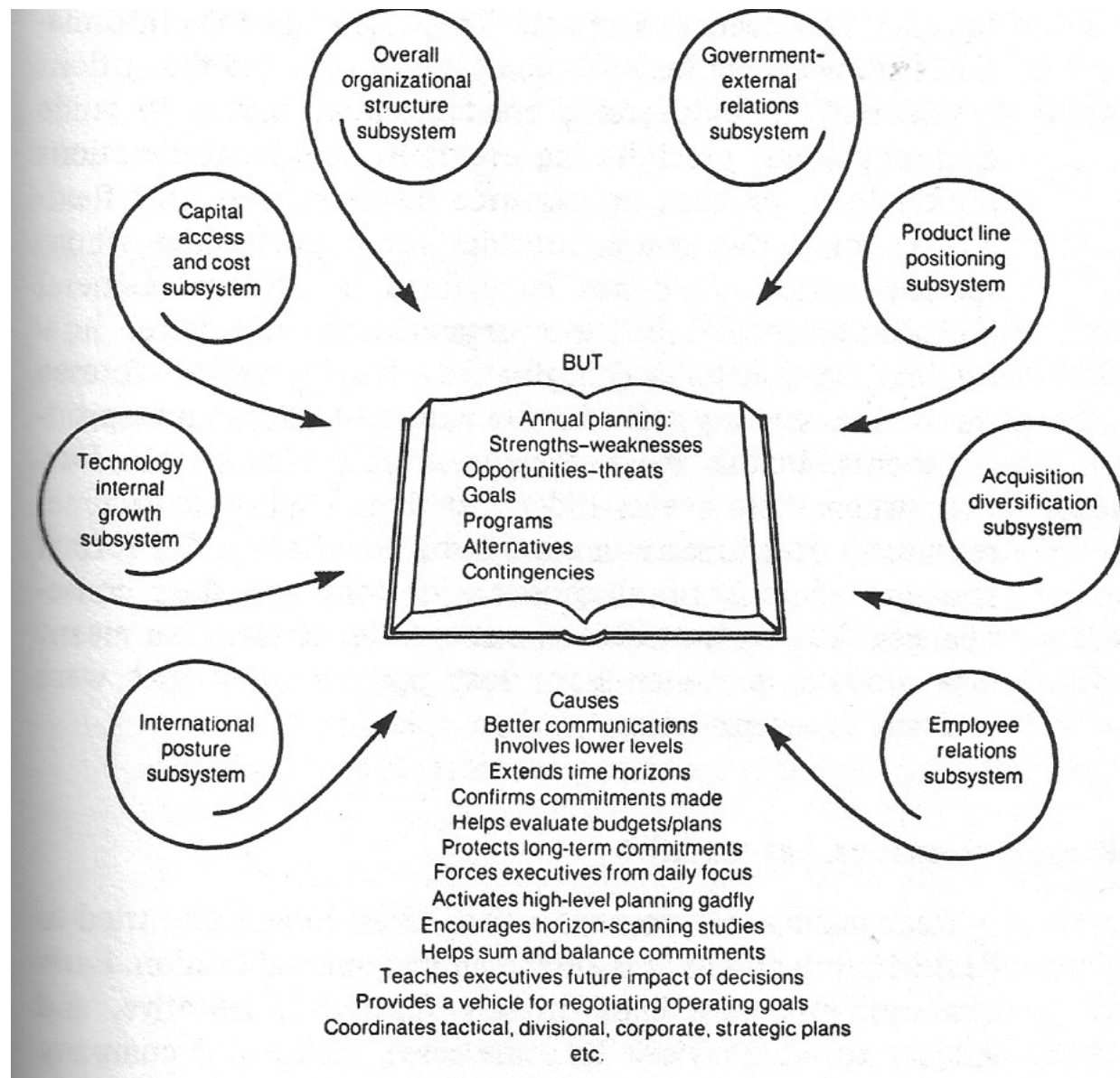
**FIGURE 4:** A model of strategic management as guided evolution, adopted from Lovas & Ghoshal (2000)

	Exogenous independent variables		Endogenous independent variables		Dependent variables
	Strategic intent	Administrative systems	Sources of variation	Agents of selection and retention	Units of selection
Definition of variable	Those long-term goals which reflect the preferred future direction of the firm, as envisioned by top management (Prahalad and Doz, 1987). In this model: Top management's decision and articulation of the one main ambition of the firm.	The basic way in which tasks are divided and work is organized in the firm (Chakravarty and Doz, 1992). In this model: The organization of all work in relatively independent projects, and the use of practice groups to retain and develop functional expertise.	Those who identify/suggest new variants of the units of selection In this model: Everyone working in the organization	Those who decide which suggestions will be acted on, and those who decide which of the existing ways will be continued. In this model: Everyone (veto principle) working on a strategic initiative	The units the selective system is operating on. In this model: 'Strategic initiatives' and 'human and social capital'.
Role of variable in the model	Defines the objective function—and thus the preferred outcome—of the strategy process.	Enable and facilitate resource allocation according to a logic of guided evolution.	Provide variance which the selective-retentive system may operate on.	Determine which new variants (of the units of selection) to select, and which previously selected variants to retain.	Focus the strategy process on those variables considered most important to the strategic adaptation of the firm.
Why important in the model	Necessary to define direction and legitimate claims on resources in the strategy process (Winter, 1994). Helps focus variation; reduces disturbances to the existing adaptive system.	The administrative system is necessary to make it in people's self-interest to contribute to the organization's adaptation, and to give them guidelines for how to do so.	Serves to elicit a broad/diverse set of suggestions.	Serves to enable selection and retention based on the knowledge of a large group of people.	The main way (strategic initiatives) and the main resources (human and social capital) the firm relies on to create and appropriate economic value.
Important issues related to the variable	Must remain stable over time periods (Campbell, 1969). Nestedness and maladaptation (March, 1994): 'copying errors' and unintended mutation, recombination, and hybridization of human and social capital (McKelvey, 1982; Nelson and Winter, 1982).	Most people adapt to organizational cues as opposed to the environment (Meyer, 1994). 'Whole-part' competition means that 'firm-level adaptations will be under continual undermining pressures' (Campbell, 1994: 38).	The diversity and general 'quality' of the variation. There must be enough variation for the selective systems to operate on (Campbell, 1969)	Variation-selection is at the expense of the already achieved adaptive system (Campbell, 1969)	For the evolutionary process to function satisfactorily in social systems, there are certain requirements to the frequency, independence, and importance of the units of selection (Campbell, 1969, 1994)

**FIGURE 5:** The Research Allocation Process, adopted from Bower (1970)

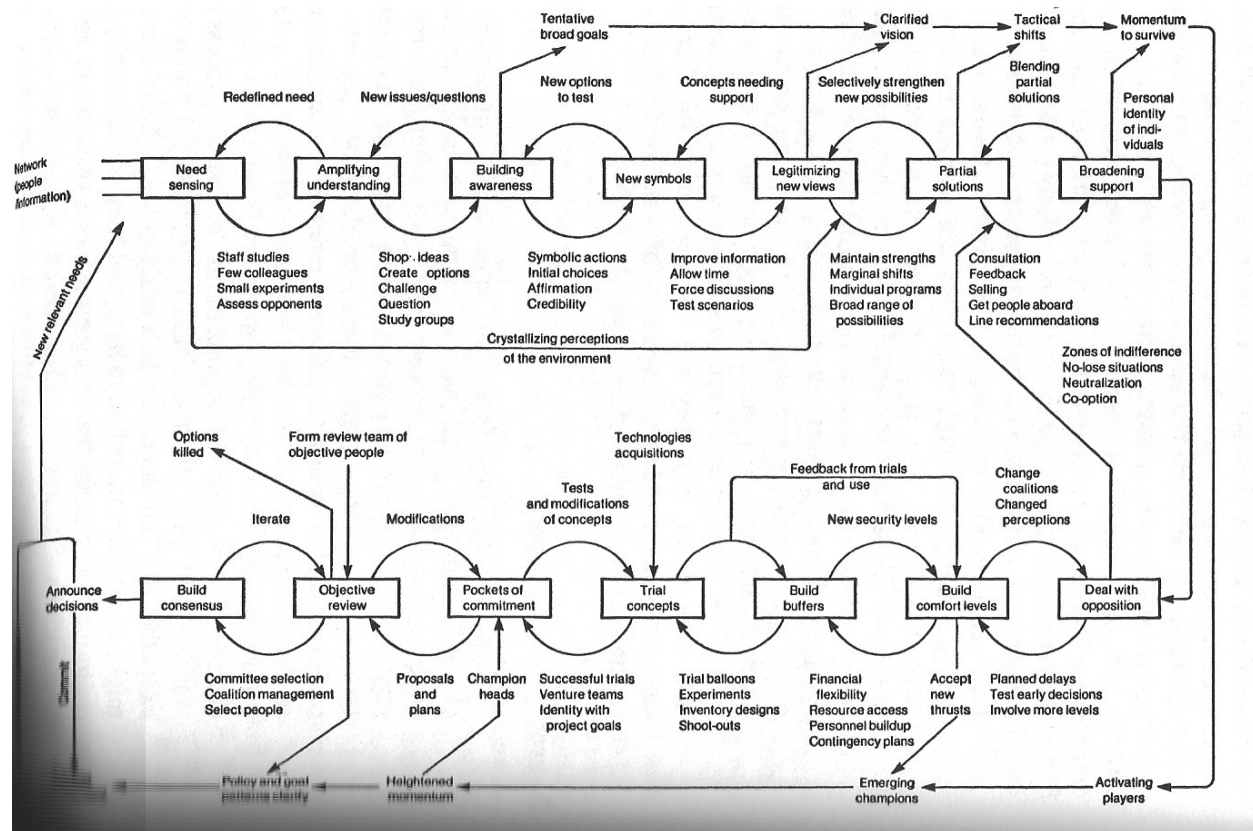
**FIGURE 6:** Types of Strategies, adopted from Mintzberg (1978)

**FIGURE 7:** Strategies form in subsystems (involving different people, skills, goals, information, and timing imperatives), adopted from Quinn (1980)





**FIGURE 8:** Some typical process steps in logical incrementalism (highly simplified to help visualize a few basic relationships), adopted from Quinn (1980)



**FIGURE 9:** Key and peripheral activities in a process model of ICV, adopted from Burgelman (1983)

