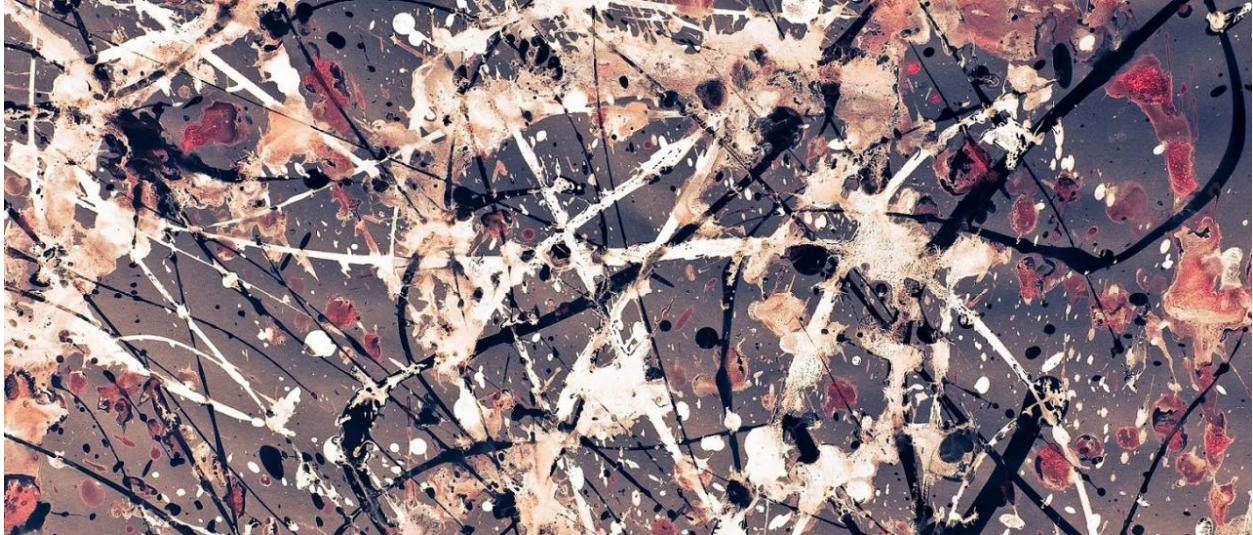

How Founding Conditions Shape the Way Start-Ups Deal With Change



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Diverse founding teams formed in unpredictable environments tend to perform better in similar subsequent conditions.

Dealing with environmental change – be it unforeseen supply chain shocks, sudden fluctuations in demand or rapid developments in the competitive landscape – is par for the course for companies doing business today. For start-ups to grow and mature, they must find a way to successfully navigate the opportunities and risks presented by these dynamic conditions.

Prior research has investigated how external changes to the business environment influence venture performance depending on how these changes enable or hinder firms. However, there is limited insight into how a start-up's ability to benefit from such changes may depend on past factors, including the environmental conditions under which the firm was founded.

To add to the existing literature on the topic, **our study** published in *Strategic Entrepreneurship Journal* examines how a start-up's environmental conditions at founding – both in terms of the level of dynamism at the time and the composition of the founding team – shape its enduring internal processes and influence whether it can benefit from environmental change later in its life.

Born into chaos

We predicted that firms with functionally diverse teams founded during periods of high environmental dynamism would be associated with better performance outcomes when this increased later in its life. On the flip side, these teams would be associated with worse performance outcomes – such as a decrease in venture survival length and the likelihood of achieving a positive exit through an initial public offering, merger or acquisition – when dynamism decreased over time.

In this study, we define functional diversity as the range of distinct roles (e.g. engineering, business development and finance) within the team structure. Environmental dynamism refers to the degree to which changes in key performance indicators (e.g. value-added, profit or customer acquisition) are unpredictable, uncertain or unexpected.

We analysed the relationship between environmental change over time and venture outcomes using data obtained from an alumni survey. Our final sample consisted of 1,060 start-ups founded from 1960 to 2011 across 19 industries ranging from agriculture to energy to utilities. This made our results more broadly applicable as compared to those from single-industry studies.

The survey assessed the length of time between when a venture was conceived and the last year of its operation, and whether it had a positive exit. Founders of the companies provided detailed information on the founding composition of their firms. We also used data from Compustat (public companies) and Dun & Bradstreet (private companies) to verify respondents' self-reported data on venture outcomes.

Our findings indicate that ventures with functionally diverse teams created in dynamic environments tend to survive longer (an additional 1.3 years based on our sample) when environmental dynamism increased over time. However, we didn't observe an uptick in the likelihood of them achieving a

positive exit under these conditions. On the flip side, we found that decreased environmental dynamism after founding was associated with a reduced likelihood of these firms experiencing a positive exit.

Thriving in dynamic environments

Our findings suggest that ventures can only benefit from environmental change when it aligns with their enduring ways of working formed under the influence of the founding environment. One possible explanation for why diverse founding teams born in dynamic environments thrive in similar settings later in life is that they have developed unique processes to suit these uncertain conditions. When processes are linked with success in the founding environment, they are likely to be used repeatedly during the venture's formative period. Consequently, these ways of working become embedded in routines, guiding future expectations and behaviour.

Functionally diverse teams tend to seek out and exchange large amounts of information as they embody a wide variety of viewpoints. This can be advantageous in dynamic conditions, which reward firms for being flexible and maintaining optionality. Environmental dynamism also accentuates functionally diverse teams' tendency to engage in intense debate as they tend to have more varied positions.

These diverse teams are also likely to adopt risk-averse processes due to the combined influence of internal team dynamics and the benefits these processes confer in dynamic environments. This refers to unpredictable conditions where slower, decentralised decision-making and increased creativity and flexibility are favoured.

More rigid or aggressive teams may commit resources too quickly, exacerbating the risks of biased or untested assumptions and ineffective information processing. Risk-averse processes may mitigate these dangers by promoting a more careful approach and are thus rewarded in dynamic conditions.

However, in stable and predictable environments, fast, centralised decision-making and increased routinisation are associated with high performance. This could explain why risk-averse, slower decision-making processes that tend to be adopted by diverse teams in dynamic environments do not have the same positive effect in stable conditions.

What can entrepreneurs do?

Persistent founding processes may improve performance when they continue to fit a venture's surrounding environment, as teams refine, improve and optimise these initial and ingrained ways of working. But when the environment changes and that same set of internal behaviours doesn't match up with what is now required to thrive, the misalignment can hamper performance.

Our findings suggest that founding processes become embedded and institutionalised within the beliefs and routines of a start-up's team. Teams may continue to apply these same processes even if they are not suited or transferable to the new environment. Even if savvy entrepreneurs become aware of this mismatch and strive to adapt their internal behaviours, our results indicate that they don't seem to be having much success with this.

This suggests that ventures experience inertia when they need to adjust entrenched processes and behaviours to better align with new environmental conditions, and that how a firm is born and raised exerts a lasting influence on how it operates. A similar effect was shown in [a study](#) on CEOs of publicly listed firms in China, which found that those who lived through the Great Chinese Famine during their formative years (between the ages of 6 to 18) displayed risk-averse behaviour.

Given the results of our research, we recommend that entrepreneurs pay even closer attention to how they **build their founding team** and establish **internal processes** in the early stages of their venture. These behaviours and ways of working will have a lingering effect on the firm and may not be as easy to tweak down the road as they may think.

Furthermore, instead of being razor-focused on the present, founders should widen their perspective and consider how things may look like in the future. By accounting for possible long-term environmental changes, they can devise the best strategy to help their team cope with and adapt to these developments should they materialise, allowing them to thrive.

Instead of developing founding processes and setting them in stone, leaders ought to regularly reassess how their team is operating relative to the current environmental conditions. Such exercises can assist them in better identifying potential misalignments and should ideally be done on a continual and frequent basis. While it may be hard for teams to change how they do things, being aware of a potential mismatch early on can empower

leaders to take corrective action before it's too late.

Find article at

<https://knowledge.insead.edu/entrepreneurship/how-founding-conditions-shape-way-start-ups-deal-change>

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About the research

"[Born into chaos: How founding conditions shape whether ventures survive or thrive when experiencing environmental change](#)" is published in *Strategic Entrepreneurship Journal*.