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Microfoundations of Strategic Flexibility in Young Ventures: The Role Of Founder-CEOs' Decision Rules

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SUMMARY

Strategic flexibility is widely accepted to be a capability that helps organizations deal with uncertainty. However, how individuals contribute to the emergence and evolution of strategic flexibility and how young ventures develop this capability despite emerging or unstable orientations, structures, and routines are relatively under-researched aspects. To address these gaps, we investigate decision rules that function as a microfoundation of strategic flexibility. We have conducted interviews with 28 founder-CEOs of young ventures. Based on a qualitative analysis of interview transcripts enriched with secondary data, we aim to develop a typology of decision rules based on decision patterns representative of microfoundations of strategic flexibility.

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Introduction

Uncertainty is a fundamental aspect of the environment for most organizations, and their continued survival and generation of profits depends on its successful management (Rindova and Courtney, 2020). Steering an organization in the presence of uncertainty necessitates that organizational actors perform actions, make commitments and investments, and accept material risks without knowing the complete set of possible consequences or the probabilities of the known and unknown consequences (Alvarez and Porac, 2020). Given the necessity of managing uncertainty for organizations, considerable research has been devoted to understanding how organizations work with and around uncertainty to be able to operate in their respective environments (Beckman, Haunschild and Phillips, 2004; Alvarez and Porac, 2020).

From this research, strategic flexibility has emerged as a key capability that allows organizations to deal with uncertainty (Volberda, 1996; Grewal and Tansuhaj, 2001; Brozovic, 2018). Strategic flexibility refers to the organizational ability to take advantage of emerging opportunities and respond to emerging threats (Zahra *et al.*, 2008). This capability can encompass proactive and reactive, offensive and defensive orientations, and activities such as changing current strategic actions, asset deployment, and investment strategies (Evans, 1991; Nadkarni and Herrmann, 2010). Its effects include improved organizational performance, increased competitive advantage, and other positive outcomes, especially for organizations that operate in dynamic and uncertain environments (Brozovic, 2018; Herhausen *et al.*, 2021).

As for the sources of strategic flexibility, research points to the importance of organizational resources (Brozovic, 2018). Organizations are more strategically flexible when available resources afford a wider range of alternative uses, and the cost, effort, and time required for switching from one use of a resource to another are lower (Sanchez, 1995). The second important source of strategic flexibility are the faculties within an organization that operate on the resources to flexibly (re)allocate them as new opportunities and threats emerge (Nadkarni and Narayanan, 2007). However, considerably greater attention has been paid to the former so far. Specifically, we still know little about the role that individuals play in shaping resource adaptation and utilization to enable (or constrain) strategic flexibility (Brinckmann *et al.*, 2019; Herhausen *et al.*, 2021) with a few noteworthy exceptions (such as Combe *et al.*, 2012; Fernández-Pérez *et al.*, 2016; Nadkarni & Narayanan, 2007).

The role of individuals gains considerably greater importance when resources are already scarce, and individual decision-makers have to exercise their superior judgment to ensure that their organization is not un(der)responsive to emerging opportunities or threats despite resource scarcity (Schmidt, 2015; Felin, Kauffman and Zenger, 2021). This necessity for exercising superior judgment is particularly acute for founder-CEOs leading young ventures since resource scarcity characterizes the context of most young ventures, in addition to the frequent high uncertainty (Laforet and Tann, 2006; Woschke, Haase and Kratzer, 2017). It is, however, not imperative that since most young ventures face resource scarcity, they are condemned to have low or no flexibility. The fact that most young ventures start from a place of relatively few or no commitments implies that they can, in fact, have more flexibility relative to larger firms since “they are unencumbered by the needs of pre-existing customers and revenue streams, organizational architecture and capabilities, or diseconomies of scope” (Gans, Stern and Wu, 2019, p. 742). It is when Founder-CEOs of young ventures start to commit to certain paths of exploiting the opportunity that they begin to directly or indirectly operate on their venture’s strategic flexibility and start to bring it from the excessive flexibility afforded by the proverbial “blank slate” to a level that is actually conducive to the venture’s survival and growth (Stevenson and Gumpert, 1985; Gans, Stern and Wu, 2019, p. 742).

Thus the general relative lack of research on individuals' role in enabling strategic flexibility has contributed to a gap in the research on strategic flexibility, where "we do not fully understand what determines new ventures' ability to be strategically flexible" and how strategic flexibility comes about in the entrepreneurial context (Brinckmann *et al.*, 2019, p. 155).

We therefore undertake a qualitative exploration of how Founder-CEOs negotiate commitments and their effects on flexibility to keep their young venture's strategic flexibility at a level that is conducive to operating under environmental uncertainty (McGrath, Ferrier and Mendelow, 2004). Our objective is to uncover the implicit or explicit decision rules that act as microfoundations of strategic flexibility. By decision rules, we refer to the basic inferences and guidelines that undergird Founder-CEOs' strategic decisions, i.e., decisions that significantly impact "the future direction and success" of the venture by having reverberating effects across time and across other decisions (Sharfman and Dean Jr, 1997, p. 202; Felin, Foss and Ployhart, 2015; Leiblein, Reuer and Zenger, 2018). By identifying and categorizing these rules as members of distinct "bundles" (Cavarretta, 2021, p. 1599) and codifying their evident and expected effect on the strategic flexibility of young ventures, we aim to arrive at a typology of decision rules representative of the cognitive microfoundations of this capability.

Decision rules, strategic decisions, and young venture capabilities

Our research builds upon the simple rules research program (Bingham, Eisenhardt and Furr, 2007; Davis, Eisenhardt and Bingham, 2009; Bingham and Eisenhardt, 2011; Looock and Hinnen, 2015). Simple rules "are heuristics or rules-of-thumb that save time and effort by focusing attention and simplifying thought" (Eisenhardt & Bingham, 2017, p. 251), thus "enabl[ing] flexible, yet coherent capture of opportunities" (Bingham and Eisenhardt, 2011, p. 1439).

Existing research on simple rules has established them as the constituents or influencers of various capabilities, including internationalization (Bingham, Howell and Ott, 2019), business process design (Reijers and Liman Mansar, 2005), and lean startup approaches (Artinger *et al.*, 2015; Ghezzi, 2020). However, instead of presupposing simple rules to be "at the heart of... high performing capabilities" (Furr, Eisenhardt and Bingham, 2020, p. 560) and assuming a direct relationship between the existence of simple rules and an organization being 'capable' in a certain way, we focus on simple rules as they exist and operate within strategic decisions, potentially leaving a positive or negative impact on the capability, i.e., strategic flexibility of young ventures. This distinction is supported by the recursive relationship between cognition, capabilities, and strategic decisions, where cognition shapes decisions about which capability development actions to take or avoid and thus influences how capabilities are built, which in turn have a bearing on which decisions are made (Laamanen and Wallin, 2009; Eggers and Kaplan, 2013).

Following this logic, we allowed founder-CEOs to discuss decisions they deemed most important and obtained data on a broad set of strategic decisions, such as those about product offering, product portfolio evolution, target market selection, internationalization, partnerships, funding, etc (Nutt, 2008). At an aggregate level, all of these different types of decisions represent the commitments Founder-CEOs make to specific opportunities and the commitments they make with internal and external stakeholders to acquire resources and install processes for exploiting these opportunities (Fisher *et al.*, 2020). For example, by committing to a specific configuration of their product, they render alternative configurations of the product less viable. Similarly, the preferred configuration of the product will be more suitable for certain markets or market segments, rendering certain alternative market segments less

accessible (Gans, Stern and Wu, 2019). This initial commitment to the product configuration might also privilege certain upstream and downstream supply chain partners over others and make the whole endeavor more (or less) attractive for certain investors (Leiblein, Reuer and Zenger, 2018; Mitchell *et al.*, 2021). It, therefore, stands to reason that founder-CEOs exercise judgment and take measures to increase the likelihood that the calculus of pathways pursued (versus abandoned) will work out in their favor and that the inhibitory effect of their commitments on the venture's strategic flexibility will be contained. It is our objective to scrutinize the strategic decisions of founder-CEOs and uncover the rules that guide their exercise of judgment and negotiation between committing and maintaining flexibility.

This nuanced investigation of decision rules is necessary to uncover how decision rules act as both enablers and limiters of strategic flexibility, whereby founder-CEOs try to ensure that their ventures are sufficiently flexible while avoiding the potentially unfavorable costs of (over)flexibility and under-commitment.

Methodology

Given our research objective – an exploration of the microfoundations (decision rules) of an organizational capability (strategic flexibility) – a qualitative approach was deemed most suitable (Zayadin *et al.*, 2022). Therefore, we purposively sampled and interviewed 28 founder-CEOs leading young ventures that were between 2 and 7 years old and which had not undergone mergers or acquisitions. We focused on technology-driven ventures because of the acute technological and market uncertainties they face (Andries, Debackere and van Looy, 2013). We expected that most, if not all, such ventures would have had to respond to additional substantial threats and, possibly also, opportunities to be able to weather the Covid-19 pandemic, global supply chain issues, the war in Ukraine and its effects (Klein, 2020; Scheidgen *et al.*, 2021; Stephan *et al.*, 2022; Zahra, 2022). Furthermore, we recruited these technology-driven ventures from various industries, such as fintech, health tech, biotech, B2B and B2C platform services, etc. The rationale behind this sampling strategy was to increase the comprehensiveness of the rules we discovered and the resulting rigor of our conclusions (Andries, Debackere and van Looy, 2013).

Before each interview, online research was done via ventures' websites, LinkedIn pages, and news articles about the ventures' trajectories, including their product portfolios, partnerships, international footprint, and so on, to be able to guide the conversation to the depth required for analyzing the decisions for decision rules and strategic flexibility implications (Zuckerman, 1972; Harvey, 2011). Specific information about the founder-CEOs' and ventures' backgrounds was also collected to facilitate data analysis and theorizing. Whenever information was unavailable or unclear, it was obtained directly from the founder-CEO at the start of the interview (Farny *et al.*, 2019). Notwithstanding this preparation, care was exercised to allow the interviewees to discuss what they saw as most important and only use the pre-acquired knowledge for probing deeper or clarifying (Leech, 2002).

The bulk of the interview was guided by a core set of questions regarding specific strategic decisions, followed by questions or prompts eliciting additional details and clarifications as necessary (Leech, 2002). More specifically, interviewees were asked to recall recent strategic decisions they believed were most significant for their ventures' future direction and success (Sharfman & Dean Jr., 1997). Following the identification of 2-5 such strategic decisions, respondents were sequentially asked about important contextual variables that prompted or influenced each decision, the choices available within the decision, the final choice selected, the considerations that justified it, the decision outcomes, and lessons drawn therefrom.

A majority of the interviews (19) lasted between 50 and 60 minutes, and the rest lasted between 40 and 50 minutes, except for one 30-minute interview. All interviews were recorded and transcribed, generating approximately 277 pages of single-spaced text.

Data analysis

For data analysis, we are employing a multi-step iterative process. In the first step, transcripts of the interviews were analyzed and coded using a combination of induction and deduction (Fereday and Muir-Cochrane, 2006; Skjott Linneberg and Korsgaard, 2019). Inductive coding was guided by certain overarching questions, including, “what is the founder-CEO trying to achieve for their venture with this decision?”, “what is important for them?”, “what are the key considerations and criteria guiding the evaluation and selection of choices?” and “why did the founder-CEO make the choice as they did and not choose alternatives?”. Answers to these questions help us identify the decision rules undergirding each decision. For example, the founder-CEO of a fintech venture (Fintech_CEO_3) refuses specific customer requests for customization within their product to avoid ending up with a “spaghetti of a product,” which they see as a threat to their venture’s scalability. Another founder-CEO (AI (B2B)_CEO_1) uses a similar rule to refuse customers seeking certain (technically and otherwise feasible) services to prevent their venture from “becom[ing] a grey mouse” whose dispersed competencies and fragmented reputation will impede internationalization. Both founder-CEOs use decision rules that allow them to refuse certain opportunities, i.e., customers, to avoid risks to their ventures’ prospects. In contrast, the founder-CEO (Admin-tech_CEO_3) refuses to serve potential new customers who are competitors of their existing customers. The rule they seem to be following is prioritizing “loyalty” to existing customers and maintaining goodwill with them even if it compromises revenue and growth.

A second round of coding entailed deductive coding of the same data for evidence of SF along its six dimensions of reactivity, proactivity, speed, variety, and internal and external orientedness (Herhausen *et al.*, 2021) with openness towards other possible dimensions. We specifically identified responses to either opportunities or threats as a relevant distinction and included them as another set of dimensions.

The third step of our data analysis entails generating summaries (Farny *et al.*, 2019) at the venture level that focus on the presence and evolution of strategic flexibility and are structured using 4 aggregated classes of decisions. 2 classes of decisions relate to the content and scope of the opportunity being pursued and provide answers to the question of what the venture offers (product(s) or service(s), and the evolution and adaptations therein) and whom does it serve (i.e., market segment, mass market versus niche and geographical scope). The other 2 classes of decisions relate to the means of pursuing the opportunity, i.e., recruiting and managing external stakeholders who provide resources such as raw materials, distribution channels, and funding. We also draw upon the secondary data we collected to enrich our summaries. These summaries are meant to provide us with units of data that are comparable across ventures and which will allow us to tease out inter-venture variations and the difference in the bundles of rules used by CEOs. The inclusion of secondary data in these summaries helps us assess whether the variations in rules are due to random noise or can be preliminarily explained by background variables.

Thus overall, we perform repeated readings of the transcripts, coding, summarizing, pattern finding, referring to the literature, and discussions amongst the authors to be able to develop a robust typology of decision rules that act as microfoundations of SF (Grodal, Anteby and Holm, 2021).

Preliminary insights

Most young ventures display proactivity as their CEOs take various approaches to gather evidence for the existence and scope of the opportunity they have identified. At an abstract level, '*look before you leap*' characterizes these rules well. However, at more concrete levels, various nuances and distinctions exist. In particular, CEOs vary in their preferences for the duration and intensity of 'looking', and depending on the context, leaping can be representative of any of the four decision classes and can look different for specific decisions within these classes.

For example, the rule variant that Health-tech_CEO_7 prefers prioritizes extensive validation and collection of concrete evidence before taking almost any step and thus adheres to '*validate before you act*'. Strong influences precipitating this rule are the fact that Health-tech_CEO_7's venture has a single flagship product and there are no plans for product portfolio diversification in the foreseeable future. Having all their proverbial eggs in one basket necessitates that the Health-tech_CEO_7's decisions are based on evidence that enhances their likelihood of leading to positive outcomes and increases their posthoc justifiability in case the outcome is worse than expected. At a personal level, Health-tech_CEO_7 relies on preemptive validation and evidence collection to gain more confidence in their decision since they self-admittedly have no prior entrepreneurial experience and also because this style of cautious decision-making consorts well with their training as a scientific researcher. More specifically, Health-tech_CEO_7 identified the problem and the related opportunity based on personal experience. Their immediate next step was to interrogate their friends and family to find initial evidence for the prevalence of this problem.

Their next step was to informally reach out to experts working in this field who "confirmed this [i.e., that the problem was valid and in need of a solution]. And so, the fact that there was a huge need for this solution convinced us to really go forward with it". The specific application of the look-before-you-leap approach enacted by Health-tech_CEO_7 takes a sequential approach towards evidence collection, starting with validating the prevalence of the problem, followed by validating its acuteness. Health-tech_CEO_7 then undertook a market analysis, looking into existing products, personally testing them, and using their pros and cons to arrive at the form and features of their own potential solution. The idea of this potential solution was then taken to experts who could verify its viability and business potential.

Having been accepted into an incubator and gotten access to investors who validated their idea by providing seed funding to develop a prototype, Health-tech_CEO_7 reached out to experts again who could help validate the efficacy of their solution based on the existing prototype. It was only at this stage, when this sequential validation had been performed with various stakeholders, and Health-tech_CEO_7 had gained confidence that they had taken sufficient measures to make up for their lack of relevant experience, that they finally decide to take a leap by fully committing to the idea of establishing a venture to bring their solution to the market.

In relative contrast, Industrial-tech_CEO_1 put their own spin on look-before-you-leap by prioritizing validation only prior to the decision to scale a prototype into a minimum viable product and so forth (*validate before you scale*). Industrial-tech_CEO_1 had performed extensive validation on their initial product offering as part of their scientific training in a university where they were able to collaborate with future customers on research and development. This early, relatively extensive validation, experience, and collaborative

relationship with customers allows Industrial tech_CEO_1 to approach their subsequent product developments differently. Their approach for developing products since their first one has been to develop a variety of prototypes with very limited prior validation. These minimally validated prototypes are then sent to existing customers who are requested to test these products and provide real-time and real-life data on the performance of the product. Only when the customers are able to find a worthwhile use case for the product, the product delivers satisfactory performance, and has the potential to be scaled extensively is the decision taken to develop it further, otherwise being shelved.

Industrial-tech_CEO_1 is also primarily ensuring that their venture is proactively strategically flexible by ensuring that the opportunities that are exploited have a higher likelihood of creating value. While the validation of the prototypes is ongoing, they also have to be vigilant and reactive to emerging feedback and signals to ensure that they shelf the under-promising prototypes promptly to avoid further sunk costs and misallocation of resources.

Several other instances emerged from our data where founder-CEOs attempted to use look-before-you-leap derived rules but failed to capture relevant evidence and thus made decisions that turned out to be suboptimal, resulting in crisis situations. These crisis situations became the instigator for heightened responsiveness and learning new rules, which altered what the founder-CEOs will look for and how, in their next iteration of decision-making (Mintzberg and Westley, 1992; Atanasiu, Ruotsalainen and N. Khapova, 2023). For example, in their early days, Insur-tech_CEO_1 decided to accept a relatively lucrative order from a client. Insur-tech_CEO_1 relied on the reputation and the size of the client's organization as cues to assess the quality of the information offered by the client. Once the product had been launched, it was revealed that the client's research had overlooked key variables resulting in an exorbitantly inflated opportunity size.

This crisis situation demanded considerably heightened responsiveness from the venture and reframing and corrective decision-making from Insur-tech_CEO_1. They had to do another round of fund-raising and revise the opportunity evaluation approach to focus more on the essentials, such as the product-market fit and aspects of the end-customer journey (rather than unrelated positive signals provided by the intermediary organization). In their recounting of the crisis situation, Insur-tech_CEO_1 framed this crisis as a learning opportunity in line with their preference for learning by doing, but what they learned by doing was to look more and to look better before they leap. To further frame this crisis as not an absolute disaster, Insur-tech_CEO_1 also considers the components of the development that were salvaged, hinted at their development's reusability, which grants their venture greater variety-oriented strategic flexibility, i.e., the pursuit of an opportunity (regardless of its failure or success) provides components that are usable in adjacent opportunities.

In another example of suboptimal use of the look-before-you-leap rule, Fintech_CEO_2 did extensive research on their product and customers before they began developing their product. Upon launching their product, they realized that their research had led to a flawed conclusion about the willingness to pay. Their research found that there was indeed a need for the product they intended to develop, and the sample they surveyed also gave positive feedback on their willingness to pay. However, the sample being surveyed was not representative of the actual intended customers. The actual intended customers only had a chance to provide their feedback after Fintech_CEO_2 had already decided to take the leap and launch the product. This more

pertinent feedback was disappointing but also reasonable in retrospect. This crisis again elicited a significant response from the venture and corrective decision-making from Fintech_CEO_2. Fintech_CEO_2 decided to undertake a significant pivot and change their service model from B2C to B2B2C. However, this pivot was informed by a renewed research strategy and a focus on previously missed cues and evidence.

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