



Top management team restructuring in pre-IPO high technology startups: The influence of TMT characteristics and firm growth

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ABSTRACT

This study examines the influence of TMT (top management team) characteristics and firm growth on pre-IPO management team restructuring. Using a sample of U.S. biotechnology startups which went public between 1991 and 1999, the empirical results show that TMT tenure, TMT founder percentage, and TMT functional heterogeneity are negatively associated with management team restructuring in pre-IPO technology ventures. Further, the impact of TMT tenure and TMT functional heterogeneity on pre-IPO management team restructuring is stronger when firm growth is high than when it is low. The study extends understanding of pre-IPO management team restructuring and contributes to research on managerial turnover, new venture teams, and IPO firms.

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1. Introduction

Despite an abundance of top management team research, a review of this area reveals that much work has been conducted in the context of well-established firms, yet little has focused on top managers in young technology ventures. In recent years, there has been an increasing body of research on new venture teams (e.g., Amason, Shrader, & Tompson, 2006; Ensley & Pearson, 2005; Ensley, Pearson, & Sardeshmukh, 2007). A common underlying assumption of these studies is that new venture teams are stable over time, i.e., the studies emphasize the initial team characteristics and do not account for changes in the team as the venture grows. Empirical evidence, however, has suggested that a new venture's growth is often accompanied by management restructuring in their entrepreneurial stage (Birley & Stockley, 2000; Chandler, Honig, & Wiklund, 2002). This is typical at the point of professional management (Clifford, 1973). With only a few exceptions (e.g., Beckman, Burton, & O'Reilly, 2007; Chandler, Honig, & Wiklund, 2005; Forbes, Borchert, Zellmer-Bruhn, & Sapienza, 2006; Ucbasaran, Lockett, Wright, & Westhead, 2003), however, research on top management team restructuring in new ventures is still understudied.

To enrich this line of research, this study investigates top management team restructuring in high technology startups at their pre-IPO (initial public offering) stages. Pre-IPO stage, in this paper, is defined as two years immediately prior to the firm's IPO. This particular period provides an ideal setting for investigating management team restructuring because of the following reasons. First, IPO firms frequently change their ownership and corporate governance structure in preparation for going public (e.g., Aggarwal & Klapper, 2003). Since the quality of the management team is a very important signal to potential investors (Higgins & Gulati, 2006), private ventures often change their management teams (replacing original managers and adding new managers) to impress the investors at the time of IPO (Hellmann & Puri, 2002; Jain & Tabak, 2008; Lester, Certo, Dalton, Dalton, & Cannella Jr, 2006). Second, the transition from a private venture to a public company significantly changes the dominant problems of the firm as well as the resource and skill requirements for the management team (Kazanjan, 1988). Whether the current TMT can provide satisfactory solutions to new contingencies is closely associated with its power within the firm (Ocasio, 1994), therefore influencing the extent of management team restructuring during this period.

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I build the theory upon insights from the literature of executive turnover (Kesner & Sebor, 1994) and the top management team power perspective (Finkelstein, 1992). Executive power has been studied as an important factor in explaining managerial turnover and CEO succession in large corporations (e.g., Boeker, 1992; Shen & Cannella, 2002; Zajac & Westphal, 1996). I argue that TMT power has great impact on management team restructuring during the pre-IPO period, since the power interplay between the existing management team and the investors (most likely VCs) becomes more intensive at this stage due to the professionalization process (e.g., Higashide & Birley, 2002). In this study I examine factors that influence TMT power such as TM tenure, TMT founder percentage, and TMT functional heterogeneity and investigate their influence on the extent of pre-IPO management team restructuring.

This study makes several contributions. First, it adds to the literature of managerial turnover by looking at TMT change in pre-IPO technology ventures. Although a number of publications have explored the issue of managerial change in IPO-stage ventures (e.g., Boeker & Karichalil, 2002), little is known about what TMT factors influence management team restructuring during the pre-IPO stage. The study starts filling this gap. Second, this study extends understanding of the role of TMT power in managerial change. While large corporation studies on managerial turnover have employed the TMT power perspective (e.g., Shen & Cannella, 2002; Zajac & Westphal, 1996), few has investigated the role of TMT power in managerial change in young technology ventures. Third, many existing studies examine the factors for managerial turnover independent of other possible moderating variables. It is highly conceivable that the impacts of TMT characteristics on managerial change may vary, depending on contextual conditions. In this study I explore the moderating effects of one important contextual factor – pre-IPO firm growth – on the relationships between TMT characteristics and management team restructuring. The following sections develop a theoretical framework and major hypotheses of the paper. Research methodology, empirical results, discussion and conclusion of the study are presented afterwards.

2. Theory and hypotheses

Largely influenced by agency theory (Jensen & Meckling, 1976), current large-corporation studies on managerial change usually take a governance perspective, suggesting that the primary force of managerial change comes from the disciplining actions of owners taken to align the interests of the agents with their own (Kesner & Sebor, 1994). However, applying agency theory in entrepreneurial ventures may provide limited explanation power because of the marked differences existing between large corporations and entrepreneurial ventures (Wasserman, 2003). For example, executives in technology startups usually hold large proportions of ownership, thus the risk of managerial opportunism, which is a major concern of agency theorists for public corporations, may not exist to the same extent in the entrepreneurial firms (Wasserman, 2003). In addition, managers in technology ventures may not have a unitary set of interests and share the same motivations with each other (Pfeffer, 1981; Timmons, 1999). These differences imply that simply extrapolating agency theory to explain management team change in technology ventures may not be effective and adequate.

Instead, I employ a TMT power perspective (Finkelstein, 1992) to explain management team restructuring in technology startups. Building on Pfeffer's (1981) definition, TMT power refers to the TMT's capacity to exert influence on the behavior of other groups within the organization. Studies have shown that preparing an IPO is a process in which power contests among different parties can rise up since these parties often have different goals and motivations in the firm's IPO (Espenlaub, Garrett, & Mun, 1999; Higashide & Birley, 2002). A pre-IPO stage firm imposes a problem of information asymmetry (Rock, 1986). That is, the success of technology venture is uncertain, and it is very difficult for potential investors to fully assess the capability of the executives before investing in the IPO firm. To solve this problem, the initial investors (usually venture capitalists) frequently require the management team to address the perceived weaknesses, in which case the investors may push for a change of management team (Wasserman, 2003). On the other hand, pre-IPO managers may not want to leave the venture as they have developed personal attachments to the company and may think replacement humiliating (Hellmann, 1998). As such, it is expected that power contests and struggles over the control of the firm are inevitable in the pre-IPO stage.

The role of power in managerial turnover has been a major focus in the literature (e.g., Boeker, 1992; Cannella & Lubatkin, 1993; Ocasio, 1994). Finkelstein (1992) has analyzed and validated four sources of TMT power: structure, ownership, prestige, and expertise. In this study, I pay special attention to two relevant sources – structure and expertise, which importantly influence TMT power in pre-IPO technology startups. Structural power is referred to as hierarchical or legitimate power (Daily & Johnson, 1997; Hambrick, 1981). Formal positions grant top managers high structural power within the organization (Brass & Burkhardt, 1993; Finkelstein, 1992). For example, executive power is enhanced when the executive holds multiple titles, such as jointly serving as chairman of the board (Ocasio, 1994), or holding special positions such as founders. The source of expert power comes from TMT human capital (such as knowledge, experience, and skill sets, etc.) which enables them to address the fundamental problems at the specific stage of the firm (Hambrick, 1981; Kazanjian, 1988). For a pre-IPO technology startup, whether the current TMT has possessed necessary knowledge and skill sets for managing a new public firm becomes an important factor influencing its power within the firm.

The following section develops a TMT power model to explain the team level antecedents of pre-IPO management team restructuring in technology startups. I investigate three TMT characteristics that reflect TMT power at the pre-IPO stage and subsequently impact the extent of management team restructuring. They are: (1) TMT tenure, (2) TMT founder percentage, and (3) TMT functional heterogeneity. I also investigate potential moderating effects of firm growth on the TMT characteristics – management team restructuring relationships. The full model is depicted in Fig. 1.

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