

The fallacy of “only the strong survive”: The effects of extrinsic motivation on the persistence decisions for under-performing firms

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Abstract

Under-performing firms persist even though existing theoretical perspectives indicate that they should be selected out of the market. Building upon threshold theory [Gimeno, J., Folta, T., Cooper, A., Woo, C., 1997. Survival of the fittest? Entrepreneurial human capital and the persistence of underperforming firms. *Administrative Science Quarterly* 42, 750–783.] and using Staw's [Staw, B.M., 1981. The escalation of commitment to a course of action. *Academy of Management Review* 6 (4), 577–587.] theoretical model of commitment to a course of action, we explore and test the factors that lead entrepreneurs to persist with under-performing firms. We found environmental munificence, personal investment, personal options, previous organizational success, and perceived collective efficacy impact the decision to persist with an under-performing firm. In addition, extrinsic motivation moderates those relationships. This research adds to the growing literature on highly persistent, under-performing firms and complements and extends threshold theory.

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1. Executive summary

Although well-established theoretical perspectives (e.g. economic, population ecology) propose under-performing firms will be selected out of the environment, other research suggests that performance alone does not fully explain the persistence of under-performing firms. Why would one entrepreneur make a decision to persist with an under-performing firm while another would choose to discontinue operations? Gimeno et al. (1997) propose that heterogeneity among entrepreneurs may lead to different thresholds of performance. Other research into reference points and entrepreneurial aspirations (e.g. Kahneman and Tversky, 1979; Stewart et al., 1999) seems to support this perspective.

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Staw's (1981) theoretical model of the determinants of commitment to a course of action (the probability of and perceived value of future outcomes, self-justification, and norms for consistency) provides the theoretical foundation to explore and clarify the factors that lead to the decision to persist with an under-performing firm. To test our model we use a sample of entrepreneurs in small firms in high technology industries. We collected data using a conjoint methodology and analyzed the data using hierarchical linear modeling. Our findings suggest that high levels of environmental munificence, personal investment, collective efficacy, and previous organizational success lead entrepreneurs to persist with an under-performing firm, while increased personal options make it less likely the entrepreneur will persist.

However, the most significant contribution of this research is the impact of extrinsic motivation. We propose and test the hypothesis that there is heterogeneity among entrepreneurs in terms of their extrinsic motivation and that extrinsic motivation helps explain variance in the persistence decision policies (explains variance in the "weight" [emphasis] placed on the different decision factors). Our findings confirm this hypothesis. Entrepreneurs with high levels of extrinsic motivation put less weight on complexity, dynamism, and personal options, when making their persistence decision. This suggests that overall, extrinsically motivated entrepreneurs are less likely to be influenced by the factors that encourage persistence with an under-performing firm. There was one exception. Entrepreneurs with high levels of extrinsic motivation were even more likely to be influenced by personal investment in their persistence decision than those with less extrinsic motivation.

These results provide a strong theory-based rationale, based on commitment processes and threshold theory, to explain why under-performing firms exist. When entrepreneurs perceive growth potential in the market (environmental munificence) they are more likely to persist. When they have invested a significant amount of time, money, and energy (personal investment) they are more likely to persist and even more so if they have high levels of extrinsic motivation. When entrepreneurs have many other options available to them outside the firm (personal options) they are less likely to persist; and this is more so for those with high levels of extrinsic motivation. In addition, when the organization has had previous success and when the entrepreneur's perception of the collective efficacy of the firm is high, they are more likely to persist. Finally, entrepreneurs with high levels of extrinsic motivation are less influenced by whether the market is complex or dynamic in their persistence decision than those with less extrinsic motivation.

Our research provides important answers to the question of why under-performing firms persist—answers that extend the traditional economic rational arguments. In addition, our findings complement threshold theory (Gimeno et al., 1997) in that we establish that heterogeneity among entrepreneurs can help explain why firms have unique thresholds of (or aspiration levels for) performance. Our research begins to fill in the gaps that exist regarding under-performing firms and has implications for both scholars and entrepreneurs.

2. Introduction

What explains the persistence of under-performing firms in the market? From a purely economic or population ecology perspective one would expect that these firms would, over time, be selected out of the market. However, previous research (Baden-Fuller, 1989; Gimeno et al., 1997; Karakaya, 2000; Meyer and Zucker, 1989; van Witteloostuijn, 1998) indicates that firm performance does not fully explain the persistence of under-performing firms. Meyer and Zucker (1989, p. 9) argue that "efficient performance is only one—and not necessarily the most important—determinant of organizational survival." Under-performing firms often survive over long periods of time, even though they earn a subnormal rate of return.

Although there are several perspectives and potential explanations for why these firms persist, our work builds upon that of Gimeno et al. (1997) who found that firms had differing thresholds of performance (reflecting different aspiration levels), which helps explain variance in persistence despite poor performance. Their work suggests that these thresholds differ systematically across firms and can be partially explained by the human capital factors of the owners of such ventures. We build upon their research by exploring factors that contribute to the persistence decision, as well as exploring how an entrepreneur's extrinsic motivation enhances or diminishes the effects of these factors.

In investigating the persistence of under-performing firms we make three main contributions. First, through the application of Staw's (1981) theoretical model of commitment processes, we more fully explore the factors that lead entrepreneurs to persist with under-performing firms. Specifically, we develop hypotheses to test how the probability of and perceived value of future outcomes (predicted by environmental complexity, dynamism, and munificence), self-justifying factors (operationalized as personal investment and personal options) and norms for organizational consistency (operationalized as previous organizational success and perceived collective efficacy) impact the persistence decision.

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