

# VALUE FUNCTIONS OF INITIAL RELATIONSHIPS IN NEW BUSINESS START-UPS

## Competitive paper

There has been a growing interest in recent studies in studying the formation of new businesses from a network perspective (Aaboen et al., 2013, 2017; Baraldi et al., 2018; La Rocca et al., 2013; Shih and Aaboen, 2017; Snehota, 2011). Considering that the existence of business relationships is a necessary condition for the existence of a business (Axelsson and Easton, 1992; Håkansson and Snehota, 1995), the industrial networks' approach is useful for research into the formation of new businesses. In new business development it is important to focus on those processes that lead to the emergence of new organisations, such as how start-ups develop initial business relationships (Aaboen et al., 2017; Snehota, 2011). In this context, the emergence of a new firm involves the need to deal with entry into a pre-existing network, that is to say, a new firm has to establish and develop relationships with those actors already operating in the network.

The acceptance of a start-up by the network is linked to the perception of its usefulness to the established actors (Baraldi et al., 2018). Accordingly, pre-existing network actors try to foresee the value-creation associated with the establishment and development of a business relationship with a new venture. This paper concerns the insertion process of new ventures in the business network focusing on the initial business relationships.

Research has paid little attention to the process of the first relationship development of a new venture (La Rocca et al., 2013). Certain sections of the network may have less demanding connection points in one or more of those dimensions. Thus, the (perceived) benefits associated with changing the portfolio of relationships with other actors can be diverse, and, for the same relationship, can change over time. We approach these aspect by using the notion of high- and low-involvement first relationships. In addition, previous studies have focussed on the value of a business relationship in established firms from the point-of-view of the notions of direct and indirect value-creating functions (Ritter and Walter, 2012; Santos et al., 2018; Song et al., 2012; Walter et al., 2001; Young et al., 2008). Aaboen et al. (2011) and La Rocca et al. (2017) addressed some of these dimensions in the context of start-ups relating to an existing network, in particular the relevance of a first relationship between the start-up and customers and suppliers. An incubator can be seen as a supplier that can assist a new venture by intervening passively (e.g., physical and administrative resources), counselling (e.g. advice), and networking (e.g. credibility) (Rice, 2002). Thus, an incubator can influence the establishment and development of relationships of the new venture with other actors (Baraldi and Havenvid, 2016; Shih and Aaboen, 2017). Our study complements prior research by adopting a process-oriented approach to look at the value-creating functions of initial relationships in new ventures.

Given the exploratory nature of this study, in order to understand how new firms enter and develop within a network, we adopt a case study strategy. This allows us to address complex social phenomena in their actual context (Dubois and Araujo, 2004; Yin, 2009). The research

adopts a longitudinal character. Dubois and Gadde (2002) point out that a case study facilitates the systematic combination of theory and the empirical world as the study unfolds. In the selection of cases followed a purposeful sampling. EDP Starter was chosen, due to its interest in incubating new businesses in the energy sector. The case study includes two new ventures, that we call “ALPHA” and “BETA”, both of which are associated with the EDP Starter. The first firm was selected because it had been operating in the market for just a fairly short time and already formed a network of relationships. Products from ALPHA are relatively complex to produce and use, as, in addition to having to comply with tight country-specific regulations. Their combination in user contexts may also require technical adaptations. The second firm was selected as it was in the process of entering the market and was starting to establish its first relationships. In contrast with ALPHA’s products, the products from BETA are basically plugs for charging various household devices and, therefore, their interface with other equipment is relatively straight forward. From 2014 until 2019, seven interviews were carried out. Secondary data, such as incubator’s data, provided a better understanding of the empirical setting and established a common ground for conducting the interviews. Other secondary sources, such as firms’ data and local news, enabled us to complement and frame the information collected during the interviews.

EDP Starter supports the transformation of a new idea into a start-up, providing support ranging from the idea phase, through to the prototype, incubation and pilot project to the stage where the project is able to be funded by venture capital. The EDP Starter programme began with three companies, including ALPHA, and had a team of four managers: CP (Entrepreneurship and Business Incubation), PG (Special Projects and Oporto Operations), BA (Events and Communication), and VG (Branding and Digital Media). Subsequently, 12 more start-ups were introduced, which included BETA and GAMA. Six of these start-ups are going well and have entered the market, among them being ALPHA and GAMA - “*Their total turnover, in 2013, was over 3 million euros*” (CP of EDP Starter).

The development of new businesses requires being connected to several actors over time. For instance, EDP Starter is an important actor, which supports the initial insertion of new firms into sections of the network. The relationship with the incubator seems to have been important for building the identity of the new firms under study. EDP Starter provided access for both firms. Large and reputed customers can be valuable references even when they are not the main customers (Walter et al., 2001). For ALPHA, EDP Starter was considered to be a key player in the early months of the start-up, as it provided the credibility and confidence to accomplish the first deals with actors of a network section. ALPHA’s attractiveness embodies the development of initial relationships, for example: INEGI, EDP Ventures, and Changes Partners and also some distributors. The same is true for BETA. The incubator is considered to be co-responsible for the idea of Product-B-Slim. Furthermore, EDP Starter influenced the prioritisation of relationship establishment with network actors and created opportunities for the testing and marketing Product-B. The firm’s identity, and therefore its attractiveness, is associated with the development of early relationships, for example, in the case of BETA, the relationships with EDP Ventures, EDP Comercial, and Hotel Altis. Table 1 summarises the involvement and value-creating functions for both ALPHA and BETA.

	Involvement		Direct Functions				Indirect Functions		
	Low	High	Profit / cost r.	Volume	Quality	Safeguard	Market	Access / scout	Innovation
<b>ALPHA</b>									
EDP Innovation		X					X	X	X
EDP Starter		X	X		X		X	X	X
INEGI (engineering)		X			X				X
Financial Partners	X		X				X		
Suppliers, S1-A, S2-A	X		X						
Distributors	X		X		X	X	X	X	X
Prescribers	X						X	X	
External consultants	X						X		
<b>BETA</b>									
EDP Innovation		X					X	X	X
EDP Starter		X	X		X		X	X	X
EDP Partners (prod. and engineering)		X	X				X		X
Altis Hotel (pilot test)	X				X		X		X
EDP Comercial	X			X			X	X	X
Financial Partners	X		X						
Distrim2 (supplier)		X	X		X				X
ISQ (engineering)	X				X				

Table 1: Involvement and value functions of the initial relationships for new firms

Regarding network insertion, our study corroborates the notion that an emerging company needs to acquire support from those actors already present in a pre-existing network. For instance, the relationship with EDP Starter, the incubator, illustrates how this support can be critical for accessing complementary skills and for building a new firm's identity. This study shows that the process of insertion is, in part, a gradual learning process for the new venture (on the network context), and for some actors already in the network (on the emerging firm).

Relational diversity is manifested in the value functions of relationships. Sales volume and profit dimensions are a typically-used criteria to consider whether a new firm is developing along an economically-viable path. However, turning an idea or product into a saleable solution appears to require a combination of direct and indirect functions. In fact, the value perception regarding the portfolio of initial relationships in both cases is strongly related to indirect functions. As our cases illustrate, the relationships between each start-up and the incubator organisation are evidenced by their indirect functions, including their role in the initial construction of the identity/attractiveness of the new firm as an exchange partner in their respective network contexts (Purchase et al., 2016). This is consistent with the notion of organisational legitimacy (Fisher et al., 2017; Suchman, 1995; Überbacher, 2014). Thus, our study suggests that one critical indirect value-creating function of the business relationships for the new firm could be its role in the process of starting to build an identity, or legitimacy.

Our study also shows that among the indirect functions, the innovation function seems to be the least relevant when it comes to the relationships between the two start-ups and their first customers. The restrictions imposed by the regulatory framework associated with the use of firm's products but also restrictions imposed by the firms involved in distribution structures with practices consolidated over time. This seems to contradict the usual emphasis in many entrepreneurship studies on the key role of creativity when it comes to gaining legitimacy in the industry. This finding is in line with the notion that "rather than being innovative, the major challenge for a start-up is becoming accepted by the broader network" (Baraldi et al., 2018, p. 8).

Finally, our data on the dynamics of the relationships between the focal companies and other specific actors (table 1) shows that in some of these customer relationships, after a period of high 'intensity' (Aaboen et al., 2011) or high involvement (Gadde and Snehota, 2000), there was a stabilization of economic exchanges on a routine basis. In this later period, the logistics operations became prevalent and the communication between the parties was only intended to synchronize deliveries. These relationships became less "intense" and the emergence of a degree of stability arose closely associated with the generation of efficiency in the exchange processes. This change over time corresponds to an increased relevance of direct value functions. The demand for more financial resources in both firms mainly aims to increase the installed capacity in ways that respond to the expectations of demand for larger quantities of standardized products by customers. In an important sense, both firms intend to replicate existing resources and organizational routines expecting to move to a period of stabilization in their relevant network (Baraldi et al., 2018).

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