# CONSTRUCTING MARKETS AND ORGANIZING BOUNDARIES: ENTREPRENEURIAL ACTION IN NASCENT FIELDS

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## INTRODUCTION

How do managers define their firm's scope of activities in nascent markets? The organization and strategy literatures have focused primarily on the definition of organizational boundaries in large, established firms operating in existing markets. Yet, nascent markets pose different and perhaps more difficult challenges as compared to those faced by managers in existing markets (Dougherty 1990; Aldrich and Baker 2001). We define nascent markets as new fields of activity emerging outside the bounds of existing industries. They constitute high-velocity settings characterized by frequent, often non-linear change (Eisenhardt and Bourgeois 1988), extreme ambiguity regarding industry structure, and lack of shared understandings from which to create meaning (Aldrich and Fiol 1994). Therefore, the applicability of extant theories on how executives make decisions regarding the scope of the firm is unclear. Consider TCE (Williamson 1981): how can managers decide between contracting and internalizing an activity in the absence of an industry value chain providing alternative governance arrangements? Regarding resource dependence views, how can managers control key dependencies when important players are not identified and their potential role in the nascent market is ambiguous (Aldrich and Baker 2001)? Regarding competence views (Argyres 1996), how can managers leverage resources into different markets when it is not clear which resources are valuable and market segments are not yet defined (Brown and Eisenhardt 1998)?

These challenges in defining the firm's scope in nascent markets are compounded for entrepreneurial firms, who are often the pioneers that address these markets. In contrast to established firms, entrepreneurial firms typically have an incipient set of activities (Aldrich and Fiol 1994; Aldrich 1999). In this situation, the received wisdom on boundary decisions may not apply. For example, minimizing costs may not be a central concern for entrepreneurs because typically they do not have a well-defined and stable set of activities to perform. Simply surviving may be more crucial since entrepreneurs usually start in a weak strategic position. Moreover, entrepreneurs need to establish themselves in an initial market, but do not usually have a strong resource base nor established competencies to leverage.

Yet, for a team of entrepreneurs creating a firm to address a nascent market, managing boundaries may be critical in creating a context within which economic activity is organized and sensemaking can occur (Aldrich 1999). Moreover, while founding a firm to address a nascent market is, perhaps, the most "foolish" and failure prone entrepreneurial activity (Aldrich and Fiol 1994), it is also the one with the highest potential for creating value and transforming industries (Schumpeter 1934; Drucker 1985). If wise choices regarding the scope of activities can improve the likelihood of success for these firms, then it is important to understand what processes are used and how they are implemented. Specifically, the research question is: *how do executives in entrepreneurial firms addressing nascent markets organize the boundaries of their firms*?

## RESEARCH METHODS

Given the limited theory, and the goal of exploring organizational phenomena in a new setting, an exploratory approach based on grounded theory building is suggested (Glaser and Strauss 1967; Eisenhardt 1989). The research design is an inductive, multiple case, embedded study. Multiple cases enable a replication logic in which the set of cases is treated as a series of experiments, with each case serving to confirm or disconfirm the inferences drawn from the others (Yin 1994). A multiple case study typically results in better-grounded and more general theory than single cases (Glaser and Strauss 1967; Eisenhardt 1989).

The sample is composed of five firms founded to address different nascent markets. To enhance the generalizability of the findings, the sample includes firms addressing nascent markets in five different domains and reflects diverse founding situations (Harris and Sutton 1986). Given the goal of understanding how boundaries are managed, this is a descriptive study requiring a longitudinal design. The sampling thus focuses on firms that were still in existence in 2001, the year that the study started. This allows studying the early drivers of boundary-setting and the temporal dynamics of the process (Aldrich and Fiol 1994).

This study has two main data sources: archival and interviews (see table 1). The archival data include both internal and external sources. The interviews were semi-structured and focused on both internal and external informants. We conducted an average of nine interviews per case for a total of 45 interviews, including the founder and/or senior executives for the five firms.

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Table 1 about here
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## RESULTS

The emergent theoretical framework suggests that entrepreneurs aim to attain a defensible leadership position by reaching critical mass in a distinct market segment that the firm constructs. To achieve this objective, entrepreneurs use three main processes:

First, entrepreneurs attempt to claim a distinct segment of the nascent market by reshaping the pattern of meanings held by market actors. They do this by developing an identity for both the firm and the market. The mechanisms used to develop an identity are the adoption of templates, the provision of leadership signals, and the dissemination of stories. Entrepreneurs use these mechanisms in an attempt to become *the* legitimate and leading player for the market, making the firm a cognitive referent. Failing to achieve this, entrepreneurial firms risk becoming a marginal player because either a distinct market does not emerge or it grows under the direction of other players.

Second, entrepreneurs carve out clear boundaries by reshaping the structure of roles of established players vis-a-vis their firm. This is done through the co-optation of powerful players, using revenue sharing agreements, "anti-leader" positioning, and equity investments as mechanisms to obtain the support of these players. By structuring the roles in the market, entrepreneurs are able to reduce the ambiguity they face and prevent competition in the market. Failing to achieve this, entrepreneurs risk early competition from powerful players, which can reduce the profitability of the nascent market or lead to the firm's demise as a central player in a distinct market segment.

Third, entrepreneurs attempt to dominate the space within the defined boundaries by reshaping the ownership of resources. The rationale is to preserve the integrity of the market against the efforts of other firms trying to construct their own markets or trying to assume control of the market they are claiming. Entrepreneurs use acquisitions of smaller firms to increase their market coverage, cancel possible entry points for more powerful competitors, and eliminate threatening business models. Failing to sustain control of the market, entrepreneurial firms risk losing market share and no longer being able to influence the direction of the market.

Fundamentally, this study suggests how entrepreneurs in nascent markets conceptualize and try to achieve competitive advantage. Given the challenges that they face (i.e., high ambiguity, low legitimacy, weak resource base, surrounded by powerful players), entrepreneurs attempt to construct a distinct market that they can control using a combination of identity mechanisms, alliances, and acquisitions (see table 2). The data suggest that entrepreneurs try to establish boundaries in different arenas (i.e., cognitive, relational, ownership) in order to define a new market and establish their leadership in it.

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Table 2 about here
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By managing boundaries over time in these different arenas, entrepreneurs achieve a position and size that makes the firm's viability independent of other market actors. This view on competitive advantage suggests that efforts to reach critical mass will often dominate traditional competitive drivers, such as governance cost, in making strategic decisions. It also suggests that the survival of entrepreneurial firms as viable organizations seems inextricably linked to their ability to control a growing market.

## DISCUSSION

This research suggests that the boundaries of the firm and the boundaries of the market are interwoven and often indistinguishable. Entrepreneurs do not necessarily select a particular product/market domain for the firm (Chatterjee and Wernerfelt 1991) since markets are not simply "out there" waiting to be chosen (Baum and Singh 1994) or even waiting to be discovered by people with better access to localized information (Kirzner 1997). Entrepreneurs construct new markets by structuring the nascent market around a perceived opportunity for the creation of value. In a sense, the emergence of the segment as a viable market depends on the actions of entrepreneurs (Rindova and Fombrun 2001). Thus, new markets are not inevitable outcomes of technological advances or demographic changes, but fragile social constructions. They are willed into existence by active entrepreneurs who operate in different arenas to define and maintain boundaries over time. A central finding of this study is that nascent markets can be appropriately interpreted as the outcome of creative entrepreneurial action.

Second, this research contributes to resource dependence theory (Pfeffer and Salancik 1978) by showing that entrepreneurs may prefer the dependence that they can manage rather than the ambiguity that they cannot control. Entrepreneurs pursue a strategy of reducing ambiguity using co-optation alliances (Selznick 1949) to clarify their boundaries in relation to established players in nearby markets. They do so even if they create dependence on these players. This suggests a preference for pro-active structuring market relations to reduce ambiguity over a pure strategy of dependence reduction.

Third, this research contributes to identity perspectives (Albert and Whetten 1985; Dutton and Dukerich 1991). The evidence supports the usefulness of sensemaking processes driven by identity in shaping organizational boundaries in ambiguous settings (Weick 1995; Sarasvathy 2001). This study also extends the identity literature by describing the mechanisms through which identities are created. It suggests that claims to leadership (Rindova and Fombrun 2001) need to be substantiated by high-profile and concrete actions of entrepreneurs.

Fourth, this study offers several implications for the strategy literature. One is suggesting a use of alliances that goes beyond the access to new resources. Whereas recent literature see alliances as an opportunity to access resources and competencies (Dyer and Singh 1998; Gulati 1998), the data show that entrepreneurs in nascent markets use co-optation alliances to clarify the boundaries between their firm and powerful players. In addition, this study extends the social capital literature related to alliances (Gulati 1995; Eisenhardt and Schoonhoven 1996) by suggesting that "who you know" is not enough to attract partners. Entrepreneurs need to provide concrete concessions to powerful players in order to co-opt them effectively, such as giving partial ownership of the firm, sharing the revenues of the nascent market, or helping partners compete against other powerful players. Finally, this study reveals a more varied use of acquisitions that predicted by the literature. For example, some literature has focused on using acquisitions to internalize new technology-based resources (Ahuja and Katila 2001). Although the evidence supports the use of acquisitions to obtain new resources, it also suggests that many acquisitions have a power rationale, involving either acquiring resources to prevent competitors from getting them, or absorbing threatening firms to destroy them.

## CONCLUSION

Fundamentally, this study suggests an expanded role for entrepreneurs. The focus of attention in entrepreneurship research has typically been on garnering tangible resources to develop new products for an identified market (Kirzner 1997; Gartner 1985). This study, however, suggests that entrepreneurs do more than discover markets and recombine resources. Entrepreneurs perceive new opportunities for the creation of value, and construct a market around those opportunities. Constructing a market requires that entrepreneurs operate in different arenas and set boundaries in each of them, using strategic mechanisms such as identity, alliances, and acquisitions. Only by understanding what entrepreneurs do in these arenas and how they do it, can we truly understand entrepreneurial action and the processes of creating viable firms.

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**TABLE 1: DESCRIPTION OF SAMPLE FIRMS AND CASE DATA**

| **Pseudonym** | **Harbor** | **Secret** | **Magic** | **Midway** | **Saturn** |
|---|---|---|---|---|---|
| **Domain** | Virtual Marketplace | Digital Services | Online Commerce | Enterprise Software | Networking Hardware |
| **Founding Context** | Stumbled into market | Technology looking for market | Opportunity looking for market | Opportunity then acquire technology | Opportunity then build technology |
| **Archival Data** | | | | | |
| Audio/Video | 4 | 4 | 5 | 4 | 6 |
| Int. Sources | 1700 pages | 1600 pages | 1800 pages | 1400 pages | 1300 pages |
| Ext. Sources | 1100 pages | 800 pages | 1400 pages | 1000 pages | 1000 pages |
| **Interviews** | 11 | 7 | 8 | 12 | 7 |

Note: All firms were founded in the period from late 1994 to end of 1995 in the U.S.

**TABLE 2: FRAMEWORK FOR MANAGING BOUNDARIES**

| **Framework Elements** | **Claiming a Market** | **Demarcating the Market** | **Controlling the Market** |
|---|---|---|---|
| **Goal** | Reshape patterns of meaning | Reshape structure of roles | Reshape ownership of resources |
| **Dominant Logic** | Sensemaking | Co-optation | Ownership |
| **Process** | Shaping an identity | Developing alliances | Making acquisitions |
| **Mechanisms/ Rationales** | - Adopt templates<br>- Disseminate stories<br>- Provide leadership signals | - Equity investments<br>- Revenue sharing agreements<br>- Anti-leader alliances | - Increase market coverage<br>- Eliminate competitive threats<br>- Block entry of powerful players |
| **Desired Outcome** | Become cognitive referent | Reduce level of competition | Increase market share |