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LOVE HURTS – HOW SOCIAL RELATIONS IN VENTURE TEAMS IMPEDE THE PERFORMANCE BENEFITS OF HUMAN CAPITAL

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ABSTRACT

With whom should entrepreneurs create their firms in order to enhance nascent venture performance? Conventional wisdom suggests that the stronger human capital and social relations in nascent venture teams are, the better the nascent venture's performance. We draw from social embeddedness literature, however, and argue that the positive effect of team members' human capital on nascent venture performance is weaker when team members exhibit strong social relations. Our analysis of 488 nascent venture teams in the PSED II dataset confirms our predictions. The study thus offers valuable contributions particularly to literature on entrepreneurial teams and on the determinants of new venture performance.

INTRODUCTION

Literature agrees that human capital residing in start-up teams is a critical predictor of venture success (Becker, 1962; Campbell, Coff, & Kryscynski, 2012), thereby differentiating between general human capital (e.g., education) (Unger, Rauch, Frese, & Rosenbusch, 2011) and specific human capital (e.g., start-up experience) (Stuart & Abetti, 1990). Other main performance drivers are the relationships and social affiliations between the founding team members (Discua Cruz, Howorth, & Hamilton, 2013; Schjoedt, Monsen, Pearson, Barnett, & Chrisman, 2013). For instance, strong social relations between founders (Granovetter, 1985) can foster the venture's performance due to mutual support, better resource flows, and knowledge acquisition abilities within the team (Hoang & Antoncic, 2003). Human capital and those social relations, in turn, are assumed to interact in predicting performance due to influencing effects of social relations on the effectivity and efficiency of utilizing human capital (Argote, McEvily, & Reagans, 2003; Granovetter, 1985; Majchrzak, More, & Faraj, 2012; Zheng, 2012); put differently, knowledge and skills are used and implemented differently in teams with socially strong or loosely related members (Argote et al., 2003; Majchrzak et al., 2012).

While common wisdom thus might suggest that "the stronger both, the better" and that there is a positive interaction between human capital and social relations of founding team members, it is in fact unclear how these elements play together exactly (Hoang & Antoncic, 2003; Schjoedt et al., 2013). Consequently, closing this gap is very valuable; it is very important for entrepreneurship research to better understand the drivers of nascent venture performance.

We attempt to do so by first drawing from literature about human capital (Becker, 1962) which leads us to propose a positive relationship between human capital residing in founding teams (education and start-up experience) and nascent venture performance (Delmar & Shane, 2006; Kotha & George, 2012; Mosey & Wright, 2007; Shane & Delmar, 2004; Unger et al., 2011) as a starting point. Then, we draw from social embeddedness literature (Granovetter, 1985) and theorize that the relationship between human capital and nascent venture performance is weaker when social relations between founding team members are strong.

We test our hypotheses by using the Panel Study of Entrepreneurial Dynamics (PSED) II dataset with which we investigate 488 nascent venture teams in the very early stage of formation using three different performance measures. Our regression models and robustness checks confirm our predictions: both general and specific human capital are positively related to all three performance dimensions, with significant and negative moderation effects of social relations in all six corresponding models.

With these findings, we advance research on entrepreneurial teams and nascent venture performance in several important ways. First, on a general level, we strongly support the notion that in founding teams, human capital and social relations between team members interact in explaining nascent venture performance (Argote et al., 2003; Schjoedt et al., 2013; Zheng, 2012). Second, we demonstrate that stronger human capital and stronger social relations in the sense of more of each is better (Pierce & Aguinis, 2013) are not necessarily the best combination to enhance nascent venture performance. Instead, strong relations are found to have a downside as they dampen the positive effect of human capital on performance. Third, we also advance existing research on success probabilities of teams with different human capital and social relations combinations (Schjoedt et al., 2013; Wilson et al., 2013) as we illuminate how teams with either strong or weak human capital and either strong or weak social relations differ in terms of nascent venture performance; specifically, while teams with strong human capital and weak social relations perform best, we find that in teams with strong relations, having weak or strong human capital only implies little performance differences. This offers valuable insights to scholars investigating the determinants of nascent venture performance.

HYPOTHESES DEVELOPMENT

Human Capital and Nascent Venture Performance

In general, literature strongly agrees that human capital residing in individuals and in entrepreneurial teams is positively related to the performance and success of a nascent venture, mostly because human capital fosters entrepreneurs' ability to explore and exploit opportunities and to judge the value of new entry (Alvarez & Barney, 2004; Becker, 1962; Campbell et al., 2012; Davidsson & Honig, 2003; Dencker et al., 2009; Wiklund & Shepherd, 2008; Wright et al., 1994). This applies to general human capital in the form of education (Unger et al., 2011) and to specific human capital represented by start-up experience (Mayer-Haug et al., 2013; Stuart & Abetti, 1990). We follow this established reasoning and the strong prior theoretical and empirical evidence by formulating a baseline hypothesis which states that the stronger general and specific human capital in entrepreneurial teams are, the higher should be the likelihood that the nascent venture performs well. Formally stated:

> *Hypothesis 1: Human capital (general and specific) in nascent venture teams is positively related to the nascent venture's performance.*

The Moderating Effect of Social Relations

On the one hand, human capital and social relations could strengthen their respective positive effects on nascent venture performance. Reasons could be that strong social relations may improve the team's resource flows and knowledge acquisition abilities (Hoang & Antoncic, 2003; Tortoriello, Reagans, & McEvily, 2012), its effectivity and efficiency of utilizing expertise and skills (Zheng, 2012), and may help to overcome knowledge differences (Majchrzak et al., 2012). This is important because in teams, the collective knowledge and insights are the road to success (Beckman, Burton, & O'Reilly, 2007); therefore, an efficient and embracing exchange of individual knowledge is required to establish a profound base of knowledge throughout all team members and ensure knowledge integration across team members (Majchrzak et al., 2012).

On the other hand, there are several good theoretical reasons to argue that strong social relations weaken the positive relationship between human capital and nascent venture performance and thus impede the benefits of stronger human capital for the nascent venture.

First, although teams with strong social relations can benefit from information and knowledge on a more general level (Hurlbert, Haines, & Beggs, 2000), those strong relations limit the insights and new ideas that can come into the team from outside (Adler & Kwon, 2002; Gargiulo & Benassi, 2000), for example through non-related experienced persons. As a consequence, strong social relations undermine the likelihood to be open towards changes (Wilson et al., 2013) and lead to less innovative inputs (Gargiulo & Benassi, 2000). Also, they might hinder innovations and entrepreneurial activity in general (Adler & Kwon, 2002). This is unfortunate as particularly in the setting of nascent ventures, teams operate in dynamic environments where they need to overcome the liability of newness (Stinchcombe, 1965). A lower probability of more profound changes and innovation thus decreases the performance prospects of those firms. As such, we support the notion that "ties that bind may also turn into ties that blind" (Powell & Smith-Doerr, 1994) which work against the established beneficial outcomes of strong human capital.

Second, entrepreneurial team members with strong social relations (i.e., in entrepreneurial family teams, see Schjoedt et al. (2013)) are likely to strive for excessive harmony and to avoid cognitive conflict (Sharma et al., 1997). This may lead to a situation where team members agree on the smallest common denominator, which leaves many ideas and human capital potential untapped. This, in turn, further reduces the likelihood of implementing substantial changes and innovations and ultimately lowers the chances of success.

Third, starting a new firm involves high risk and high failure rates (Shepherd, Douglas, & Shanley, 2000). Hence, for teams with strong social relations, there is more to lose: not only do they potentially loose the resources that they have invested in the startup (time and money), they also bear the risk of destroying close social relationships in case of arguments and conflicts during difficult times. Put differently, teams with strong social relations put those relationships at stake; friendships or partnerships might be harmed in the not unlikely case of failure. As a consequence, these teams will be limiting themselves even more to the common denominator to preserve harmony and to avoid blaming each other in case the new venture does not perform well; as such, they might focus more on relationship- instead of profit-maximization (Newbert & Tornikoski, 2013; Witt, 2004). As a result, they will opt for less risky strategies and will be more hesitant in pursuing promising but risky opportunities; thus, the entrepreneurial potential that resides in their human capital will be used to a lesser extent.

To sum up, we reason that strong social relations will impede human capital's contribution to nascent venture performance as they work against the beneficial outcomes of human capital such as for instance entrepreneurial opportunity recognition and exploitation, innovation, and change. This leads us to argue that strong social relations in entrepreneurial teams weaken the positive relationships between both general and specific human capital and nascent venture performance.

H2: Strong social relations within the team impede the positive relationship between human capital and the nascent venture's performance.

H2a: Strong social relations within the team impede the positive relation between education, i.e. general human capital, and the nascent venture's performance.

H2b: Strong social relations within the team impede the positive relations between start-up experience, i.e. specific human capital, and the nascent venture's performance.

METHOD

We test our hypotheses on nascent venture teams of which one team member each has participated in the Panel Study of Entrepreneurial Dynamics II (PSED II). PSED II provides a representative, longitudinal dataset on nascent ventures in the United States. A total of 31,845 individuals were initially surveyed, which led to the identification of 1,214 nascent entrepreneurs, some as individuals (628), some in teams (586), whereby the latter constitute the relevant sample for our study. A team member was defined as someone who expects to share ownership of the new business. Each of those entrepreneurs was interviewed on a yearly basis for 60 minutes per phone from 2005/2006 until 2010/2011 (Reynolds & Curtin, 2007). In the interviews, these individuals answered questions covering different areas for all other team members (up to five members): demographics, human capital, relations between all members, efforts, and roles in the ventures. Not all of the 586 respondents answered all questions relevant for our research; depending on the dependent variable applied our sample size thus varies between 488 and 476.

For our hypotheses testing we use three different types of dependent variables that capture different aspects of *nascent venture performance:* a) progress of the nascent venture, b) subjective financial performance (expected revenues), and c) objective performance (whether the venture received outside funding). For the first two variables, we applied hierarchical regression; for the third one, we use a logistic regression model. Referring to our independent variable, and following existing literature about the operationalization of general and specific human capital (Davidsson & Honig, 2003; Dimov, 2010; Gimeno, Folta, Cooper, & Woo, 1997), we measure general human capital through the *level of education* and specific human capital through *start-up experience*. To assess the *strength of social relations* within the founding team, we use a PSED II variable where the interviewee had to indicate the type of relations between all team members, ranging from spouses, partners sharing a household or living in different households, relatives living in same or different households, friends or acquaintances from work or who have not worked together, to strangers before joining the new venture team. The measure thus focuses on the network ties between group members prior to the formation of the entrepreneurial team (Ruef, Aldrich, & Carter, 2003). We measure the social relations within the team as the average relational connections between all team members.

RESULTS

We find that both human capital constructs (education and start-up experience) have a significant and positive effect on all three performance measures: First, for nascent venture progress, education ($\beta = 1.035$; $p < 0.01$) and start-up experience ($\beta = 1.495$; $p < 0.001$) show a strong positive impact. Second, for the dependent variable of expected revenues, education ($\beta = 0.221$; $p < 0.05$) and start-up experience ($\beta = 0.326$; $p < 0.01$) again have a significant positive influence. Third, for the binary dependent variable whether the start-up received external funding, education shows a significant positive influence ($\beta = 0.160$; $p < 0.05$). While the coefficient of start-up experience is positive but not significant, it turns significant when adding the interaction terms ($\beta = 0.397$; $p < 0.05$). Overall, this provides strong support for Hypothesis 1.

We also find strong support for Hypotheses 2a and 2b. For nascent venture progress, the negative interaction effect between education and social relations ($\beta = -0.700$; $p < 0.05$) and between start-up experience and social relations ($\beta = -1.095$; $p < 0.01$) is significant. Alike, for expected revenues, social relations negatively interact with education ($\beta = -0.197$; $p < 0.05$) and start-up experience ($\beta = -0.218$; $p < 0.05$) of the team. Finally, for our binary dependent variable on whether the nascent venture team received outside funding within their first five years of activity, the negative interaction term of social relations and education ($\beta = -0.079$; $p < 0.05$) is significant, and the social relations - start-up experience interaction is marginally significant ($\beta = -0.075$; $p < 0.10$).

DISCUSSION & IMPLICATIONS

With whom to create a firm in order to enhance new venture performance? Our study set out to investigate this question from a social embeddedness perspective and by assessing the interplay of human capital within the founder team and the social relations between the respective team members. As a main finding, we reveal that these elements do interact but in an interesting way: both general and specific human capital positively affect all three performance measures that we apply; this effect is weakened, however, by strong social relations within the team. These findings deserve more in-depth interpretation.

For our nascent venture progress variable, we see that strong social relations indeed weaken the positive effect of both human capital dimensions. Interestingly, in teams with strong social relations, the effect of enhanced human capital seems to be quite marginal; in those teams, stronger human capital does not have a substantial effect on performance. Furthermore, teams with weak human capital (general or specific) perform better when social relations are strong (compared to when they are weak); teams with strong human capital, in turn, perform better when social relations are weak. Similarly, strong social relations weaken the positive effect of general and specific human capital on expected revenues in a way that the marginal benefit of enhanced human capital in teams with strong relations is almost negligible. Put differently, when social relations are strong, the level of human capital does not seem to really matter. However, we observe that teams with weak social relations always perform better than teams with strong social relations (also when human capital is weak). Related to the probability of receiving external funding, we see that the relationship between education level and performance turns slightly negative when social relations are strong. In other words, when founding team members have strong social relations with each other, stronger general human capital makes it less likely that external funding will be received. Referring to specific human capital, we see that the relationship with performance turns negative as well when social relations are strong; however, the absolute level of performance (in terms of receiving external funding) is still always higher than in teams with weak social relations.

These findings advance existing research on entrepreneurial teams and the related performance determinants of new ventures. While we confirm the general notion that human capital and social relations between team members interact in explaining nascent venture performance (Argote et al., 2003; Schjoedt et al., 2013; Zheng, 2012), we theorize and empirically show that this interaction is in fact negative. Having "more of both", meaning having a founding team with highly skilled members that have strong social relations (cf. Pierce & Aguinis, 2013), does not seem to be the best strategy for maximizing performance. This offers new insights to literature about human capital and social relations as interdependent performance drivers (Campbell et al., 2012; Hoang & Antoncic, 2003; Unger et al., 2011). Specifically, we advance research by addressing the "importance of social relations in understanding knowledge creation, retention, and transfer" (Argote et al., 2003). Furthermore, we answered the call for looking behind the scenes of social capital, the interplay with human capital as well as enabling factors and barriers of distinctive forms of social capital (Adler & Kwon, 2002). In particular, we challenge literature that tends to argue that strong social relations are universally beneficial. For instance, some scholars argue that teams with strong previous bondages "achieve a greater degree of coordination, and hence a level of productivity that is unattainable by teams that are less well connected" (Reagans & Zuckerman, 2001). Our theorizing and our empirics show the opposite, however. In that sense, we also challenge the statement that poor relations between team members are a reason for ventures to fail (Watson, Stewart, & BarNir, 2003); in fact, we who that teams with highly skilled but only weakly connected members can perform very well. Also, we support recent literature that has investigated the downsides of social embeddedness and social relations in the entrepreneurship context and beyond (Arregle et al., 2015; Au & Kwan, 2009; Sieger & Minola, 2015). Our findings are also in line with the argument that when team members are mainly chosen due to relational reasons, this may lead to adverse selection problems and lower performance (Wilson et al., 2013). In that sense, we also contribute to research about the rather underdeveloped topic of constraints coming along with familiarity in venture teams (Schjoedt et al., 2013).

Furthermore, we advance literature about success probabilities of teams with different human capital and social relations combinations (Schjoedt et al., 2013; Wilson et al., 2013). We demonstrate which combinations lead to better or worse performance in different dimensions. This further illustrates that human capital and social relations should not be regarded separately from each other; their interaction in various forms is very essential and a crucial driver of new venture performance.

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