IT’S NOT ALL GOOD: THE NEGATIVE INFLUENCE OF SOCIAL CAPITAL ON NEW FIRM PERFORMANCE (SUMMARY)

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SUMMARY

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Principal Topic

Extant entrepreneurship research notes the positive effects on firm performance that might be generated by network relations and social capital. It does not, however, consider how social relationships may constrain a firm's choices and possibly impair its performance. Raising the issue of ideological biases inherent in many discussions of social networks and social capital, Portes and Sensenbrenner note that “it is our sociological bias to see good things emerging out of social embeddedness: bad things are more commonly associated with the behavior of homo economicus.” (1993, p. 1338). We propose that high levels of closure and embedded ties negatively influence firm performance because of the enforcement of group norms that are counterproductive to any individual firm. In other words, embedded ties and high levels of closure may constrain a new firm’s options and subsequent performance, because of adherence to group norms.

We examine this relationship using start-up venture capital (VC) firms and their co-investing relationships with other VCs. New VC firms are an ideal population to study the examination of the relationship between social capital, firm resources and performance, without the confounding effect of other resources, such as technologies or brand equity.

Method

Our sample consists of investments by start-up VC firms from 1980 through 2005. Using these longitudinal data, we test a mediating model and develop measures of conformity to group norms and firm performance. Our dependent variable of new firm performance is the ratio of investments in companies that subsequently fail. Our mediating variable, conformity to group norms, is the funding of late rounds. Our independent variables include measures of the focal VC firm’s centrality within the network, and the strength and multiplexity of the ties with other VC firms within the network.

Results and Implications

Our primary contribution is in the examination of the negative influence of social capital on new firm performance. Our use of the VC industry as a research context and the tracking of VC firms after founding helps extend entrepreneurship research on what contributes to the performance of VC firms as they grow and mature. The use of longitudinal data allows us to establish a causal relationship between social capital, firm resources and firm performance, addressing the concerns voice by Hoang and Antoncic (2003) relative to entrepreneurship research using a social capital lens.

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