THRESHOLD MENTALITY AND FIRM GROWTH: THE ROLES OF SOCIAL CAPITAL AND STRATEGIC ISSUE INTERPRETATIONS AMONG SMALL AND MEDIUM-SIZED ENTERPRISES (SME)

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ABSTRACT

Why do some small firms stop pursuing growth while others continue to do so aggressively? There has been extensive work on small firm growth and failure, but what explains the decision to seek a path of stability after a period of growth? Or, to put it another way, what makes a firm achieve contentedness with its level of achievement? This paper seeks to present a theoretical explanation of these questions by specifically introducing a socio-cognitive perspective of managerial action. This paper proposes the term ‘threshold mentality’ in reference to the reluctance of small firms to grow beyond a certain organizational threshold. Specifically, this paper draws from the social network (capital) and managerial cognition literatures to argue that: (1) some small firms adopt a threshold mentality due to the composition of their social networks and the corresponding relational capital; and (2) this relationship between social capital and ‘threshold mentality’ is mediated by managerial interpretations of market cues. Implications of the proposed model are also discussed.

Keywords: Small business, Firm growth, social capital, managerial cognition, Entrepreneurship

INTRODUCTION

Firm growth has been a primary focus of entrepreneurship research, specifically as a performance measure, and generally as one of several outcomes seen as desirable (Wiklund & Shepherd, 2003; Pisano, Ireland, Hitt & Webb, 2007). Indeed, some have even declared that “growth is the very essence of entrepreneurship.” (Sexton, 1997). An extensive line of research has improved our understanding of the antecedents and dynamics of firm growth (Davidson, 1989; Davidson, Delmar & Wiklund, 2002; Delmar & Wiklund, 2008). The underlying premise of most of small firm growth studies has generally been that small business managers have robust growth aspirations (Dennis & Solomon, 2001; Human & Matthews, 2004). That some firms don’t pursue growth seems to fly in the face of the conventional view of the entrepreneur, and of firm research in general (Autio, Sapienza & Almeida, 2000; Chen, Williams & Agarwal, 2012; Feeser & Willard, 1990). Despite the disproportionate scholarly interest in small firm growth, some researchers have focused on firms that have other outcomes in mind (Davidsson, 1991). It may be the case that for some managers, the goal is a small, stable firm, even if opportunities for growth present themselves. For others, there may simply not be enough causes that lead to the effect of attempted growth (Davidsson, 1991; Davidsson, Achtenhagen & Naldi, 2005; Greve, 2008).
This paper makes use of existing research to propose a socio-cognitive explanation of how some firm decision-makers will ultimately reach a point at which they develop such a ‘threshold mentality’ - a condition in which small firm managers become reluctant to further expand the size and scope of their businesses. Specifically, why do some small firm managers embrace the ‘threshold mentality’ and fail to pursue firm growth? There has been extensive work on growth and failure, but what explains the decision to seek a path of stability after a period of growth? Or, to put it another way, what makes a firm achieve contentedness with its level of achievement?

Recently, this issue has begun to receive some scholarly attention. Runyan, Droge, and Swinney (2008), for instance, introduced the construct of Small Business Orientation (SBO) to understand and explain the very ‘threshold mentality’ that is the focus of this paper. SBO is an important and under-studied concept, in that many small business owners are likely find themselves at a point where they may have achieved the initial goals they set out to achieve. They will reach a threshold that marks a notable level of either contentedness or perceived inability to grow. They may seek to enjoy stability after a long period of stressful risk. They may feel that their firm is successful in fulfilling its vision. They may have never had a vision of continuous growth as a goal in mind at all. Or, they may not see opportunities to grow, or feel that they have the means to grow, due to a lack of relevant mental models, or entrenched habits (Gary & Wood, 2011; Weinstein & Standifird, 2010).

It has been proposed that these issues may be related to a leadership perception derived from a conscious analysis of the firm’s opportunities (Marcel, Barr & Duhaime, 2011), and to the actual exhaustion of the advantages brought about by the firm’s initial opportunities. Satiation of need, or aspiration level (Davidsson, 1991; Greve, 2008) may be a primary factor in determining why small firms stop growing. In other words, the firm may reach a threshold at which the discovery of new opportunities requires a change of strategy, or an active attempt to seek more information and social capital related to opportunity identification. Thus, there may be a socio-cognitive explanation for the focal question of this paper: how does social capital influence the development of SBO? If it does, is such influence exerted primarily through a direct relationship, a relationship filtered through interpretation and preexisting managerial tendencies, or both?

LITERATURE REVIEW

Overview of Entrepreneurship and Small Firm Growth

Firm growth has been an issue of primary interest to business research in general, but in a small business context, it is perhaps considered more emphatically relative to other firm issues. Growth has been considered in the research as a process, and one that is experienced in stages (Davidsson et al., 2005). Entrepreneurship, for example, has at least three stages: entrepreneurial opportunities must exist, be discovered, and finally a person in a position of authority at a firm must make a decision to exploit such opportunities (Shane & Venkataraman, 2000). As such, existing literature proposes several factors driving small firm growth, including ability, need, and opportunity, with need issues apparently accounting for more variation in growth than ability and opportunity (Davidsson, 1991). This model of factors supportive of growth is mirrored, albeit imperfectly, in Wiklund and Shepherd (2003) in the form of aspiration (perceived need),
education and experience (perceived ability) and the dynamism of the environment (perceived opportunity). It also has an analogue in Covin and Slevin (1997, p.106), who provide a model of growth aspiration as “a function of growth aspirations (perceived need), moderated by market constraints (perceived opportunity), entrepreneurial capability, and organizational resources (perceived ability).”

As Hite and Hesterly (2001) note, networks are a central component of models of firm growth, a view that they argue is supported by the relational view (Dyer & Singh, 1998), and the resource based view (Penrose, 1959; Barney, 1991). Firms undergo distinct stages of growth, with each stage representing its own challenges, specifically in terms of external resource needs (Hite & Hesterly, 2001), with growth requiring that such challenges be addressed successfully. In the terms described by Shane and Venkataraman (2000), social capital may cause opportunity to come into existence, but discovering and deciding to exploit opportunity would seem to lie more squarely within the realm of managerial interpretation and disposition.

Beyond the concerns of external resource needs, the existing literature has shown support for managerial aspiration as positively related to firm growth (Wiklund & Shepherd, 2003). External (environmental/social) and internal (personal) influences may lead to the expectation that growth is worthwhile, and this is especially true in young firms that do not yet assure a stable standard of living. However, for those without such aspirations, or without perceived opportunity or ability, the status quo may be satisfying, even to the point that managers protect it (Davidsson, 1991).

**Overview of Small Business Orientation (SBO) Construct**

Small firms tend to grow through either organic or acquisition-based growth (Davidsson et al., 2005), with smaller firms tending to grow organically (Delmar, Davidsson & Gartner, 2003). The arrival of a manager at a threshold mentality leading to a lower rate of desired firm growth may be driven by the perception that the firm lacks opportunities for growth, that the firm lacks the ability to grow, or that it lacks the need to grow. Whatever combination of these factors exists in a specific manager, the manager’s personal goals, including non-economic goals, are often primary factors in determining small firm behavior (Douglas & Shepherd, 2000).

Runyan et al. (2008) present a conception of SBO derived from an earlier work, Carland, Hoy, Boulton and Carland (1984), which emphasizes that some small business owners have goals other than those typically considered characteristic of the entrepreneur. Runyan et al. (2008) is interesting in that it attempts to disentangle SBO from another construct, Entrepreneurial Orientation (EO). In that some of the literature has treated SBO as a simple inverse of EO, detaching SBO from EO is a useful endeavor.

Runyan et al. (2008) take a groundbreaking step in the creation of a distinct measurement scale of SBO. Their work is also groundbreaking in that it finds that SBO, as they measure it, leads to improved firm performance as a firm matures. Their scale focuses on purpose and goals, and emotional attachment. Yet, existing theory regarding social capital and stable managerial characteristics suggests that there may be more leading to SBO than these two factors.
Social Capital and Entrepreneurial Venturing

Social capital clearly has an influence on whether a firm is inclined toward growth or change away from the status quo (Hambrick, Geletkanycz & Fredrickson, 1993), and the extent to which it is able to take advantage of opportunities (Florin, Lubatkin & Schulze, 2003), but the effect of social capital on SBO may not be entirely direct. The proportion of social capital that can be acted upon by a firm will require interpretation before it prompts action or inaction, and the firm will have a limited number of schemata to draw upon in performing such interpretation. At the same time, some of the benefits of social capital will have effects on a firm without interpretation or intervention. With regard to the interpretation event, however, there is currently a gap in the research. Social capital has been defined as "both the network and assets that may be mobilized through that network" (Nahapiet & Ghoshal, 1998, p. 243), and from a more external point of view, as any associations (personal or professional) that offer opportunities that extend a manager’s available choices (Burt, 1992).

Social capital can be understood as a source of information, but also as information itself (Woolcock, 1998; Florin et al., 2003): it can be conceived of as information about relationships, information about the strength of those relationships, information about what those relationships offer, and most directly, it is intelligence transmitted through social ties. This intelligence can be classified into at least two forms, one being the nature of what resources are available, and at what cost, and another being schemata (Poole, Gioia & Gray, 1989; Walsh, 1995; Balogun & Johnson, 2004) about how a firm might approach a given problem. Accurate schemata lead to better decisions (Gary & Wood, 2011), and to knowledge production (Hauser, Tappeiner & Walde, 2007), and as a result enhance performance.

Social capital has shown the ability to positively influence the growth and performance of firms (Baum, Calabrese & Silverman, 2000; Park & Luo, 2001; Uzzi & Gillespie, 2002), but the relationship between social capital and firm outcomes is not completely consistent (Wu, 2008). Whether social ties are strong or weak appears to make a difference, as does the extent to which one bridges structural holes in social networks (Burt, 2000; Granovetter, 1973; Rowley, Behrens & Krackhardt, 2000). Part of this variation may be due to alternative definitions of social capital. If one treats social capital as bridging or brokering weak ties at a nexus of strongly tied networks, the relationship between social capital and firm performance is more clearly positive (Burt, 2000). The firm arguably exists because it has an advantage in facilitating the creation and sharing of intellectual capital relative to the marketplace (Nahapiet & Ghoshal, 1998). This being the case, a firm's ability to distinguish itself from the marketplace through information management will determine a significant proportion of its ability to grow, and inclination to grow (Uzzi & Gillespie, 2002; Inkpen & Tsang, 2005).

Managerial Interpretation and the Entrepreneurial Process

The organization has been conceived of as a system that interprets managerial scanning of the environment (Daft & Weick, 1984). The extent to which an organization views the environment as interpretable, and the extent to which it is willing to intrude upon its environment would be important factors in determining the outcome of such interpretation. Managerial cognition is essential not only to goal formation, but in the entire process of strategic development (Stubbart,
Information is gathered, given meaning through interpretation, and transformed into action (or inaction). Experience allows the manager to make sense of new information, through interpretation in light of managerial knowledge structures (Porac & Thomas, 1990; Balogun & Johnson, 2004). Such schemata give meaning to information, and connect the manager’s personal memory to new experiences of the present (Axelrod, 1976; Greenwood & Hinings, 1988). At the same time, information acquired through social capital may be received in the form of new schemata.

Once information is interpreted through managerial interpretation, there may be another factor influencing the firm's movement towards a given action: the predisposition of a decision-maker to take action. If not, it assumes that firms are purely logical information processing units, without personality or humanity. Unfortunately or fortunately for firms, we know this is not the case. Managerial interpretation relationship with firm performance has been supported (Kabanoff & Brown, 2008; Kunc & Morecroft, 2010), as certain managers have greater ability than others to effectively interpret the importance and significance of different information resources. Furthermore, factors external to the firm (such as industry conditions and social capital) may not only influence firm performance directly, they may influence managerial interpretation (Nadkarni & Barr, 2008). Alternatively, the extent to which a manager feels able to influence their organization may change as a firm grows beyond its initial startup period, and such a changing sense of control may reduce the extent to which a manager seeks to implement new strategy (Plambeck & Weber, 2010). Small business research has also found support for the contention that “the individual matters”, specifically referring to the CEO or top-level manager’s influence, and indicating that “the core of the matter is the subjectively perceived situation and its relation to personal goals” (Davidsson, 1991).

The cognition literature emphasizes these very same issues of perception and impulse to intrude in the environment. Thomas, Clark, and Gioia (1993) confirmed a positive relationship between information gathering (scanning) and interpretations of controllability. If these interpretations are taken as an aspect of all of the interpretations inherent in managerial interpretation, and Proactive Personality is taken as a parallel to organizational intrusiveness, then perhaps the model this paper provides can serve as one model for addressing the gap in managerial resource cognition research (Danneels, 2010). Interpretation of information gained from social capital has been considered in terms of categorization, specifically with regard to threat, loss, or uncontrollability (Dutton & Jackson, 1987), although these are not considered orthogonal dimensions (they are correlated). Managers tend to be more highly sensitive to threats (there is a threat bias), indicating that a consideration of this negative mirror of opportunity may be a more appropriate focus for the study of managerial interpretation (Jackson & Dutton, 1988).

**THEORY AND PROPOSITIONS**

Existing theory indicates a positive relationship between social capital and new venture growth (Baum et al., 2000; Prashantham & Dhanaraj, 2010), which is necessarily preceded by the impulse to grow (leading to the development and execution of a strategy that leads to growth), or more broadly, an attitude that permits the firm to change from its current state of being into something else. Social capital also appears to be an enabler of an attitude that permits individuals, specifically entrepreneurs, to change their state of being from employee to employer,
or to self-employment; this appears to be a function of the material support as well as the informational support provided by social capital (Allen, 2000). Social capital is also positively related to firm performance, and strategic orientation is a precedent to performance outcomes: “the relationship between social capital and organizational performance is contingent on an organization’s competitive strategic orientation” (Acquaah, 2007). In other words, as social capital increases, there is an increased likelihood that the firm will have at its disposal the resources and opportunities required for growth. Given that the impulse to grow derives at least in part from social capital, the impulse to maintain and protect the status quo of a firm (here taking the form of SBO) may represent a lower level of social capital, or an exhaustion of the ability of the firm’s existing social capital to provide new, growth-compelling resources and opportunities. Likewise, higher levels of social capital are likely to decrease SBO by presenting resources and opportunities that lead the firm away from outright protection of the status quo, for example, by increasing exploratory innovation (Phelps, 2010) or providing financial support (Florin et al., 2003).

**Proposition 1:** The level of managerial social capital will be negatively related to SBO among SMEs.

The presence of social capital alone is not sufficient for the growth of a firm, nor is the opportunity presented by social capital sufficient to produce the impulse to attempt growth. One of the significant opportunities rendered by social capital is information diversity (Baum et al., 2000), and the utility of social capital in terms of the learning opportunities it represents is limited by the ability of the firm to exploit such opportunities (Prashantham & Dhanaraj, 2010). And, new information requires some form of interpretation before it can be acted upon. Prashantham and Dhanaraj (2010) found that “network learning emerged as a clear differentiator between…more and less successful ventures”. A clear implication of that work is that the ability to acquire social capital represents an important differentiator of firm outcomes. But, as far as the informational component of social capital is concerned, interpretation is a necessary precedent to decision-making, or strategic orientation. Such a path indicates an acknowledgement that perception of opportunity plays a significant role in determining growth motivation (Davidsson, 1991). So, while social capital’s relationship with a firm’s growth orientation may have components that are direct (or mediated by other interpretive factors), some proportion of its influence can be inferred as occurring only through managerial interpretation of its significance.

**Proposition 2a:** The extent of managerial interpretation of information in terms of loss (gain) will positively (negatively) mediate the relationship between managerial social capital and SBO among SMEs.

**Proposition 2b:** The extent of managerial interpretation of information in terms of threat (opportunity) will positively (negatively) mediate the relationship between managerial social capital and SBO among SMEs.

**Proposition 2c:** The extent of managerial interpretation of information in terms of uncontrollability (controllability) will positively (negatively) mediate the relationship between managerial social capital and SBO among SMEs.
This is not to say that the manager’s own tendencies do not play a role in determining firm orientation or the manner in which social capital is interpreted. Proactive personality has been defined (Bateman & Crant, 1993) as “the relatively stable tendency to effect environmental change”, and developed into a unidimensional scale measuring a dispositional construct. According to that work, the concept of a propensity to engage in proactive behavior arose from the interactionist view of psychology (Bandura, 1977; Bowers, 1973; Schneider, 1983). As a disposition to effect environmental change, it can be seen as a representation of the extent to which an one is willing to intrude upon and change their environment, a concept which mirrors the firm-level discussion of organizational intrusiveness introduced by Daft and Weick (1984), a factor, which along with management beliefs about the environment has been posited as leading to four possible interpretation modes: undirected viewing, conditioned viewing, enacting, and discovering. Such modes are associated with differences in “environmental scanning, equivocality reduction, strategy, and decision making (Daft & Weick, 1984).

As far as proactive behavior’s dispositional nature is concerned, Bateman and Crant (1993) emphasize that it is relatively stable over time, indicating that short-term events are not likely to significantly alter one’s dispositional nature. And, in terms of its unit of analysis, Bateman and Crant (1993) also emphasize that “proactive processes occur also at the levels of groups and organizations”. For the purposes of this paper, however, the use of small and medium sized enterprises intends to reduce the concern between measurement of proactive disposition at the individual (top manager) level, and the firm level. The dispositional nature of the construct also makes it more appropriate as a predictor (or moderator of a predictor) of an orientation (such as SBO) than a behavioral construct. Proactive personality has also been shown to be a useful construct across cultures (Claes, Beheydt & Lemmens, 2005). Proactiveness is “the willingness and ability to take action to change a situation to one’s advantage” (Randler, 2009), and has been shown to have a positive relationship with entrepreneurial intention (Crant, 1996; Becherer & Maurer, 1999; Drost, 2010), which is contrary to the behavioral outcome one would expect from SBO.

**Proposition 3: The degree of managerial proactive personality is negatively related to SBO.**

Bateman and Crant (1993) noted proactive personality as a factor that potentially limits the extent to which environmental conditions are constraining in decision outcomes, and this is supported by Seibert, Kraimer and Crant (2001), as well as Kirby and Kirby (2006). In a model in which social capital is mediated by managerial interpretation, one could expect that rather than moderating social capital directly, proactive personality may moderate interpretations of social capital. In such a case, proactive personality can be seen as environmental intrusiveness, while managerial interpretation represents the creation of beliefs about the environment (Daft & Weick, 1984). Such a path indicates an acknowledgement that perception of need plays a significant role in determining growth motivation (Davidsson, 1991). This path also aligns well with research indicating proactivity as anticipatory in nature, focused on aggressive information gathering and usage (Aspinwall, Sechrist & Jones, 2005).
Proposition 4a: The degree of managerial proactive personality will negatively (positively) moderate the relationship between managerial interpretation of information as loss (gain) and SBO.

Proposition 4b: The degree of managerial proactive personality will negatively (positively) moderate the relationship between managerial interpretation of information as threat (opportunity) and SBO.

Proposition 4c: The degree of managerial proactive personality will negatively (positively) moderate the relationship between managerial interpretation of information as uncontrollable (controllable) and SBO.

The path presented in the model that includes a mediation through interpretation and influence through proactive personality is representative of concepts found in the cognition literature (Daft & Weick, 1984), and the small business growth literature (Davidsson, 1991; Wiklund & Shepherd, 2003).

**Figure 1. A Socio-cognitive Model of Small Firm ‘Threshold Mentality’**

**DISCUSSION AND CONCLUSION**

Do the new opportunities represented by weak ties become exhausted, and ultimately become only as effective as strong ties in delivering new opportunities (Granovetter, 1973; Granovetter, 1985)? Do cognitive factors such as managerial interpretation mediate the effective exploitation of social capital? Finally, are some firm decision-makers more inherently inclined, in terms of personality, toward a goal of stability? If so, what are the relative impacts of these effects?
This paper contributes to the literature in two ways. Firstly, it proposes that the literature has thus far focused on managerial impulse toward the growth of firms, at the expense of understanding what may be a practically important and widespread behavior of managers: a threshold mentality that seeks stability and is attached to the firm as it is, not as it could be. By seeking to focus on this issue, this paper hopes to inspire work that deepens our understanding of the many small firms that measure success in ways other than growth.

Secondly, this paper proposes that some component of social capital’s contribution to managerial intent is explicable through concepts explored in the cognition literature. From this point of view, a proportion of social capital’s relationship with managerial orientations such as SBO is mediated by managerial interpretation. This paper proposes that such a socio-cognitive explanation is a logically sound in light of the social capital and cognition literatures, and is implied by both. This explanation of some proportion of variance in the relationship between social capital and managerial orientation as mediated by managerial interpretation also emphasizes the importance of understanding managerial cognition in firms where managerial power is especially concentrated, such as in small and medium-sized enterprises.

Granovetter, Granovetter, Castilla, and Hwang (2000) indicates that weak ties represent better sources of “non-redundant information”, implying that the informational and other resource advantages rendered by social capital (interpreted or not) are at risk of becoming exhausted over time. This could be a significant factor in the experience of entrepreneurial firms as they reach different stages of growth, leading some to eventually adopt a posture representative of SBO. Alternatively, the founders of some firms may, as a definitional quality of their vision, conceive of SBO as a desired outcome, such that a certain level of success and stability, such that SBO is not so much a function of social capital and interpretation, so much as it is the result of success.

Another issue that needs to be considered is that organizational commitment can mean very different things. Does organizational commitment represent commitment to the firm’s entrepreneurial growth, or does it represent commitment to sustaining the firm as it is, maintaining it in a stable condition? As Messara and Dagher (2010) noted, empirical results focused on the relationship between proactive personality and organizational commitment are mixed, and this may be due to the very different ways in which individuals view the meaning of commitment.

It is also worth considering that some of the relationships discussed in this study may exhibit curvilinear characteristics when empirical data have been collected. Threat and opportunity are both perceptions of the existence of information that is actionable in some way, but future research should consider the possibility of interpretation of information as neither threat nor opportunity, but as uninteresting or unremarkable.

Because the model presented in this study implies that SBO is arrived at by a combination of factors including but not limited to social capital, managerial interpretation of social capital, and managerial proactive personality, there is an implication that managers arrive at an inclination to SBO because they desire stability in their firms due to their availability of resources, interpretations of such, and their disposition toward the way in which growth sometimes does not
serve their vision of the firm. Yet, it is also implied that the inability to correctly identify and interpret what social capital has to offer could lead to SBO, even if social capital presents exploitable opportunity. Further research should also consider that interpretation of social capital, as well as proactive personality, could determine the urgency and thoroughness with which social capital’s resources are analyzed, as well as the extent to which the manager expends energy toward the expansion of social capital and all of the resources, informational and otherwise, that it offers.

So, it may be that some managers arrive at SBO because they determine that the firm has met their goals and is in alignment with their disposition, but research should not discount that some managers who exhibit SBO may be trapped at a threshold due to a lack of opportunity caused in part by a lack of social capital, or a lack of ability to understand what their social capital offers them. Understanding how managers overcome SBO, if they do, would seem as interesting as understanding why they arrive at it in the first place.

REFERENCES


