Scaling New Ventures

Abstract Although scaling is a “hot topic” in the practitioner literature, it has mostly been ignored (at least explicitly) in the academic literature. Building on a recent editorial, this chapter highlights the importance of scaling for new venture growth. Scaling refers to spreading excellence within a venture as it grows (organically or through acquisition) from a new (and often small) organization to an established, large organization (Shepherd & Patzelt in *Entrepreneurship Theory and Practice*, <https://doi.org/10.1177/1042258720950599>, 2020). In this chapter, we explore the drivers and consequences of scaling and explain how knowledge management facilitates scaling, how founder replacement impacts scaling, and how current scaling influences subsequent scaling.

Research on new venture growth has primarily focused on explaining how some organizations grow faster than others. *Growth* refers to an increase in a venture’s size (e.g., sales, employees, profit) over a particular period. Growth drivers include a venture’s positioning in an attractive market, resource endowments, and relationship networks. However, 10 years ago, McKelvie and Wiklund (2010, p. 261) concluded that the “development of firm growth research has been notably slow.... A major reason for this lack of development is the impatience of researchers to prematurely address the question of ‘how much?’ before adequately providing answers

This chapter is based on Shepherd and Patzelt (2020).

to the question “how?” In particular, for ventures that grow organically (i.e., not through external acquisitions), addressing the question of how is critical because doing so can provide entrepreneurs a roadmap of the actions necessary to expand their operations quickly. This topic’s importance is echoed in the practitioner literature, which prominently uses the term “scaling” to describe how ventures can quickly grow their internal operations. *Scaling* refers to spreading excellence within an organization as it grows.

This chapter builds on the organizational-learning and knowledge-transfer literatures and a recent call for scaling research (Shepherd & Patzelt, 2020) to develop a knowledge-based framework to organize our thinking about scaling. We focus on knowledge as a critical resource for scaling because knowledge plays a crucial role in recognizing potential new business opportunities (see Chapters 1 and 2) as drivers of growth as well as in creating (Chapter 3) and managing (Chapter 4) new ventures. Moreover, based on years of discussions with entrepreneurs involved in scaling their ventures, Rao and Sutton (2014, p. 1) indicated that scaling involves “spreading constructive beliefs and behaviors from the few to the many”—that is, “build[ing] and uncover[ing] pockets of exemplary performance, spread[ing] those splendid deeds, and as an organization grows bigger and older recharge[ing] it with better ways of doing the work.” Therefore, next to founders’ intentions to grow their ventures, knowledge and its distribution throughout new ventures seem to be prerequisites for new ventures’ effective scaling.

In explaining this knowledge-based scaling framework (see also Shepherd & Patzelt, 2020), we offer the following key insights. First, while the entrepreneurship literature has primarily focused on explaining how much new ventures grow, the how of growth is poorly understood (McKelvie & Wiklund, 2010). Thus, we suggest a focus on scaling as a way to explain *how* new ventures grow. Second, in this chapter, we begin to explore how knowledge can be transferred throughout an organization through scaling. That is, rather than focusing on prior knowledge (Shane, 2000) or even the acquisition of knowledge (Bresman et al., 1999), this chapter focuses on exploring the mechanisms of intraorganizational knowledge transfer that promote organizational scaling.

A KNOWLEDGE-TRANSFER PERSPECTIVE ON ORGANIZATIONAL SCALING

An essential aspect of spreading excellence within an organization is transferring knowledge from the few initial organizational members to those added to the organization (i.e., from individual to individual) and to the organization itself (i.e., from members to the organization). *Knowledge transfer* refers to the purposeful exchange of information between two entities (individuals or ventures) such that at least one of the entities becomes more knowledgeable (Kumar & Ganesh, 2009). While there is a common misconception that knowledge transfer is costless and instantaneous, the stickiness of information means that knowledge transfer is typically effortful and time consuming. Thus, we note that scaling a new venture is an effortful and time-consuming process for the focal entrepreneur and the new venture's members and other stakeholders.

In Fig. 5.1, we present the knowledge-transfer framework of scaling (see Shepherd & Patzelt, 2020) as a basis for advancing our understanding of how new ventures scale. In the center of the model is *scaling*—spreading excellence within an organization as it grows. The drivers of scaling (solid boxes and solid arrows) include (1) *accumulating* knowledge, especially tacit knowledge, from learning by doing and learning by observing; (2) *communicating* knowledge by articulating, codifying, and otherwise disseminating knowledge to organizational members; (3) *relocating* knowledge repositories, such as people, tasks, tools, and templates; and (4) *connecting* knowledge based on social capital, formalization, and improvisation. Founders play a central role in the scaling process for several reasons. For example, founders make key strategic decisions related to knowledge-transfer activities within organizations, which are essential to scaling new ventures. However, we note that as the knowledge demands of new ventures change during the scaling process, stakeholders may replace founders with professional managers who possess the knowledge required for scaling.

Accumulating Knowledge to Scale a New Venture

Discussions of organizational learning and knowledge transfer often start with experience, mainly how “organizational experience interacts with context to create knowledge” (Argote & Miron-Spektor, 2011, p. 1123). Organizational learning results in a positive change in this knowledge

Fig. 5.1 A knowledge-transfer framework of scaling a venture (Adapted from Shepherd & Patzelt, 2020)

and often occurs as organizational members gain additional experience. This experience can be acquired directly by engaging in tasks (i.e., experiential learning) and indirectly by observing others engage in tasks (i.e., vicarious learning). For example, one study found that knowledge is transferred more easily across stores owned by the same franchisee but not to stores owned by other franchisees in the same franchise system (Darr et al., 1995).

Given the uncertain environments of many new ventures, founders often learn by doing. Learning by doing can lead to various missteps, mistakes, and failures, which, in a new venture, can be an important source of new knowledge. This learning process can help reduce uncertainty, test the validity of opportunity conjectures (see Chapter 3), and determine the best way to exploit potential opportunities.

In addition to learning by doing, new venture members can learn by observing others and then performing those activities or practices themselves (i.e., vicarious learning). Because a new venture's potential competitive advantage may lie in the cognitions, actions, and practices of its founder(s), scaling depends on other organizational members engaging in learning by doing and learning by observing to transfer the founder's knowledge to organizational members. Therefore, scaling is likely enhanced when new venture members learn both by doing and by observing the founder to gain knowledge to effectively and efficiently exploit potential opportunities for growth.

Communicating Knowledge and Scaling a New Venture

Knowledge Articulation and Codification

While learning can be passive based on experience and observation, it can also be a more deliberate cognitive process through knowledge articulation and codification. *Knowledge articulation* refers to a deliberate process of collective learning in which individuals express their unique information to others, engage in task conflict, and debate differing viewpoints. Through this knowledge-articulation process, new venture members can better understand the causal links between their actions and firm outcomes. By understanding these causal links, new venture members have a foundation from which they can begin to question and adapt their current routines. Routines are stable behavior patterns for performing specific organizational tasks. Despite the collective-learning benefits of articulating knowledge, many organizations do not do so.

To further enhance collective learning within a new venture, members can codify articulated knowledge. *Knowledge codification* refers to documenting a new venture's knowledge in some way, such as in manuals, documents, memos, spreadsheets, support software, and so on. Not only does codifying knowledge make an individual's knowledge available to a new venture (transfer from individual knowledge to organizational knowledge), but the process of codifying knowledge can facilitate learning for the codifier as he or she makes causal links explicit. Interestingly, organizations only codify a small fraction of their articulated knowledge. The reluctance or inability to codify articulated knowledge could be due to the cognitive costs associated with engaging in these collective-learning tasks (e.g., the investment of managerial attention, which is then unavailable for other tasks; see Chapter 1).

Further, even when organizations can successfully codify their knowledge, it does not appear to be easy to transfer this codified knowledge throughout organizations. However, when new venture members codify their knowledge, it appears to generate several benefits. For example, one study found that entrepreneurs who codify their decision making are better able to secure others' commitment to their venturing efforts (Mitchell & Shepherd, 2012). Similarly, another study reported that founding teams that use professional documentation practices in decision making are able to better advance their opportunities (Preller et al., 2020). Therefore, scaling is likely enhanced when venture members engage in learning by doing and learning by observing to gain knowledge critical for the effective and efficient exploitation of potential opportunities.

We note that there are different types of knowledge, and these differences likely impact the knowledge transfer involved in scaling. There is explicit knowledge (which can be articulated) versus tacit knowledge (which is difficult to articulate); there is declarative knowledge (i.e., know-what) and procedural knowledge (i.e., know-how); and there is variation in the causal ambiguity of knowledge—the extent to which the individual (or venture) understands the nature of the cause and effect of the relationships underlying the know-what or know-how. Unsurprisingly, tacit knowledge appears to be the most difficult to transfer. However, transferring tacit knowledge within a venture is particularly important in high-velocity (i.e., dynamic and complex) environments. Similarly, while the causal ambiguity of knowledge can impede its transfer, high-velocity

environments contribute to this causal ambiguity. Therefore, scaling is likely greater for new ventures that are better at transferring tacit and causally ambiguous knowledge among their members.

Communication Avenues

Communication can act as a mechanism linking knowledge-transfer efforts to effective scaling. Specifically, communication as a knowledge-transfer mechanism takes different forms, including regular communication (e.g., status reports, phone calls, emails), face-to-face meetings, personal and international acquaintances, and storytelling practices. The entrepreneurship literature has already begun to explore new ventures' communication with external investors (e.g., Allison et al., 2017; Martens et al., 2017). Although new organizations typically use communication to inform external audiences about the nature of their potential opportunities and strategies for organizational growth, communication that informs new ventures' internal audiences about their success in exploiting opportunities for venture growth likely facilitates scaling.

Relocating Knowledge and Scaling

Relocating knowledge repositories (i.e., people, tasks, tools, and templates) can be an effective knowledge-transfer mechanism within an organization and facilitates scaling. *People* possess and display knowledge such that when an entrepreneur relocates a person to another part of the focal venture, others can learn from that person, representing the transfer of both tacit and explicit knowledge. *Tasks* often involve tacit knowledge, and a network of tasks contributes to the formation of routines, which enable organizations to function. The extent to which an entrepreneur can relocate tasks and routines such that others within the focal venture can perform them facilitates knowledge transfer. Tools are also knowledge repositories (e.g., a knowledge-management system or other forms of technology) such that relocating the tools used by organizational members is a means of transferring knowledge. Relocating a tool can help transfer knowledge inherent in the tool and how to use it to others within the focal venture. Finally, *templates* are working examples of an organization's routines that specifically detail "both critical and noncritical aspects of the routine[s], providing details and nuances of how the work gets done, in what sequence, and how various components and sub-routines are interconnected" (Nelson & Winter, 1982, pp. 119–120). Exploring

how and when different combinations of these knowledge repositories are relocated within organizations can provide greater richness to our understanding of organizational scaling.

Connecting Knowledge

Social Capital

As scaling involves spreading excellence within a growing venture, venture members' ideas, efforts, and work need to be connected with those of other members. The personal connections inherent in social capital provide a basis for transferring knowledge within an organization. Intraorganizational social capital "is an intangible asset that is based on interactions between people" (Hador, 2016, p. 1119). This social capital facilitates knowledge transfer by opening communication channels and increasing information-exchange incentives between organizational members. Social capital can also decrease the perceived complexity of the knowledge being transferred, the time for knowledge transfer (due to relationship heuristics), and information-exchange costs.

There are many social-capital attributes and many associated organizational implications (for a review, see Hoang & Antoncic, 2003). Indeed, social capital involves (1) structural aspects, such as network ties, configurations, stability, cohesion, and range; (2) cognitive aspects, such as shared goals, shared vision, and shared culture; and (3) relational aspects, such as cooperation, norms, and identification. All or some of these aspects of social capital are likely to facilitate the knowledge transfer necessary for scaling. For example, knowledge transfer is more effective when the recipients have a shared business strategy, shared mental models, shared trust, and a superordinate identity. This knowledge transfer between new venture members based on "sharedness" appears to be enhanced by geographical proximity, similar tasks, and an organizational-safety culture. Therefore, ventures with higher intraorganizational social capital (i.e., structural, cognitive, and relational) are likely more effective at scaling. However, the specific impact of different types of social capital—founders' social capital and ventures' social capital—is likely contingent on contextual factors characterizing new ventures' environments. We now turn to two such considerations—formalization and improvisation.

Formalization

As a scaling venture grows to a larger size, formalization becomes an essential aspect of designing the organization. Formalization refers to the extent to which organizational tasks are standardized in the form of rules and procedures that direct members' behaviors. An organization's formalization promotes the knowledge transfer critical to scaling. Specifically, formalization reduces the uncertainty of communication among new venture members and establishes routines, thereby facilitating the transfer of both explicit and tacit knowledge.

Introducing formal structures in an organization—for example, through “hiring and training, performance measurement and rewards, job design, conflict resolution, protocols, and meetings”—can enable personal relationships to become embedded into organizational roles (Gittell & Douglass, 2012, p. 709) and thus facilitate scaling. That is, the “well-crafted rules and processes” of formalization “create predictability, reduce conflict, facilitate cooperation and reduce cognitive load because people are armed with proven responses to routine situations... rather than having to reinvent the wheel each time” (Rao & Sutton, 2014, p. 107). Therefore, entrepreneurs can enhance scaling when their ventures transition from more personal, informal relationships to more formalized relationships to connect organizational members. Even with the benefits of formalization, ventures still face the challenge of formalizing their operations without building an unresponsive bureaucracy—a bureaucracy that obstructs entrepreneurial action, such as improvisation, to which we now turn.

Improvisation

Although we have emphasized the importance of relocating knowledge repositories for scaling, the new locations will likely need to adapt to these people, tasks, tools, and templates. Rao and Sutton (2014, p. 52) emphasized the need for adaptation when scaling in the following quote: “While each decision unfolded differently, our analysis always seemed to end up in the same place; the trade-offs and tension between encouraging and forbidding departures for some template, practice or behavior took center stage.” Such trade-offs and tension trigger improvisation that can facilitate the knowledge transfer necessary for scaling. Improvisation refers to a creative and spontaneous process of generating novelty by fusing design and action. An experimental culture, minimal structures, storytelling practices, and shared mental models within an organization

facilitate new ventures' improvisation. This improvisation is important because it enables transferred knowledge to fit new contexts. Therefore, improvisation is a scaling mechanism because it enables growing ventures to quickly enact change to fit their changing environments (internal and external).

Although not directly related to knowledge transfer (because it was not prior studies' focus of research), improvisation has been highlighted as a beneficial attribute of founders. For example, improvisation is important in the founding process and for venture performance (e.g., high sales growth for founders high in entrepreneurial self-efficacy [Hmieleski & Corbett, 2008]) because it is a source of rapid and novel responses to a changing environment and transferring the knowledge critical to scaling (as detailed above). Therefore, more improvisational ventures are more likely to succeed in scaling.

Founder Replacement and New Venture Scaling

Much has been made of founders' influence in creating new ventures. Founders make the key decisions that influence their ventures' early development including, as we argued above, decisions related to accumulating, communicating, relocating, and connecting knowledge. However, starting a venture and scaling a venture require different skills, experience, and knowledge. Indeed, investors ask whether a focal founder can perform both tasks—starting and scaling a venture. Conventional wisdom suggests that the answer to this question is often “no.” Some believe that a growing venture requires managerial skills beyond those of the typical founder (Ewens & Marx, 2017; Willard et al., 1992). As a venture transitions from startup to scaleup, the expectation is that the leadership of the organization needs to transition from (1) creativity and exploration to efficiency and exploitation, (2) a single individual and tightly centralized decision making to a team of executives with participation and delegation in decision making, (3) passionate commitment to dispassionate objectivity, and (4) an entrepreneurial management style to a professional management style (Churchill & Lewis, 1983). Paradoxically, one study found that the more successful the CEO-founder, the more likely a professional manager would replace him or her (Wasserman, 2003). Specifically, for CEO-founders, success generally involves raising funds from outside investors, investors who desire (and use ownership power

to accomplish) the transition from founder-CEO to professional-CEO. Therefore, the more rapidly founders scale their ventures, the more likely they will be replaced by professional managers.

A FEEDBACK FRAMEWORK OF KNOWLEDGE TRANSFER IN ORGANIZATIONAL SCALING

Above, we built on the knowledge-transfer literature to offer a framework of scaling. In the remaining sections of this chapter, we explore the interrelationships among the drivers of scaling (i.e., the dotted-line arrows of Fig. 5.1) and the relationships between founder replacement and the different scaling drivers.

Accumulating and Communicating Knowledge for Scaling

While accumulating knowledge (from learning by doing and learning by observing) can drive scaling, this positive relationship is likely magnified when knowledge is articulated, codified, or otherwise successfully communicated to other organizational members. Although we recognize that the “tacitness” of experience-based knowledge can obstruct its communication, the capability of communicating knowledge itself can be enhanced by learning by doing these communication activities. Similarly, members can learn to better share knowledge within a venture by observing others engaged in such communication activities. That is, observing a founder articulating and codifying his or her knowledge for scaling may provide the opportunity for organizational members to learn not only the content of that knowledge (i.e., learn know-what) but also how to articulate and codify their own knowledge (i.e., learn know-how) to advance further scaling efforts. It appears that in scaling an organization, it is essential that new venture members (and not just the founder[s]) accumulate knowledge on how to articulate, codify, and otherwise communicate their knowledge to other organizational members.

Accumulating and Relocating/Connecting Knowledge for Scaling

Scaling involves accumulating knowledge by relocating and connecting knowledge. For example, as members are relocated to other parts of the focal venture, undertake different tasks, use new tools, and engage

with new templates, they can learn how to engage in such relocation activities more effectively for the future. Moreover, founders can learn what knowledge needs to be transferred within their ventures, where that knowledge resides (e.g., in which people, tasks, tools, and templates), and how and where to relocate these knowledge repositories to facilitate scaling. Founders likely know this information from their interactions with people, tasks, tools, and templates and their relocation within organizations. However, under some circumstances, relocating knowledge can diminish knowledge accumulation and decrease this knowledge's usefulness for scaling. Indeed, relocating to promote scaling may require discarding knowledge repositories that were useful in the past but are no longer useful. That is, new venture members may need to unlearn some knowledge before they can absorb transferred, new knowledge. Rao and Sutton (2014, p. 28) summarized this notion in the following way:

As organizations grow larger and older, as the footprint of a program expands, and as the consequences of past actions accumulate, once useful but now unnecessary roles, rules, rituals, red tape, products and services build up like barnacles on a ship; to make way for excellence to spread, these sources of unnecessary friction must be removed.

Similarly, new venture members who connect different knowledge chunks can create new knowledge to facilitate scaling. New venture members can better connect chunks of knowledge to create new knowledge when they have developed more social capital (i.e., role-based and hybrid relationships); commonality with other organizational members; and skills for improvising new ways of communicating, relocating, and connecting that promote scaling.

Communicating and Relocating Knowledge for Scaling

Relocating knowledge repositories likely facilitates the knowledge articulation and codification useful for scaling. For example, in relocating a tool to another organizational member, the transfer may require a member to articulate to others how to use the tool and what to do when it breaks down. This articulation is then available to transfer through other communication avenues and to be codified. Indeed, the distinction between different types of knowledge repositories is likely important in

explaining heterogeneity in scaling. That is, under some conditions, relocating a tool (as a knowledge repository) leads to effective scaling. Under different conditions, an entrepreneur can more effectively scale his or her venture by relocating a person rather than the other types of knowledge repositories. It could be that relocating a tool transfers know-how information through members' learning by doing while relocating a person transfers know-what and know-how through other members' learning by observing. The question then becomes which knowledge transfer is most critical for the current stage of venture scaling. Thus, there seems to be a complex mutual relationship between communicating and relocating knowledge in scaling a venture.

Communicating and Connecting Knowledge for Scaling

Scaling also depends on the interrelationship between communicating and connecting knowledge within a venture. For example, communicating knowledge facilitates the development of connections within organizations for transferring knowledge critical to scaling. In taking the effort to articulate and perhaps codify their knowledge, founders make themselves vulnerable to criticism (and perhaps imitation by competitors). However, such vulnerability is often important in developing strong relationships and increasing audience receptivity to knowledge transfer. Indeed, some of this communication may involve developing structures such that personal relationships begin to become more role based and transfer social capital from the individual level to the venture level. In return, connecting organizational members likely fosters the knowledge articulation and codification and the establishment of communication avenues necessary to promote scaling.

Relocating and Connecting Knowledge

While it seems rather obvious that relocating people within an organization helps increase connections through personal relationships and greater shared experience, it is unclear how relocating the other types of knowledge repositories—namely, tasks, tools, and templates—impacts connections for scaling. Relocating tasks likely helps build role-based relationships that we believe are important for organizational scaling. Furthermore, relocating tools likely promotes improvisation in the use of those tools for scaling. Indeed, improvisation may trigger (or arise

from) the relocation of people, tasks, tools, and templates. For example, improvisation can bring together different tools from across a venture to work in concert to enhance scaling. More specifically, improvisation can combine (through relocation) (1) different people with different tools, tasks, and templates; (2) different tools with different tasks and templates; and (3) different tasks with different templates. The combination and recombination of knowledge repositories within organizations through improvisation can facilitate organizational scaling.

***Founder Replacement and Accumulating, Communicating,
Relocating, and Connecting Knowledge for Scaling***

Of course, the change from a founder to a professional manager can influence scaling through several mechanisms. (1) Professional managers likely bring a different set of accumulated experience than founders (presumably), engage in management in a different organizational context (as a basis for learning by observing and learning by doing), and serve as a potential source of others' vicarious learning by observing. However, professional managers are likely less improvisational than the founders they replace. (2) Not only do professional managers generally have different knowledge than the founders they replace, but they may also have greater experience and skills in articulating, codifying, and otherwise communicating excellence to a growing number of venture members. (3) Founders relocating out of ventures and professional managers relocating into ventures not only influence the composition and size of organizations' knowledge repositories but might also encourage new movement of people, tasks, tools, and templates (or the solidification of these knowledge repositories' "locations"). (4) Professional managers typically institute greater formalization and more role-based relationships. On the one hand, these actions can disrupt relationships within a venture and thus obstruct efforts to connect different knowledge sources within the venture. Professional managers may face some obstacles to scaling due to the reduced receptivity of organizational members who are loyal to founders and/or who resist efforts to introduce bureaucracy (for efficient exploitation). On the other hand, formalization and role-based relationships can provide systems for sharing and combining knowledge from different parts of a venture.

*Scaling and Accumulating, Communicating, Relocating,
and Connecting Knowledge for Scaling*

The effectiveness of ventures' scaling efforts can influence the drivers of subsequent scaling activities. First, scaling provides more and different tasks for organizational members to do and more organizational members performing different tasks to observe (and therefore opportunities to learn). Second, scaling generates a greater need for venture members to articulate, codify, and communicate their tacit knowledge to reach a larger (and perhaps more diverse) set of recipients within the focal venture. Finally, scaling provides opportunities to relocate people, tasks, tools, and templates within an organization; bring in new knowledge repositories from outside the organization; and adapt or "relocate out" people, tasks, tools, and templates holding knowledge that is no longer needed. These feedback effects (and the nature of the mutual relationships) are important because they highlight (and have the potential to inform us about) the dynamism of scaling as new, small ventures become established, large organizations.

CONCLUSION

Organizational scaling refers to *spreading excellence within an organization as it grows*. This chapter illustrated that knowledge transfer may play a key role in new ventures' successful scaling efforts. In particular, while different knowledge-transfer mechanisms facilitate scaling, scaling can also impact how ventures engage in knowledge transfer. The summarizing model in Fig. 5.1 suggests the following:

- Accumulating, communicating, relocating, and connecting knowledge within a new venture are important activities that trigger the new venture's scaling.
- Accumulating, communicating, relocating, and connecting knowledge within a new venture are interdependent and mutually influence each other.
- Scaling itself influences the means and extent of accumulating, communicating, relocating, and connecting knowledge within a venture.
- Scaling can also trigger founder replacement, which influences a new venture's knowledge base and therefore the means and extent of accumulating, communicating, relocating, and connecting knowledge within the venture and thus the venture's subsequent scaling activities.

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