Strategic Management Society

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The Dark Side of Institutional Intermediaries:
Less Than Optimal Investments, Institutional Conflict

Junior stock exchanges can cause investors to ignore potentially better investments. And intermediaries such as incubators, accelerators, and science parks can be invaluable in launching new firms, but they also introduce “conflict” that can limit the growth of these firms.

Those are the conclusions of new research by Assistant Professor Robert N. Eberhart, Santa Clara University, and Associate Professor Charles E. Eesley, Stanford University, published this week (September 15, 2018) in the Strategic Management Society’s *Strategic Management* Journal (SMJ).

Junior stock markets play an important role because they can ease the path to an IPO. But because the new exchanges usually restrict investment to technology firms, they may motivate early stage investors to favor newly founded technology firms over more optimal investments in non-technology firms.

The prior norms of investing in the best opportunity come into conflict with the newly introduced norm of risky technology investment. Overall growth is lowered owing to the possibility that without the skills to execute due diligence in this new arena, less worthy firms are funded.

“For investors,” write the authors, ”the enthusiasm for technology firms engendered by a new exchange can motivate investment in marginal firms to maintain an adequate deal flow…

“For entrepreneurs, our results indicate that it is more challenging to manage technology firm growth when intermediaries make IPOs easier to obtain.

“Finally, for policy-makers and supporters of the new exchanges, our results imply that . . .unless listing standards remain high, the virtuous cycle of investment upon which a health entrepreneurial climate rests may be disrupted to mute the intended effects of the new exchange.”

Intermediaries, including junior stock markets, entrepreneurship training, and government funding agencies are expanding at an increasing rate.

“They assist entrepreneurs by linking parties to bring about activities that would not readily happen in their absence,” write the authors. “Recent studies show how economic development efforts, private service firms, and science parks in emerging nations support the creation of new firms through certification of a new firm’s abilities, facilitating access to resources, and fostering the creation of functioning markets.”

For example, a recent study found that science parks not only provided direct funding to socially connected funders, they also offered a way for less connected entrepreneurs to become certified and thus facilitated access to government funding.

And the certification of new privately owned power plants plans by government inspectors can legitimize the emerging industrial sector for investors and other stakeholders facilitating investment in new firms.

The question is whether such intermediaries always foster new firm growth.

A new intermediary, say the authors, introduces conflict between the new practices of the intermediary and the practices of the existing institutional environment. One major conflict is that intermediaries may be far less risk-averse than the companies they are serving. They may also value business practices over other considerations important to the institution.

In addition to causing conflicts and the problems of investing in marginal firms and limited future liquidity, another issue of intermediaries is a "means-ends decoupling of actions from intentions."

"Means-ends decoupling focuses on actors that either cannot anticipate or cannot understand the outcomes that their actions will bring," write the authors. While they may intend to comply with the relevant norms and practices, managers and staff may not know how to comply or for them the link between actions and outcomes is too complex. Consequently *intentions* and *actions* are *decoupled*.

In the case of non-profits, because they are staffed by individuals skilled in the social purpose of the organization, they may fail to implement audits or other business procedures because they lack the skills or knowledge to implement the required policies.

The institutional conflict created by the introduction of business practices can alter the activities that charities pursue because they now serve business interests that conflict with the incumbent practice of action for the benefit of social causes.

"In another example," write the authors, "non-profits face conflict when the new practices of business discipline on spending are introduced to encourage sustainability but conflict with incumbent values of charitable operations."

The **Strategic Management Journal** (**SMJ**) is the official journal of the **Strategic Management Society (SMS)** and published by Wiley. The SMS is comprised of 3,000 academics, business practitioners, and consultants from 80 countries and focuses on the development and dissemination of insights on the strategic management process. SMJ, which publishes 13 issues per year, is consistently rated one of the top publications in the management area and publishes papers that are selected through a rigorous double-blind review process.

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