Startups in the buyer-supplier relationship, limitations to be an attractive customer: definitions and theoretical framework

Juliano Afonso Tessaro (j.a.tessaro@utwente.nl)
University of Twente

Rainer Harms
University of Twente

Holger Schiele
University of Twente

Summary
When startups want to buy from large suppliers, they may find it challenging to establish a business relationship. As startups are new, small, have limited resources and scarce track record, they could be perceived as not attractive to start the relationship with large suppliers. Startups could benefit from understanding the challenges and opportunities from a customer attractiveness perspective. Therefore, we offer a systematic literature review and develop a framework for what makes a startup an attractive buyer from large suppliers.

Keywords: Entrepreneurship; Customer attractiveness; Liability of newness

Submission category: working paper

Topic(s): Purchasing and Supply Theory and Methodology Development; Supplier Relationship Management and Development;

Introduction
Jawbone to Be Liquidated: The consumer electronics startup was valued over $3 billion in 2014. The Wall Street Journal reported on the liquidation proceedings of a once Silicon Valley unicorn startup (Haggin, 2017). The company produced wireless speakers, and Bluetooth earpieces went bankrupt in 2017. In an interview, the former CEO and founder, explain the relationship with suppliers, manufacturers in his own words. "Given you're a startup, no manufacturer really wants to give you big credit or anything like that. So, we scrambled in early 2013 to figure out, how do we get this working capital cycle figured out." (Johnson, 2018). In 2014, three years before the liquidation, one of the Jawbone suppliers filled a lawsuit due to USD 20 million overdue payments. According to multiple sources, late payments was a repeated problem during the years Jawbone operated (Lashinsky, 2015). Problems faced by Jawbone included delays in product launches, the ability to keep a stable executive team, competition, and costly lawsuits with its suppliers and one competitor (Cohan, 2018). Jawbone's case is one example of the challenge's startups may face with suppliers. Operative excellence challenge regarding the late payments. Relational behavior regarding a legal dispute with a supplier. Trust and credibility regarding credit restrictions from suppliers. These limitations could be customer attractiveness issues.

The customer attractiveness concept will be used in the context of the startup as a buying firm, where the startup is the customer, and large firms are the suppliers. "A customer is perceived as attractive by a supplier if the supplier in question has a positive expectation towards the relationship with this customer." (Schiele et al., 2012; p. 1180). Further explanation will be provided in the theory section.

This paper will focus on the startup as the buying firm. Authors often use alternative terms for startups as a new firm or entrepreneurial new ventures or merely new ventures. Entrepreneurship can also have a wide range of definitions, and it is hard to find a precise one (Davidsson, 2004). New and small ventures could be classified into different types. It can have a considerable degree of variation form high-tech startups in the biotech sector to a newly founded neighborhood dinner (Harms et al., 2007). In the context of this research, startups are defined as young firms, and the maximum age varies from eight-years-old (Song et al., 2008) to twelve-year-old (Begley, 1995). Startups are involved in the introduction of a new product or production method or entering a new market (Carland et al., 1984, Davidsson, 2004). Startups are faster-growing companies (Begley, 1995) and innovative (Carland et al., 1984).

The are several reasons for the difficulty of startups as a buying firm to become an attractive customer to large suppliers. Startups are particularly disadvantaged in areas where the availability of venture capital or other forms of external finance is limited (Criscuolo et al., 2012). The short existence of an entrepreneurial firm creates uncertainty for its suppliers (Das and He, 2006). Compared to established firms, startups have less legitimacy, scarce track record, and commitment consistency is subject to change (Das and He, 2006). Given these characteristics, startups may be less attractive to suppliers than established buying firms.

Being an attractive customer is important as industrial markets can often be characterized by oligopolies. In the modern race for suppliers, it is essential for buyers to be more attractive to suppliers than their competitors (Hüttinger et al., 2012). Customer attractiveness and supplier satisfaction are the keys to become a preferred customer. Nevertheless, it is challenging to achieve supplier satisfaction without an initial attraction (Schiele et al., 2012).

Good supplier relations can be vital for startups to perform and survive. Supply chain management practices, including supplier relationships, significantly impacted startup performance as financial and business growth (Amedofu et al., 2019). There is a direct association between supplier integration and new venture growth (Cavazos et al., 2012).

Where could startup actors refer to for improving their attractiveness? Research on the intersection between purchasing and supply chain management and entrepreneurship is increasing over the years. Amedofu et al. (2019) take the perspective of supply chain management as a brother area from supplier to customer and the effects on startup performance. Cavazos et al. (2012) explore the perspective of stakeholder theory on buyer and supplier groups and the mitigating effects on new venture growth. Zaremba et al. (2016) focus on new ventures as suppliers on one side and established firms as the buyer on the other side. It covers a significant gap in how established buying firms can collaborate with new ventures as suppliers. However, the research on startups as a buying firm is almost nonexistent. “There is a lack of studies on new ventures' supplier relationships” (La Rocca et al., 2019 ;p. 149). The recent research conducted by La Rocca et al. (2019) is one of the firsts that takes the perspective of a startup as the buying firm. However, it is based on the business network perspective on the new venture’s supplier relationship and how these relationships impact new venture development, not addressing the startup attractiveness issue.

Nobody takes the perspective of a supplier having to decide to supply to a startup or not. Also, the attractiveness literature has identified a series of factors that make up for an attractive customer, as offering growth opportunity, being operative excellent, and having a positive relational behavior. However, the literature is exclusively based on the incumbent supplier relationships.

For example, the prominent findings of the importance of a long-lasting business relationship (Schiele et al., 2012, Hüttinger et al., 2012, Hüttinger et al., 2014, Vos et al., 2016) is not applicable for a new firm which by definition does not yet have such a relationship. Hence, neither the startup nor the customer attractiveness literature, so far, provides help for the seller to assess the quality of the startup as a customer. It also does not help the startup to identify the factors that could influence the seller in order to get a supply contract. This paper addresses these research gaps.

Nevertheless, more recent papers suggested some directions for future research targeting the startup supply-side and supply chain management (SCM) practices, including supplier relationships. “Literature on SCM practices of start-ups should also be extended by exploring what accounts for different levels of SCM practices among start-ups to create insights on how to enhance adoption of SCM practices among start-ups” (Amedofu et al., 2019 ;p. 2280). “A second line of research should examine the actual micro practices through which new ventures engage with suppliers to gain further insights into supplier resource mobilization processes and unpack even further the concept of ‘relating’ between new ventures and established businesses” (La Rocca et al., 2019; p. 157).

This review, adding to the existing literature, aims to synthesize the antecedents, drives, and impacts of liability of newness on startup attractiveness as a buying firm. The following research question is proposed: What are the factors, due to startup newness or smallness characteristics, impacting startup attractiveness as a buying firm?

Theory

Customer attractiveness

Contrary to the classical view that companies compete for the customer, not for suppliers, customer attractiveness is drawn from the sometimes counter-intuitive reverse marketing concept that buyers will compete for key suppliers (Leenders and Blenkhorn, 1988).

Customer attractiveness is the first step to engage in a supplier relationship to eventually become a preferred customer and enjoy preferential treatment. The conceptual model is composed of three phases: a) customer attractiveness, b) supplier satisfaction, and c) preferred customer status (Hüttinger et al., 2012). This paper will focus on relationship initiation, discussed in the first phase.

Customer attractiveness is defined as the buying firm's positive characteristics (Hüttinger et al., 2012). Startup smallness and newness can be seen as liabilities, negative characteristics. Therefore smallness and newness can negatively impact startup-customer attractiveness.

Three successful manufactures that had not enough size or power but managed to found a way to engage with large suppliers have been analyzed by Christiansen and Maltz (2002). The conclusions are as follows. First, smaller firms, in order to become a more interesting customer to large suppliers, should compensate their inability to deliver higher economic value by finding ways to create value to them. Second, also critical is the commitment to innovation and mutual knowledge transfer. And third, the recognition that the purchasing function should be managing the buyer-supplier relationship.

Customer attractiveness antecedents have been empirically tested by Hüttinger et al. (2014). The three influencing factors are a) growth opportunity, b) operative excellence, and c) relational behavior. Innovation potential was also tested but found non-significant. Another finding that could be well related to startup size is that operative excellence has a stronger customer attractiveness explanatory power for small firms than for larger ones.

The Preferred customer status and Preferred customer treatment construct are composed of first-order and second-order antecedents. The first-order variables explaining the model are a) growth opportunity, b) profitability, c) relational behavior, and d) operative excellence. As second-order, innovation potential is the antecedent of growth opportunity. Contact accessibility as the operative excellence antecedent. And support, reliability, and involvement as relational behavior antecedent (Vos et al., 2016).

If the buying company can not offer economic value to suppliers, as could be the case of small and new startups, “ these buyers can still influence the suppliers' satisfaction and receive preferential treatment by being reliable, operationally excellent, and presenting good relational behavior.” (Vos et al., 2016, p. 4621)

Purchasing function in startups

The purchasing function usually is the one responsible for managing the supplier relationship. Different from large buying firms, small and medium firms use different purchasing practices to manage supplier relationships. As they are small, most of the cases the supplier is being handled by the owner-manager, and the relationship is often based on social factors such as openness, honesty, and trust play a central role. (Morrissey and Pittaway, 2006)

Part of the startup customer attractiveness problem can be justified by the lack of purchasing knowledge, as small firms usually do not have an established purchasing function due to its small size. Morrissey and Pittaway (2006) research shows that a discrete purchasing role can be found when companies have at least 26 to 50 employees, and the revenue exceeds £1 million. Otherwise, this function is performed by the manager-owner. How would then the purchasing function be performed by startups? Will startups have a discrete purchasing function role in the early stages when they are still too small?

Contact accessibility, support, reliability, and involvement drives relational behavior and operative excellence, that influence customer attractiveness. How startups manage supplier relationships, and what are the consequences for the startup-customer attractiveness?

Liabilities of newness & survival of firms

The liability of newness is defined as the age dependence in organizational death rates. Higher failure rates are associated with young age (Freeman et al., 1983).

Following the formalization of liability of newness construct by Stinchcombe (1965), one of the first studies to demonstrate the link between age and organizational death rates was Freeman et al. (1983). The study provided equations to estimate death rates probabilities. It has analyzed historical data from three types of organizations in the US: national labor unions, semiconductor electronics manufacturers, and newspaper publishing companies. From this research, three influencing factors can be distinguished: a) company age, b) company size, and c) type of organization. Even though the research demonstrated the opposite effects for size given the nature of the industry, the effect of size can not be ignored. Therefore, Freeman et al. (1983) also mentioned another liability, the liability of smallness. It can not be used interchangeably with the liability of newness but also affects organizational death rates.

Startup-customer attractiveness

We already know from the literature about classical startup fragilities, frequently summarized as the liability of newness (Stinchcombe, 1965), we also know from Preferred Customer theory (Hüttinger et al., 2012, Hüttinger et al., 2014, Vos et al., 2016), what is required for an established company to become an attractive customer. This review focus on the specific startup case as a buying firm, aiming to answer the following research questions: How can startup attractiveness towards suppliers be defined and explained? Furthermore, what do startups have to do to become more attractive for large suppliers?

We propose to merge two research streams: a) customer attractiveness in the buyer-supplier relationship that is a well-established research stream, and b) liability of newness, summarizing startup relevant problems and troubles, that is also a fruitful field of research in a broader spectrum of firm types, but still new when the research is conducted on the startup specific case, but it is gaining popularity in the last decade. Nevertheless, the intersection of customer attractiveness and liability of newness research streams is almost unique in the literature.

The proposed approach, to understand startup attractiveness as a customer towards large suppliers is to build on the existing concept of customer attractiveness and preferred customer (Hüttinger et al., 2012, Hüttinger et al., 2014, Vos et al., 2016).

Literature review

The goal of this literature review is to identify the liability of newness impacts on startup-customer attractiveness through a systematic literature review. As a result, we propose a definition of startup attractiveness by checking the existing customer attractiveness criteria in the light of startups.

Previous literature reviews have not looked at the "liability of newness" influence on startup-customer attractiveness. Cafferata et al. (2009) focus on finding evidence on literature that supports Stinchcombe (1965) liability of newness construct, concluding that this liability still is accepted by the majority of management literature.

Abatecola et al. (2012) provide a historical overview of the impact of the liability of newness on the management literature over several decades. The liability of newness construct formalization characterized the 1960s. In the 1970s-1980s, researchers have been supporting the phenomenon, and the liability of smallness concepts has emerged. The 1990s started a debate on the liability of newness versus liability of adolescence, changing the death rate curve associated with age from a monotonic declining curve towards an inverted U-shape. The 2000s changed from verifying the existence of the phenomenon towards proposing ways to deal with these liabilities. The new century also inaugurated researches on the possible relationship between a resourced based view of the firm and the liability of newness. (Abatecola et al., 2012)

Methodology and data extraction

This review aims to synthesize the liability of newness factors impacting startup attractiveness as a buying firm. For this purpose, a systematic literature review was performed. It followed Tranfield et al. (2003), widely adopted guidelines for evidence-based literature review in business management in the past 15 years, and reported using Moher et al. (2009) flow diagram. The review was performed as much rigorous as possible, which is transparent and reproducible.

We used the following leading question to guide this review: What do we know about the factors that, due to startup newness or smallness characteristics, impact startup attractiveness as a buying firm?

As recommended by the literature review guiding principles, the first step was the identification phase. A full search was performed in the EBSCO Business Source, Web of Science core collection, and Scopus databases. The search was performed on title, abstract, and keywords according to the search string in Table 1. Data were extracted on December 5th, 2019. Data were further analyzed.

Table 1 – Full search string

(startup* OR start-up* OR "new firm" OR "new venture") AND (entrepreneur*) AND (small* OR newness OR age) AND (attractiv* OR surviv* OR death OR decline OR crisis)

The symbol (*) was used to capture different word variations.

Regarding the search strategy (see Table 1), as startups are the unit of analyses, search word "startup" and alternative terms "new firm" and "new venture" were used. As the word startup has a broader meaning, "entrepreneurship" word was also added to the search to limit the results to entrepreneurial firms. To find out papers related to the liability of newness in this context, but also to capture papers that do not use specific liability of newness terminology, the search words "small", "newness" or "age" and its variations were added. As "new" is too generic, "age" was added as an alternative to capture papers not using newness terminology.

We are looking for relevance in the literature regarding factors or problems impacting startup attractiveness as a buying firm. In this case, the word “attractive”, and alternative terms associated with problems as “survival”, “death” or “declining business” represented by the search on table 1 were also added. These words are needed for the effects on customer attractiveness antecedents: growth opportunity, profitability, relational behavior, and operative excellence. A similar strategy used by Cafferata et al. (2009) literature review on the liability of newness to capture the problems faced by firms during its life cycle.

In the second phase, the screening process, papers were limited to English language, publication year from 1980-2019, and only peer-reviewed journal articles were included. In the screening phase (Fig. 1), all titles, keywords, and abstracts reading were performed. The theme and the setting were evaluated to ensure the papers were relevant regarding the research question. Typical exclusion included papers regarding the profile of business angels, for example. Also, incubators, and how to build a successful incubator or business accelerator were not included. Entrepreneurship education and learning, entrepreneurial motivations as what lead people to start a business like job loss or retirement, for example, were also excluded.

There is another broader set of research streams excluded, the research on the entrepreneur as a person. The impact of gender, age, race, nationality, wealth, being minority, marital status, religion, number of children, level of formal education, type of university, or formal training are exclusions examples. As the paper focuses on the Enterprise itself as a small but yet a corporation on the context of business to business relationships, those papers were excluded.

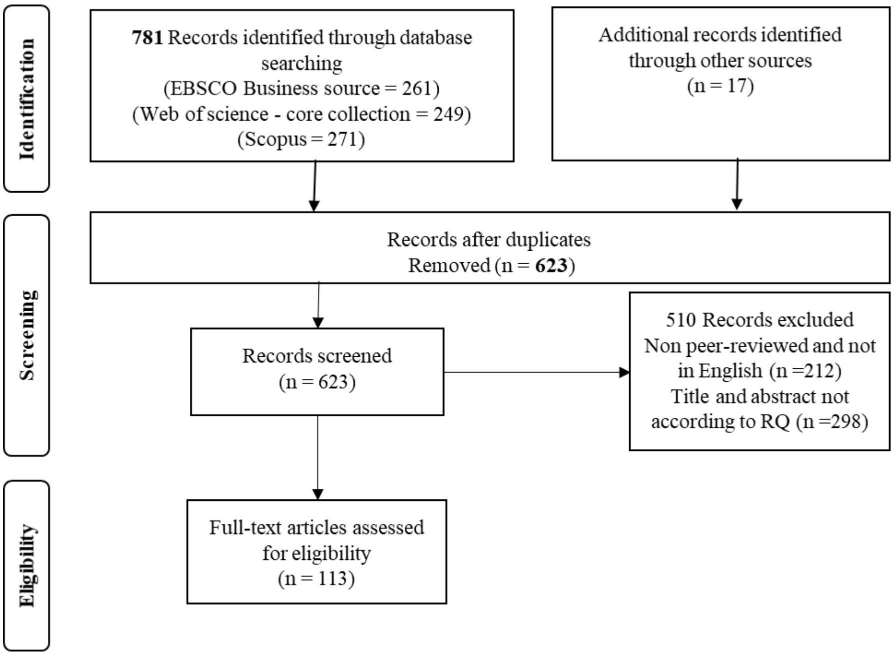

Figure 1 – Screening process

Source: Adapted from the PRISMA flow diagram (Moher et al., 2009)

Preliminary Findings

For the presented working paper, partial results from the 113 eligible papers are explained in the following section.

In this paper, the goal is not to test the liability of newness, as the literature has sufficiently supported it. Nevertheless, describe how this liability of newness and its underlying factors impact startup-customer attractiveness.

From this literature review, three clusters of influencing factors have been identified. The classification was based on shared common characteristics and based on existing frameworks in the literature (Chrisman et al., 1998, Song et al., 2008). The three clusters are (1) resources, (2) product and market, and (3) external recognition. Clusters are further described as follows.

Resources: (a) supplier equity share; in this concept, the startup will give partial ownership to the supplier through supplier equity share on the startup. This mechanism can compensate for the supplier's initial risk involved in doing business with the startup and is also an opportunity for the supplier to benefit from startup success (Song et al., 2019). In this context, we argue that a startup having the practice to offer equity shares to relevant suppliers can be more attractive than the ones that do not use this mechanism. (b) Supplier's specific investment is an antecedent of supplier involvement. "once the chosen supplier has made specific investments, it has a financial reason to continue its involvement, or else lose the investments, since by definition they are not easily transferable to other settings." (Song and Di Benedetto, 2008 p; 14). (c) Startup commitment, it can improve the impact of supplier's specific investment on supplier involvement. (Song and Di Benedetto, 2008). (d) Public ownership, in the concept, startups that are publicly owned are more attractive as alliance partners than startups that are privately owned (Rothaermel, 2002).

Product and market: The startup's attractiveness as an alliance partner construct was introduced by Rothaermel (2002). It is composed of public ownership included in the resource cluster and: (a) regional technology cluster, is stated that startups located in a regional technology cluster are more attractive than a startup that is not located in a regional technology cluster (Rothaermel, 2002). (b) New product development, there is a direct relationship on the level of new product development and the level of startup attractiveness as an alliance partner (Rothaermel, 2002). (c) The economy of scope, as the strategic option to focus on several technological subfields, positively impacts attractiveness (Rothaermel, 2002).

External recognition: (a) suppliers' trust. Building trust is a long-term exercise, but once the supplier builds trust in the relationship with the startup, they will be more willing to take risks. Trust can be achieved through startup appropriate behavior in the relationship with the supplier (Song et al., 2019). (b) Legitimacy. Organizational attractiveness was explored in the research on the challenges for new ventures in attracting qualified employees. Legitimacy impacts organizational attractiveness, in the perspective of a startup as an employer under potential employee's perception. Can be divided into founder legitimacy and startup legitimacy. "legitimacy signals of both the new venture's founder(s) (e.g., education, previous work or founder experience) and the new venture itself (e.g., endorsements such as awards or reputable investors)" (Moser et al., 2017 p; 588).

Definitions and framework

Startup-customer attractiveness can be explained not only by age and size, but by checking the resources, product and market, and external recognition. The direct impacts of these factors on customer attractiveness and the moderating effects on growth opportunity, profitability, relational behavior, and operative excellence will explain the startup attractiveness towards large suppliers.

It is already possible to draw conclusions on what startups must do to become more attractive for large suppliers. Building reputation and other forms of external recognitions seem to be one of the ways. Technological choices and startup innovativeness levels could be well related to future potential profitability. Innovation potential has been previously tested by Hüttinger et al. (2014). Nevertheless, it is expected a diverse interaction on the startup as a buying firm-specific case.

The founder's role can impact relational behavior and operative excellence. Despite startup sometimes reduced size, having a discrete purchasing function could be a strategy to improve both relational behavior and operative excellence.

To explain startup attractiveness towards large suppliers, we propose to introduce a new construct by adding the Liability of newness as a variable into existing customer attractiveness construct from Hüttinger et al. (2014) and Vos et al. (2016) as Figure 2 illustrates.

The propositions are:

P1: Liability of newness is negatively related to startup-customer attractiveness.

P2: Liability of newness will moderate the relationship between customer attractiveness, and the drivers: growth opportunity, profitability, relational behavior, and operative excellence and.

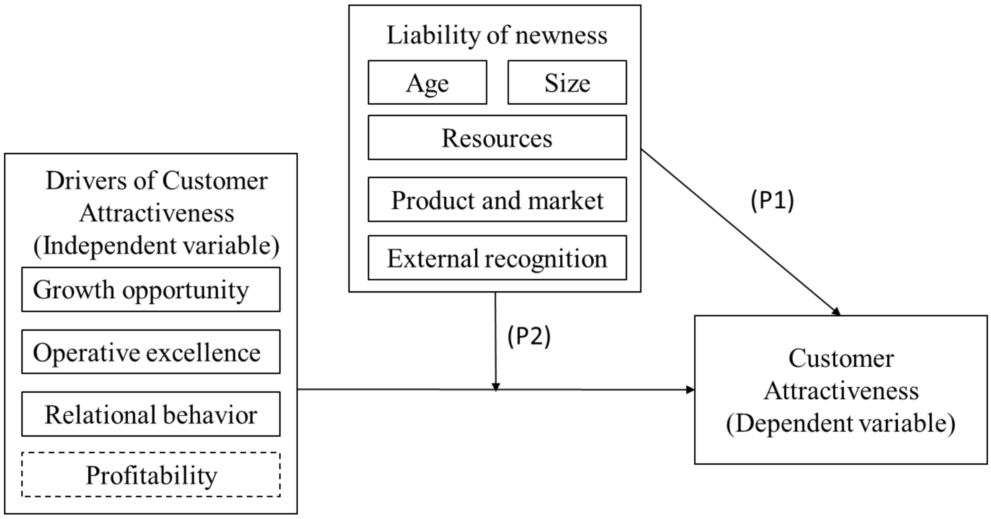

Figure 2: Conceptual framework

Contributions and next steps

The theoretical contributions are four as follows:

The first contribution is to expand the boundaries of current customer attractiveness literature, that is well delimited for established buying firms, contributing by expanding the understanding not only for established buying firms but also startups as buying firms.

The second one, introduce a new construct by adding liability of newness as a variable into the existing model of customer attractiveness.

Third, expand the buyer-supplier relationship literature on startups as a supplier, well explored by Zaremba et al. (2016), by adding the perspective of the startup as a buying firm.

The fourth contribution is on recent literature on new venture supplier relationships (La Rocca et al., 2019), expanding the startup supplier relationship understanding by adding the customer attractiveness perspective.

Startup-customer attractiveness is in the preliminary stage. Therefore there is a need for exploratory qualitative research to understand how sellers perceive startup as customers. Further research could also explore the interactions and significance of exposed factors through an empirical test. Another potential stream of research could be the exploration of the purchasing role in startups and their effects on startup-customer attractiveness.

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