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The Financial Cost of Errors in Venture Selection and Launch Timing

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Principal Topic

The twin choices of which ventures to pursue and when to pursue them may very well be the two most important decisions in an entrepreneur’s career. My previously-developed theoretical model (e.g., Croson (2006)) derives the optimal timing for venture launch decisions based on the entrepreneur’s return on capital, her wage forgone when she quits the corporate job, and negative cash flow from living expenses. Since the derived formula specifies the optimal timing for venture launch, it naturally follows that launching either too early or too late will reduce the NPV of the entrepreneur’s future earnings. Such an NPV loss can arise either through a pure error of timing (i.e., quitting too soon or too late), through a choice of venture with an inferior return to invested capital (e.g., committing to a 16% ROI opportunity vs. an 18% ROI opportunity), or a combination of the two (e.g., choosing an early quit time anticipating an 18% ROI opportunity, whereas the actual realized return of 16% would justify a later quit time.)

Method

I calibrate the model’s parameters using typical data from MBA graduates -- many of whom first become entrepreneurs 4-10 years after graduation -- to explicitly calculate the costs of plausible errors (e.g., premature or delayed launches from 6-36 months too early or late, and/or the imperfect targeting of a venture returning either $\pm 1\%-8\%$ rather than a certain $x\%$ return) compared to the benchmark of perfect decisions. The difference in lifetime NPV between optimal and actual decisions is the financial cost of these entrepreneurial error(s).

Results and Implications

Most entrepreneurs launch businesses too early and would substantially improve their lifetime earnings from delaying up to 2.5 years; launching too soon costs the average entrepreneur more than $250,000 in lifetime NPV. The shape of the gradient of lifetime NPV (as a function of launch time) indicates that while the opportunity cost of launching a little too late costs slightly more than that of launching a little too early, launching much too early is substantially more costly than launching much too late. Compounding launch-timing errors with return-estimation errors reduces the NPV of entrepreneur wealth substantially more than the sum of the costs of either alone.

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