VENTURE RISK AND VC INVESTMENT: THE MODERATING ROLE OF LEAD FOUNDER LEADERSHIP STYLE (SUMMARY)

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SUMMARY

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Principal Topic

Conventional wisdom states that if a venture capitalist must choose between a grade A business idea with a grade B founder or a grade B business idea with a grade A founder, then the VC will invest in the second venture. In this study, we examine how a lead founder’s leadership style moderates venture risk to influence VC investment.

Transactional leadership entails an exchange relationship between the leader and the follower, whereby the follower is rewarded for completing tasks within specified quality and timeliness parameters. On the other hand, transformational leadership encompasses a more charismatic and inspirational relationship between the leader and follower that incites the follower to exceed expectations. In a young, high-tech venture operating in turbulent environments where specific expectations are virtually impossible to define, transformational leadership is especially important to firm performance. Since venture capitalists specialize in identifying firms with high expected future performance, we hypothesize that a venture’s lead founder’s leadership style influences VCs’ initial investment decisions as well as post-investment performance.

Method

The sample is composed of 257 ventures that sought funding from six VC firms. Venture risk was assessed from each submitted business plan using the Risk Diagnosing Methodology. Lead founder leadership style was determined prior to the VC investment decision using a survey based on the Multifactor Leadership Questionnaire. VC investment decisions and post-investment performance were gathered from VC records. Control variables address industry and economic context, as well as differences among the VC firms.

Results and Implications

The empirical results challenge traditional views. Coupling transformational lead founders with high risk increases, not decreases, a new venture’s ability to obtain funding from VCs. On the other hand, transactional lead founders can reduce the effects of risk on the new venture’s ability to raise VC funding.

We contribute to the entrepreneurial literature by demonstrating how venture managements’ soft characteristics influence VC investment. We also extend the leadership literature by responding to calls to explore the boundary conditions of transformational and transactional leadership styles.

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