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SUMMARY

THE INFLUENCE OF COGNITIVE ALIGNMENT ON VENTURE CAPITALIST DECISION-MAKING

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Principal Topic

Entrepreneurship scholars have examined the influence of various economic and sociological criteria on venture capitalists’ decisions to fund new ventures (Tyebjee & Bruno, 1984; Zacharakis & Meyer, 1998; Shepherd, 1999). These studies address a wide range of decision variables; however, noticeably absent is the consideration of psychological criteria that may impact the ‘compatibility’ of the VC and a given entrepreneur across a cognitive dimension. We find this omission striking in the face of the voluminous amount of psychological research indicating that compatibility across different personal axes is predictive of behavior. In this article, we investigate whether or not cognitive similarity between the entrepreneur and the venture capitalist influences the funding decision.

A considerable amount of research has confirmed the “similarity effect” (Byrne, 1971), which essentially states that individuals tend to be attracted to people who are similar to themselves. We extend this work into the cognitive arena by examining how similarity in the dominant reasoning patterns between entrepreneurs and VCs influences the latter’s decisions to fund the former. Perhaps most importantly, we link this study to previous research by analyzing how VCs may “trade-off” cognitive similarity relative to economic and personal factors that prior research indicates is influential to the VC’s decision process. Thus, we investigate the importance of cognitive similarity in the VC evaluation process relative to other decision criteria.

Method

To investigate in-use vs espoused decision policies, we employ conjoint analysis to capture, decompose, and analyze 800 decisions nested within a sample of 50 venture capitalists. We operationalize cognitive similarity based on Sarasvathy’s (2001) distinction between causal versus effectual reasoning. This data allows us to experimentally manipulate decision criteria to investigate propositions concerning 1) the role of cognitive alignment in VC investment decisions and 2) the additional variance explained by cognitive alignment relative to the entrepreneur’s personal characteristics and the economic attributes of the opportunity.

Results and Implications

This paper makes three important contributions. First, it provides insight into the relative importance of cognitive similarity between VCs and entrepreneurs in the VC’s decision to invest. Second, it gives an indication of whether VCs value diversity when selecting portfolio opportunities. Lastly, it adds to psychological/sociological literature by studying how similarities in cognitive processes influence decision-making.

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