THE ROLE OF EXPERIENCE AND PERCEPTIONS IN RISKY BEHAVIOR: EVIDENCE FROM THE VENTURE CAPITAL INDUSTRY (SUMMARY)

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Recommended Citation
Available at: http://digitalknowledge.babson.edu/fer/vol26/iss3/8

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SUMMARY

THE ROLE OF EXPERIENCE AND PERCEPTIONS IN RISKY BEHAVIOR:
EVIDENCE FROM THE VENTURE CAPITAL INDUSTRY

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Principal Topic

Business folklore often describes venture capitalists as “risk taking specialists”, as risk lies at the heart of the entrepreneurial process and the investments surrounding new ventures. Prior research dealing with risk in the venture capital setting has separately focused on investors’ investment criteria and post-investment procedures to manage risk. However, the question of whether differences in risk perceptions, risk preferences and experience prompt differing investment and risk reduction strategies remains a largely unexplored territory.

This study sets out to explore this unanswered question by taking the Sitkin & Pablo (1992) model of risky decision-making behavior as its point of departure. This model suggests that differences in risk taking may be driven by differences in experience, risk perceptions and risk preferences. The Sitkin and Pablo model is based on the assumption that venture capitalists deal with risks by first calculating and then choosing among the alternative risk-return combinations that are available. It is not clear, however, that decision makers act this way. Prior studies have shown that individuals may either deny the existence of risk (Lanir & Shapira, 1984) or, more importantly, perceive it as subject to control (March & Shapira, 1987; MacCrimmon & Wehrung, 1986). The attempts to control risk may manifest themselves in the use of a variety of risk reduction strategies, such as syndicating investments with other venture capitalists, or monitoring and coaching entrepreneurs to reduce agency risk. Therefore, we feel that it is necessary control for the venture capitalists’ actions to modify risks, when exploring the relationship between risk perception, experience and investment decisions.

The study is based on a survey sent to 142 Swedish and Finnish venture capitalists, with a response rate of 63 percent (90 responses). Our results show that venture capitalists’ experience increases the riskiness of the venture portfolio and the use of post-investment risk reduction strategies. Surprisingly, we also found that in the presence of more pronounced perceptions of risk, partly stemming from venture capitalists’ experience, investors seem to be more willing to take risks. These findings give us a reason to believe that venture capitalists are proactive and responsible risk takers, who shield themselves from potential losses through a careful application of risk reduction strategies.

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