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EXPLORING THE PUZZLE OF FUNCTIONAL HOMOPHILY IN NEW VENTURE FOUNDING TEAMS

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ABSTRACT

Despite the benefits of establishing a founding team with diverse knowledge, many entrepreneurs assemble a team whose members are homogenous with respect to functional background. In this dissertation, I found that entrepreneurs initiated contact with some potential cofounders who possessed complementary knowledge and others with similar knowledge. However, in responding to entrepreneur-initiated contact, potential cofounders were more likely to agree to join the venture of a functionally similar entrepreneur because they viewed these individuals as more competent and likeable. I also found it is possible to “de-bias” potential cofounders by increasing their feelings of attraction for functionally dissimilar entrepreneurs.

MAIN TAKEAWAYS

- One reason we observe functionally homogeneous founding teams is due to potential cofounders’ preferences to work with functionally similar entrepreneurs
- These biases held by potential cofounders can be mitigated by encouraging potential cofounders to see themselves and functionally dissimilar entrepreneurs as belonging to a common group (e.g., a shared entrepreneurial community)
- Programs aimed at establishing effective founding teams should not only focus on the entrepreneur, but also the beliefs and preferences of the potential cofounder deciding whether or not to join the entrepreneur

CATEGORY: Entrepreneur Background; Attitudes & Motivations; Team Formation

KEYWORDS: Founding Teams; Homophily; Interpersonal Attraction

New venture success often depends upon forming a founding team with functionally diverse backgrounds. Founding teams whose members possess a broad range of functional skills (e.g., marketing, engineering, operations) are more likely to attract investor funding, grow faster, and reach an IPO. Despite the potential value of establishing a founding team with diverse functional knowledge, past research has consistently shown that founding teams are often homogenous with respect to functional background. Thus, on the one hand, we know that functionally diverse founding teams are more likely to produce highly innovative ventures, and yet, on the other hand, founding teams tend to be composed of individuals who possess overlapping knowledge and skills.

In trying to explain this phenomenon, scholars have speculated that perhaps entrepreneurs do not have access to potential cofounders who possess needed skills. Others have proposed that perhaps instead, entrepreneurs choose cofounders with redundant knowledge based upon a preference to work with similar others. But, because prior research has only sampled successfully formed founding teams, scholars have been unable to empirically test these explanations.

This is problematic because past work has shown that founding team functional diversity has long-term implications for the venture. A lack theory and research about the drivers of functional homophily in the founding process ultimately undermines our knowledge about the determinants of new venture success. This phenomenon of functional homophily also carries significant practical implications. In recent years there has been an explosion of interest and funding for programs that help entrepreneurs establish a cofounding team. Some of these platforms bring entrepreneurs and cofounders into contact with one another (e.g., cofounder meetup events), others help entrepreneurs assess the competence and functional fit of potential

cofounders (e.g., cofounder “matchmaker” services). Each type of program is built upon different assumptions about the primary barrier inhibiting functionally complementary founding teams. However, without scientific evidence on why founding teams are homogenous with respect to knowledge and skills, entrepreneurship policies may be misguided, investments aimed at stimulating entrepreneurial activity may be poorly allocated, and programs dedicated to promoting effective founding team composition may be not be achieving desired results. The objective of this dissertation is to explore the interpersonal processes that produce functional homophily in new venture founding teams.

THEORY AND HYPOTHESES

Since many entrepreneurs begin the search for cofounders after they have generated their new venture idea, they are more likely to consider the specific functional skills that are needed to implement the idea. In approaching the cofounding process, then, entrepreneurs should consider as one criteria in choosing a cofounder, whether or not the potential cofounder possesses requisite functional knowledge. In this way, the functional background of the potential cofounder frames how the entrepreneur engages in the cofounding process. Specifically, entrepreneurs should be more likely to seek cofounders who can “fill in the gap” for missing functional skills.

The notion that entrepreneurs would seek potential cofounders who possess complementary skills, rather than similar skills, is consistent with work in strategic management showing that in inter-organization alliances, there is a greater likelihood of tie formation among dissimilar entities because these organizations possess complementary assets that create surplus value beyond what either party could achieve in isolation. Similar patterns emerge in scientific collaborations in which scientists seek other scientists who have distinct backgrounds because

adding redundant skills to the team brings only marginal benefits and adds coordination costs which can hinder the research team from creating new scientific knowledge. Similarly, entrepreneurs should initiate contact with cofounders who have complementary knowledge because they see these potential cofounders are more instrumentally attractive in advancing the venture from an abstract idea into a viable new business. Therefore, I expect that entrepreneurs are more likely to initiate contact with potential cofounders who possess diverse functional skills because entrepreneurs are more instrumentally attracted to these potential cofounders.

Hypothesis 1. Entrepreneurs are more likely to initiate contact with potential cofounders who possess dissimilar functional knowledge than potential cofounders who possess similar knowledge.

Whereas entrepreneurs may be more instrumentally attracted to, and therefore more likely to interact with, functionally diverse potential cofounders, these entrepreneurs may encounter challenges in eliciting feelings of attraction from functionally diverse potential cofounders. Unlike the entrepreneur, potential cofounders do not have a specific venture idea that they are attempting to implement. Rather than looking for a partner who possesses a specific functional skill (as the entrepreneur does), potential cofounders are likely to evaluate whether or not to join a venture along broader bases of attraction, such as whether they believe the entrepreneur is generally competent (instrumental attraction), would be a pleasant colleague (interpersonal attraction), and is developing a meaningful and compelling venture idea (idea attraction). In other words, potential cofounders approach interactions with entrepreneurs less concerned about skill complementarity, and instead focused more broadly on the entrepreneur and the venture.

According to social identity theory, potential cofounders may struggle to develop feelings of interpersonal attraction (i.e., evaluations of likability) for entrepreneurs who come from a

different functional background. People tend to view ingroup members in a more favorable light than outgroup members. Since functional background is an especially salient social identity for those starting new ventures, potential cofounders may be prone to outgroup biases during interactions with functionally dissimilar entrepreneurs. Past work has shown that individuals are biased in how they encode and retrieve information gleaned in social interactions with outgroup members. As a result, potential cofounders should be more likely to notice the positive qualities and traits during interactions with functionally similar entrepreneurs and may be more likely to shift their attention toward negative and potentially threatening cues from the functionally dissimilar entrepreneurs.

Hypothesis 2a. Potential cofounders are less interpersonally attracted to entrepreneurs with functionally dissimilar knowledge than entrepreneurs with similar functional knowledge.

Potential cofounders may also discount their feelings of instrumental attraction (i.e., evaluations of competence) for functionally diverse entrepreneurs. Theory and research on knowledge transfer helps to explain why a potential cofounder might be less instrumentally attracted to an entrepreneur who comes from a different functional background. Individuals with deep functional knowledge tend to develop specialized language to convey complex ideas. And while developing functionally specific terminology facilitates communication among those who share similar functional expertise, it poses challenges for interactions between people who come from different backgrounds. Because individuals who originate from distinct functional backgrounds, in some sense, speak a different language, the ability to critically evaluate the competence of another individual becomes more challenging. The language barrier that exists between people from different functional backgrounds may therefore undermine potential cofounders' ability to properly assess the entrepreneur's ability to develop the venture.

Hypothesis 2b. Potential cofounders are less instrumentally attracted to entrepreneurs with functionally dissimilar knowledge than entrepreneurs with similar functional knowledge.

Finally, potential cofounders may also be less attracted to the venture ideas proposed by functionally dissimilar entrepreneurs. Theory and research on motivation suggests that the functional background of the potential cofounder may play a role in influencing which types of ideas potential cofounders find appealing. People who come from different functional backgrounds value different objectives and these motivational differences persist even in the absence of formal incentives that prioritize functional goals. Specifically, functional background appears to influence individuals' valence for certain tasks and outcomes, suggesting that people who share a similar functional background are more likely to be motivated in similar ways than those who possess different functional knowledge. Some scholars have suggested that this is a result of similarly motivated people selecting into specific functional roles. Other scholars argue that, in addition selection effects, there is a kind of functional imprinting that occurs as individuals become socialized into particular functional domains. Thus, through both selection and socialization processes, potential cofounders should be more attracted to the ideas of entrepreneurs who come from the same functional background as themselves.

Hypothesis 2c. Potential cofounders are less attracted to the venture ideas of entrepreneurs with functionally dissimilar knowledge than the venture ideas of entrepreneurs with similar functional knowledge.

These three bases of attraction likely influence whether or not potential cofounders decide to join a new venture. First, since pursuing entrepreneurial activities requires significant personal and financial risk, potential cofounders are likely to join entrepreneurs whom they believe are competent and capable of building a successful venture. Second, due to the significant amount of time that potential cofounders are likely to spend with the entrepreneur,

potential cofounders' interpersonal attraction is likely an important basis of whether to cofound a venture. And third, potential cofounders may emphasize the personal meaning and significance they attach to the venture idea to guide their decision of whether or not to join the entrepreneur since they will be devoting their time and energy to help implement it. Thus, I hypothesize that these three forms of attraction likely influence whether a potential cofounder is likely to launch a venture with an entrepreneur.

Hypothesis 3a. Potential cofounder interpersonal attraction is positively related to the potential cofounder's decision to join the entrepreneur's venture.

Hypothesis 3b. Potential cofounder instrumental attraction is positively related to the potential cofounder's decision to join the entrepreneur's venture.

Hypothesis 3c. Potential cofounder idea attraction is positively related to the potential cofounder's decision to join the entrepreneur's venture.

STUDY 1 METHOD AND RESULTS

I collected survey and social interaction data from individuals participating in a 12-week incubator program offered through a private Midwestern university. On the first day of the program, individual entrepreneurs share their venture ideas with other program participants and teams form organically around the most popular ideas through a two hour networking event. Once formed, team members work together for roughly four months to create a prototype and business plan. At the end of the program, teams present their ventures to a panel of investors.

I collected data from 51 individuals (12 entrepreneurs, 39 potential cofounders) who engaged in 103 interactions and formed 39 cofounding ties. Research participants were on average 25.21 years old ($SD = 5.60$), mostly male (71 percent), had an average of 1.15 years of entrepreneurial experience ($SD = 1.55$), and represented a diverse set of functional skills (operations: 13 percent, basic research: 10 percent, software: 13 percent, engineering: 12 percent, finance: 21 percent, marketing: 31 percent).

Prior to individuals sharing their venture ideas, I administered an online survey to gather information about each person's functional background and various control variables. At the start of the networking event, entrepreneurs present their idea to potential cofounders in a 3-minute pitch presentation. After the pitch presentations and before individuals go to the networking event, I equipped each individual with an audio recording device, which captured the content of their conversations. After the networking event, entrepreneurs and potential cofounders rated their interactions with each other. The administrator of the incubator program provided an official roster indicating which potential cofounder joined which entrepreneur.

I did not find support for Hypothesis 1. Entrepreneurs were just as likely to interact with functionally diverse potential cofounders as they were with functionally similar potential cofounders ($B = 0.30$, $SE = 0.40$, $Z = 0.75$, $p = 0.45$). I did find support for Hypothesis 2a that potential cofounders were more interpersonally attracted to functionally similar entrepreneurs ($B = 0.32$, $SE = 0.14$, $t = 2.33$, $p = 0.02$) and Hypothesis 2b that potential cofounders were more instrumentally attracted to functionally similar entrepreneurs ($B = 0.18$, $SE = 0.11$, $t = 1.66$, $p = 0.097$). However, I did not find support for Hypothesis 2c that potential cofounders are more attracted to the ideas of functionally similar entrepreneurs ($B = 0.09$, $SE = 0.16$, $t = 0.56$, $p = 0.58$). Finally, I did not find a relationship between cofounder's interpersonal attraction and cofounders' decision to join ($B = -0.10$, $SE = 0.31$, $t = -0.32$, $p = 0.75$). I did find that potential cofounder instrumental attraction ($B = 0.81$, $SE = 0.39$, $t = 2.08$, $p = 0.04$) and cofounder idea attraction ($B = 0.55$, $SE = 0.25$, $t = 2.15$, $p = 0.03$) are positively related to cofounders' decision to join the entrepreneur. These results provide support for Hypothesis 3b and 3c, but not 3a.

STUDY 2 METHOD AND RESULTS

If cofounders prefer functionally similar entrepreneurs, it may be possible to influence cofounder feelings of attraction in a way that de-biases their evaluations of functionally dissimilar entrepreneurs. To explore that possibility, I conducted a speed dating experiment with individuals from an entrepreneur networking event hosted by a local co-working space. I collected data from 37 individuals who engaged in 206 interactions across 3 speed dating cohorts. Research participants were on average 46.43 years old ($SD = 14.70$), mostly male (72 percent), had an average of 8.26 years of entrepreneurial experience ($SD = 9.80$), and represented a diverse set of functional skills (operations: 8 percent, software: 25 percent engineering: 25 percent, finance: 13 percent, marketing: 29 percent).

Prior to the event, participants completed an online survey which collected important background information. At the start of the event, I randomly assigned participants into one of two conditions. In the superordinate condition, the experimenter induced participants to think of themselves and everyone in the room as “entrepreneurs”. Each person wore the same color name tag, and individuals shared with the group why they were interested in being part of the entrepreneurial community. In the subordinate condition, participants were encouraged to think of themselves in terms of their distinct functional background (e.g., engineers or marketers). Participants wore different color name tags based upon their background, sat by others in the room who shared their same background, and shared with the group why they chose that particular functional specialty. Next, participants moved to a new room. Each potential cofounder was matched with an entrepreneur (one-to-one). Participants then interacted with each other for seven minutes. After seven minutes, participants answered a series of questions in which they rated their feelings of attraction toward their counterpart. After answering the questions, the entrepreneurs moved one spot to their left to interact with the next potential

cofounder. This process was repeated until every entrepreneur had a chance to interact with every potential cofounder. I found marginal support ($B = -0.64$, $SE = 0.38$, $t = -1.70$, $p = 0.09$) that potential cofounders in the superordinate identity were less biased against functionally dissimilar entrepreneurs than potential cofounders in the subordinate identity condition.

CONCLUSION

In this dissertation, I sought to explain why we observe functional homophily in founding teams, despite the benefits of assembling a founding team that possesses diverse knowledge. I found that entrepreneurs interact with a range of potential cofounders – some who have similar knowledge and others who hold complementary knowledge. However, potential cofounders responded more favorably when approached by a functionally similar entrepreneur and ultimately were more likely to join their ventures. Importantly, a potential cofounder's preferences for functionally similar entrepreneurs is malleable. When potential cofounders come to see functionally dissimilar entrepreneurs as belonging to a common ingroup, these biases are mitigated. This dissertation extends our understanding of new venture team formation by bringing into sharp relief the role of the potential cofounder in shaping the cofounding process. This work potentially holds implications for entrepreneurship programs aimed at facilitating the development of effective founding teams. Rather than focus exclusively on the entrepreneur who is assembling the founding team, these programs may benefit from attempting to reach and influence the preferences and attitudes of potential cofounders who are deciding whether or not to join the entrepreneur.

REFERENCES AVAILABLE UPON REQUEST