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New Venture Teams and the Quality of Business Opportunities Identified: Faultlines Between Subgroups of Founders and Investors

JoAnne Yong-Kwan Lim
Lowell W. Busenitz
Laku Chidambaram

New venture teams (NVT) often comprise idea-conceiving founders and equity-based investors. These subgroups represent a faultline whose magnitude influences the quality of business opportunities. We propose that the faultline strength formed between founders and investors is influenced by structural factors (ownership equity, membership change, preexisting tie strength) and cognitive factor (mental models of the venture). Finally, we address how the faultline strength impacts interaction processes (relationship conflict, task conflict, knowledge exchange) and their subsequent impact on the quality of entrepreneurial opportunities. Our theoretical model provides insight into how informational resources inherent in new venture teams can be more effectively leveraged.

Introduction

With entrepreneurship becoming increasingly central to economic growth, there is growing interest in understanding how entrepreneurs and the teams that they form work together to bring to market new opportunities. Much attention has been given to individual entrepreneurs as the heroes of successful ventures. The reality is that the "entrepreneur in entrepreneurship" frequently involves a team of individuals (Amason, Shrader, & Tompson, 2006; Beckman, Burton, & O'Rielly, 2007; Ucbasaran, Lockett, Wright, & Westhead, 2003). Most entrepreneurial endeavors, including the identification of new opportunities, the positioning of a product, and target market selection, tend to be undertaken by teams rather than single individuals (West, 2007; Zahra, 2006). While

Please send correspondence to: Lowell W. Busenitz, tel.: (405) 325-2653; e-mail: busenitz@ou.edu, to JoAnne Yong-Kwan Lim at joanne.lim@skema.edu, and to Laku Chidambaram at laku@ou.edu.

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a single individual may initially conceive of an invention, it is usually a team of individuals that work to commercialize the venture. Capabilities and skills as well as financial capital limitations all point to the reliance on teams to enhance the advancement of ventures.

The individual entrepreneur is a convenient and useful unit of analysis for much research in the entrepreneurship domain, and thus, receives a great deal of attention even though the entrepreneurial processes and the development of new opportunities are so frequently pursued by teams. Capital constraints and the role of equity investors coming into the mix is an important part of the entrepreneurial process (Fried & Hisrich, 1995; Shepherd, Ettenson, & Crouch, 2000). Substantial research has addressed a range of related issues such as the decision of investors to syndicate (Manigart et al., 2006), what investor involvement entails (MacMillan, Kulow, & Khoylian, 1989), and the potential value that they add (Busenitz, Fiet, & Moesel, 2004; Sapienza, 1992). While founders and venture capitalists have received significant research attention separately, limited research has considered them as subgroups, and we know of no studies that have considered the dynamics *between* the subgroups of founders and investors comprising a new venture team (NVT). Such teams are foundational for many ventures.

Research on groups refers to the divisions between subgroups as "faultlines" (Lau & Murnighan, 2005). Faultlines have been defined as "hypothetical dividing lines that split a group into relatively homogenous subgroups based on demographic alignment along multiple attributes" (Bezrukova, Jehn, Zanutto, & Thatcher, 2009, p. 35). Further, such faultlines assume that individual members with their inherent traits—referred to as solo actors—come together to form a group. Faultlines then emerge based on the alignment of demographic characteristics once the group is formed.

This foundational concept of faultlines has been extended to address "factional faultlines" (Li & Hambrick, 2005), which presume that group members do not come as solo actors but represent different social entities. Because the basis of factional faultlines is membership in social entities, these faultlines are present at the very *beginning* when representatives of these social entities come together to form a group. Given the relevance of factional faultlines to an NVT, which is composed of two distinct subgroups—founders and investors—our paper relies on this concept (hereinafter referred to simply as faultlines). Thus, we define a faultline as the division between founders and investors that arises just from their coming together to form an NVT. Our model posits that the strength of this faultline is affected by how the members structure the venture (structural dimension) and how they view it (cognitive dimension). Further, it suggests that the strength of this faultline will affect the operations and outcomes of the venture. Specifically, our paper investigates the following research question: "What are the antecedents of faultline strength between the subgroups of founders and investors, and how does it affect the success of an NVT?"

This research makes three central contributions. *First*, we extend entrepreneurship research looking at teams to include subgroups and faultlines. Research on founders and the investors has often employed classical principal–agency theory (Eisenhardt, 1989) to view the founder–investor relationship (Arthurs & Busenitz, 2003). We propose here that the conceptualization of faultlines provides an important perspective for advancing our understanding of the founder–investor relationship (Li & Hambrick, 2005). The faultline concept assumes that there are at least two members in each subgroup (Li & Hambrick). While the faultline concept has been applied to small group research (Thatcher & Patel, 2012), it has not been extended to NVTs. We argue that the faultline perspective offers an important alternative to the principal–agent perspective and leads to a better understanding of NVT dynamics and the development of new opportunities.

Our *second* central contribution addresses factors that impact faultlines. The traditional focus of small group research has been to examine how the alignment of multiple demographic attributes (e.g., gender, race, educational background, and level) contributes to the formation and strength of faultlines (Thatcher & Patel, 2012). Our research pushes these boundaries to examine how differences in structural factors (ownership equity, membership change, and preexisting network ties) and cognitive factors (shared mental models of the venture) affect faultline strength and ultimately the quality of business opportunities identified. In so doing, we build our understanding of how ventures advance when investors are added to the founders to form an NVT.

Third, we examine the mediating roles of interaction processes on the link between faultlines and the quality of business opportunities identified. Specifically, our review identified three key interaction processes—relationship conflict, task conflict, and knowledge exchange (Boone & Hendriks, 2009; Ensley, Pearson, & Amason, 2002) and their relevance to NVT functioning (Higashide & Birley, 2002). Relationship conflict refers to interpersonal hostility that can disrupt group activities, reduce morale, and ultimately affect its well-being and performance (Jehn, 1995). Task conflict, in contrast, reflects differences in how problems are viewed, ways those problems are solved, and the assumptions underlying them (De Dreu & Weingart, 2003). Knowledge exchange refers to the discussion and review of relevant information needed for the success of a task between members of a group engaged in executing it (Boone & Hendriks). While previous research has examined the impact of relationship conflict and task conflict as outcomes of faultlines, it has been limited mainly to small group research (Thatcher & Patel, 2012) and international joint ventures (Li & Hambrick, 2005). Yet, all the three processes are important determinants of NVT success (Busenitz et al., 2004; Chandler, Honig, & Wiklund, 2005) and have not been studied in the context of *a priori* faultlines between founder and investor subgroups.

Entrepreneurship research has given scant attention to the idea of teams and the relationships formed between the founder and investor subgroups. This paper develops an integrated and verifiable model to understand more holistically the intriguing founders–investors dynamics, capturing relationships among drivers (structural and cognition factors) of faultline strength, interaction processes, and the quality of business opportunities identified.

Theoretical Model

Faultlines in New Venture Teams

Group faultlines refer to the imaginary dividing lines within a group and the alignment of attributes among members leading to subgroups (Lau & Murnighan, 1998). Typically, the relevant attributes revolve around demographic characteristics but are also likely to involve assumptions or beliefs (Tegarden, Tegarden, & Sheetz, 2007). Faultline research has been extended to "factional faultlines," which acknowledges that group members are sometimes "drawn from, and are expected, to some degree, to represent, a small number of social entities that exist outside the boundaries of the group" (Li & Hambrick, 2005, p. 797) and have preestablished faultlines (Lau & Murnighan, 2005). The assumption here is that factional faultlines are often *a priori* to formal group alignment (Li & Hambrick).

Research on faultlines is based on the similarity–attraction paradigm (Bryne, 1971) and the theory of self-categorization (Turner, 1987). These theoretical perspectives help explain the functional and dysfunctional effects of heterogeneity resulting from the two subgroups—founders and investors—in an NVT. They suggest that similarity in values,

beliefs, education, and other identifiable attributes explain the attraction among members within a group. Thus, members of a subgroup tend to communicate and identify with similar others as they assume that those who are similar also support their espoused worldviews and attitudes. Due to social categorization processes, these subgroups are strengthened (Bryne). While these theories have been employed to argue the undesirable effects of heterogeneity (e.g., gender, ethnicity), researchers have used them to explain their positive effects as well, especially with regard to interaction processes (Gibson & Vermeulen, 2003; Thatcher & Patel, 2012). As we develop later, these perspectives appear to have great relevance in understanding the subgroups comprising an NVT and how they eventually impact the identification of business opportunities. Below, we describe why the founders–investors relationship can be viewed from the faultlines perspective.

We define NVTs as "comprising of members who hold significant ownership stakes in the venture and/or are involved in strategic decision making" (Ucbasaran et al., 2003). More specifically, we identify the "idea-conceiving founders" subgroup (hereafter referred to as the "founders") as those individuals who have conceived of the business concept and are involved in the development of the technical, strategic, and operational aspects of launching the venture. At some point, many ventures need to raise capital usually in exchange for equity ownership. These "equity-based partners" subgroup (hereafter referred to as "investors"), in addition to providing capital, also provide input on strategic decisions; act as a sounding board; have seats on the board of directors; and provide connections to buyers, suppliers, and prospective employees (Fried & Hisrich, 1995; MacMillan et al., 1989; Sapienza, 1992). While there are clear differences between the founder and the investor subgroup, members of these two subgroups have to work together for the venture to succeed.

With our focus on startup and early phase ventures, we suggest that the founders–investors relationship can be better understood using the faultline lens. Here, we discuss why founders and investors attach salience to their individual social entities and thus represent two distinct subgroups: One, members of founding teams have typically built the early roots of the venture prior to the entry of investors. The founders often have overlapping work experience and beliefs as well as previous successful experiences (Beckman et al., 2007; Busenitz, Moesel, Fiet, & Barney, 1997; Forbes, Borchert, Zellmer-Bruhn, & Sapienza, 2006). As such, they already have developed a set of intra-team communications (Busenitz et al., 1997) and a shared mental model (Choi & Thompson, 2005) that represents the new venture. Further, the founding team typically has some shared chemistry (Forbes et al., 2006), which further reinforces their representative status as founders.

Two, investors generally syndicate their investments, whereby multiple investors coinvest to fund the development of a startup (Ferrary, 2010; Lockett, Ucbasaran, & Butler, 2006). The syndicate usually consists of a "lead investor" and more passive investors. These lead and passive investors are closely dependent on one another for their involvement in the venture. Typically, these investors often coinvest together in multiple deals with each taking turns as the lead investor (Ferrary). Therefore, the investors form a community (Ferrary) and attach salience to their status as being investors, forming a subgroup.

Finally, those making capital investments tend to gain some important influences. For example, investment contracts often include imposing penalties on nonperforming members, options to dismiss founders, identifying target market opportunities, and providing strategic direction for the venture (Bruton, Fried, & Hisrich, 2000; Busenitz et al., 2004; MacMillan et al., 1989). Extensive involvement by investors and battles over control are likely to sharpen the differences between the founder and investor subgroups

Figure 1

Strong Faultlines in Group A

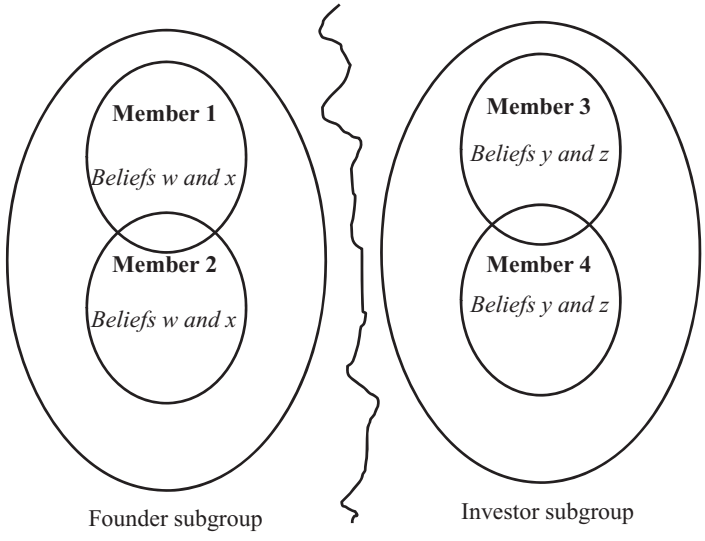
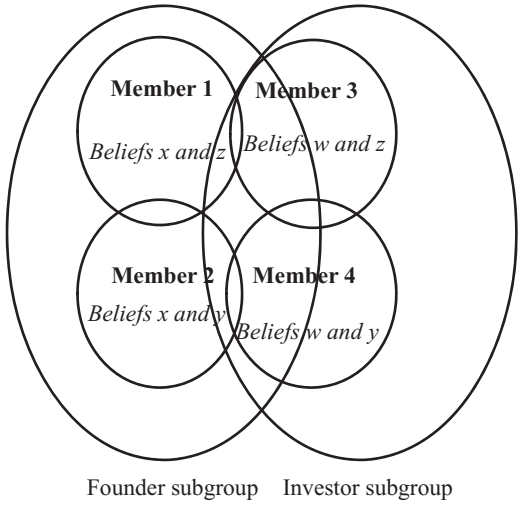


Figure 2

Weak Faultlines in Group B

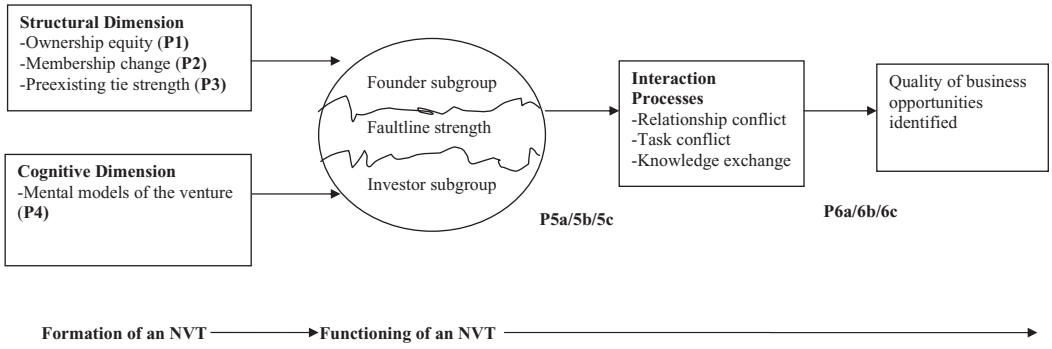


(Bruton, Fried, & Hisrich, 1997). However, as we discuss below, this faultline is not likely to remain constant (Li & Hambrick, 2005).

Assume two different NVTs (Groups A and B), as shown in Figures 1 and 2, each comprised of two founders and two investors. In both cases, members of subgroups, in addition to representing a different social entity (founders versus investors) have beliefs that may or may not overlap with others. Based on traditional diversity research, groups

Figure 3

Research Model of an NVT as Subgroups of Founders and Investors



A and B would be considered equally diverse and would, hence, be assumed to experience similar group processes, resulting in similar outcomes. However, the two groups are essentially different in terms of faultline strength. Group members 1 and 2 form a relatively homogeneous subgroup since they are founders and have similar beliefs (beliefs w and x). The same line of reasoning applies to members 3 and 4 who form an investor subgroup and share similar beliefs (beliefs y and z). Taken together, Figure 1 describes an NVT with a strong faultline. Figure 2, on the other hand, describes an NVT with a weak faultline. For instance, group member 1 (a founder) and group member 3 (an investor) have an overlapping belief (belief z) while group member 2 (a founder) and group member 4 (an investor) have an overlapping belief (belief y). There are thus overlapping cognitive attributes between members of the founding subgroup and the investing subgroup. As such, this second scenario would diffuse differences and weaken the faultline between the founders and investors. Given that neither individual beliefs nor NVT compositions are static, faultlines are dynamic and their strength fluctuates accordingly.

The above discussion sets the stage for our research model, which is shown in Figure 3. Our model suggests that when members from the two distinct social entities—founders and investors—come together to form an NVT, they can differ from each other along two key dimensions: structural and cognitive. If the founder and investor subgroups do not perceive significant differences between each other along either of these dimensions, the faultlines formed between them will not be strong. In contrast, if the differences along either of these dimensions between the subgroups are stark, the faultline is likely to be much stronger.

Given the importance of considering structural (Tuggle, Schnatterly, & Johnson, 2010) and cognitive (Tegarden et al., 2007; Thatcher & Patel, 2012) dimensions in the faultline research, we argue that these two dimensions affect the beliefs of founders and investors and hence faultline strength. The structural dimension relates to factors that influence how founders and investors perceive each other. Recent research shows that meeting informality among members—a structural dimension—reduced the negative relationship between faultline strength and entrepreneurial issue discussion (Tuggle et al.). The cognitive dimension, how members think about the venture, is central to the development of NVT team dynamics (Busenitz et al., 2004) and the development of business opportunities (Baron, 2006). Research suggests that top management team members tend to form factions as a result of diverse views (Tegarden et al.). Thus, we

assume that faultline strength is affected by both structural and cognitive dimensions of an NVT in prior research (Tegarden et al.; Tuggle et al.) and serves as the theoretical basis for our research model. Our model further posits that faultline strength will impact an NVT's interaction processes, which, in turn, will affect the quality of business opportunities identified.

More specifically, our model suggests that when an NVT is formed, its structural dimensions (including the differing amounts of venture control between members of the founding and investing subgroups, changes in the founding subgroup, and the preexisting interpersonal ties between members of the two subgroups) along with its cognitive dimension (captured by the mental model of the venture by the two subgroups) will affect the beliefs and hence the strength of the faultline between the founder and investor subgroups. After the formation of the new venture, depending on the strength of this faultline, the interaction processes of the NVT (including the relationship conflict between members of the two subgroups, their task conflict, and the extent of knowledge shared between them) will affect the quality of business opportunities identified. We now develop the theoretical arguments supporting our propositions derived from this research model.

Drivers of Faultlines Between Founders and Investors

Building from the above arguments that the faultline perspective has important implications for NVTs and the two subgroups of founders and investors, we seek to move beyond differences based on demographic factors. While earlier research has tended to focus on individual demographic attributes (Gibson & Vermeulen, 2003), we now discuss how the structural dimensions of ownership equity, membership change, and preexisting tie strength impact faultline strength of NVTs. We then discuss how the cognitive dimension of an NVT, manifested as a shared mental model of the venture between the founder and investor subgroups, impacts faultline strength.

Structural Dimension

Ownership Equity. Since entrepreneurial ventures in need of an infusion of capital are rarely able to engage debt financing given their newness and negative cash flows, the main alternative is to seek equity-based investments. Venture capitalists or other private investors typically negotiate for some equity percentage of the venture in exchange for their investment, and entrepreneurs give up part of their stake and control of the venture (Hellmann, 1998). The payback for investors and owners then usually comes several years later when the venture goes public or it is acquired by another firm. The proceeds are then divided up according to the equity stake of each owner. Along with such investments usually come contractual covenants such as earn-out arrangements, employment conditions, and seats on the board of directors (Busenitz et al., 1997; Hellmann). The greater the financial investment in the venture, the greater the control that outside investors are likely to want as reflected in equity portions and the number of positions on the board of directors.

The negotiations over these issues just prior to the actual investment can be quite extensive (Steier & Greenwood, 1995). Depending on factors such as the risk of the technology, the experience of the founders, and the amount of capital the founders have already invested, the equity proportion given in exchange for the investment will vary.

Early-stage investments seeking enough capital for approximately a year of venture operations tend to range in the 20–35% equity range. As the venture advances and additional rounds of capital are needed, the equity portion of founders can fall below 50%.

Prior to seeking outside equity investments, the founding team typically owns 100% of the venture (sometimes together with friends and family). Giving up a portion of this equity in exchange for a financial investment can tend to be viewed by founders as giving up part of "their baby." Founders understand that but giving up half or more of the equity portion may cause problems from the outset. How the investment negotiations progress can impact the strength of the faultline and the ongoing relationship. Particularly from the founding subgroup's perspective, the perceived fairness of the ownership arrangement is likely to be very important. Furthermore, a sense of fair equity distribution also acts as an *ex ante* deterrent to opportunistic acts (i.e., moral hazard or adverse selection) (Steensma & Lyles, 2000; Wright & Lockett, 2003). Founders, for example, may expend efforts on activities unrelated to venture growth but to their own personal benefits or exaggerate the prospects of their product (Arthurs & Busenitz, 2003). When founders feel that a fair amount of equity has been given in exchange for an infusion of capital, acts of opportunism and agency problems are less likely to arise, and the strength of faultlines will diminish.

In contrast, if founders feel that they gave up too much equity ownership, it will likely strengthen the faultline between investors and founders. A perceived imbalance in equity ownership refers to the perception of an unequal balance in the exchange of equity for invested capital. With a seeming imbalance in equity ownership, the possibility of perceived information asymmetries and opportunism between founder and investor subgroups is likely to increase. Founders will tend to be more wary of investors and vice versa. When this happens, each subgroup is likely to attach greater salience to its own social entity and draw in tighter to its own subgroup resulting in greater divisiveness. A perceived misalignment in equity ownership deters mutual forbearance among partners, increases disputes, decreasing the probability of a successful relationship (Geringer & Woodcock, 1989; Wright & Lockett, 2003). However, when there are limited perceived agency problems, the beliefs of the founder and investor subgroups are more likely to overlap, diffusing the faultline strength and enabling greater cooperation between investors and founders (Arthurs & Busenitz, 2003). These arguments lead us to expect that greater imbalance in the perceived ownership equity between founders and investors will increase the strength of the faultline between the two subgroups.

Proposition 1: Greater perceived imbalance of ownership equity between founder and investor subgroups will strengthen the faultline between them.

Membership Change. While the dynamic nature of group membership is widely recognized (Choi & Thompson, 2005), this seems to be especially true in NVTs (Ucbasaran et al., 2003). Indeed, changes in the composition of NVTs are relatively common in part due to frequent exits as well as additions (Chandler et al., 2005; Ucbasaran et al.). However, the parsing of turnover into member entry and exit has been largely ignored (Beckman et al., 2007; Chandler et al.; Ucbasaran et al.), particularly with investor-backed firms in early stages. Moreover, it has been argued that dynamic groups are fundamentally different from stable groups as "membership change can have a profound impact on the structure, process and performance of groups . . ." (Choi & Thompson, p. 122). We now address NVT member changes, including additions and replacements, and the resulting impact on faultlines within the NVT.

During the nascent and early stages of a venture, innovation and "growth through creativity" is usually very important in advancing venture development (Boeker & Wiltbank, 2005; Greiner, 1972). Given that new ventures typically function in a dynamic environment, working as a team and making adjustments on the fly is common for navigating these turbulent waters. However, adding new members tends to interrupt existing work practices (Choi & Thompson, 2005). Thus, it is of paramount importance to consider the effects of member addition and replacement in NVTs.

First, we consider how the addition of new members or the replacement of existing founders can have a positive impact on group dynamics. In seeing newcomers as "agents" with minority influence, the infusion of new ideas or the exposure of dissenting views from newcomers can stimulate task conflict and cognitive restructuring (Hera & Rodriguez, 1999; Nijstad, Stroebe, & Lodewijkx, 2002). Such changes can promote fresh perspectives and new thought leading to enhanced creativity (Choi & Thompson, 2005; Goncalo & Staw, 2006; Nijstad et al.). Innovative newcomers bring with them additional skills and knowledge that can serve to enlarge and diversify the knowledge base of the group (Chandler et al., 2005; Choi & Thompson; Ucbasaran et al., 2003). In short, under the right circumstances, informational gains can follow the addition of new team members.

However, changes in NVT memberships can have an adverse impact. There may be a lack of interpersonal chemistry between the founding team and those just added. Given that NVTs are less likely to have deeply established norms (Forbes et al., 2006), interpersonal chemistry plays an especially important role in carrying out tasks and group functioning. Indeed, founding teams typically band together because they share similar personalities, values, beliefs, and backgrounds as suggested by the similarity–attraction paradigm (Beckman et al., 2007; Forbes et al.). Moreover, even when identifying potential members to join, they are chosen by incumbents who are deeply involved in the search process. Forbes and colleagues found that resource dependency and interpersonal attraction play complementary roles in member additions to entrepreneurial teams. Research suggests that new members are likely to be individuals who are known by at least one incumbent member, thereby enhancing the probability that they will align with the norms and values already in place (Forbes et al.).

Investors can dominate the process of searching for new hires, thereby increasing the probability of incompatible beliefs between the subgroups (MacMillan et al., 1989). Even if the new member possesses the required skills, the incongruent beliefs heighten the subgroup boundaries between the investor and founder subgroups. In an entrepreneurial setting where interpersonal relationships are particularly potent in facilitating work processes, friction and detrimental effects are more likely to develop (Forbes et al., 2006). Indeed, MacMillan and colleagues found that there was a negative association between venture performance and investors who were highly involved in the search for management (MacMillan et al.). In sum, investor dominance in the search process for key personnel is likely to strengthen the faultlines between the founder and investor subgroups leading to the proposition below.

> **Proposition 2:** Membership change (i.e., the addition or replacement of an NVT member) by investors without the involvement of founders will strengthen the faultline between the subgroups.

Preexisting Tie Strength. Relationships and preexisting social ties are important antecedents of faultline strength between the subgroups of founders and investors, and ultimately influence the quality of new business opportunities identified. Preexisting ties and

relationships affect NVT formation as well as the obtaining of resources (Granovetter, 1973; Hite, 2005; West, 2007). Decision making is critical when navigating through the entrepreneurial frontier with open discussions and diverse knowledge potentially being very constructive (West). While the importance of strong ties and social relationships to knowledge exchange has been established in small group research (Reagans & McEvily, 2003), we argue that entrepreneurship research needs to further examine how preexisting tie strength impacts faultlines in an NVT in their pursuit of business opportunities.

The strength of preexisting ties affects the information and resource flow in a group (Shah & Jehn, 1993; Shane & Cable, 2002). "The strength of a tie is a (probably linear) combination of the amount of time, the emotional intensity, the intimacy (mutual confiding), and the reciprocal services which characterize the tie" (Granovetter, 1973, p. 1361). In other words, individuals with stronger ties tend to interact with and meet one another more often, and are emotionally attached and committed to each other. Conversely, relationships between individuals with weak ties are characterized by lower levels of intimacy and emotional intensity as well as less frequent interactions (Granovetter). The level of trust is associated with stronger ties and closer interpersonal connections (Reagans & McEvily, 2003).

Preexisting tie strength can mitigate divisions in a group (Shane & Cable, 2002). When interpersonal relationships exist between members (as in the case of strong ties), feedback, criticisms, and comments are viewed as constructive and useful rather than destructive (Kahn, 1990; Shah, Dirks, & Chervany, 2006). Moreover, the emotional attachment among members enables them to have greater tolerance for critical evaluation, with less fear of negative repercussions (Shah & Jehn, 1993). A recent study indicated that high-performing groups with strong relationships engaged in more "constructive controversy" than low-performing groups with strong relationships, while it had minimal effect on low-performing groups with weak relationships (Shah et al.). In a similar manner, investors and founders with strong ties may view the feedback and criticism from the other subgroup as constructive and be more open to adjust their perspectives.

With strong preexisting ties comes increased motivation to support fellow group members (Granovetter, 1973; Reagans & McEvily, 2003; Shane & Stuart, 2002). Recent research demonstrates the importance of relational capital in facilitating investors' support for the venture's operations (De Clercq & Sapienza, 2006). Specifically, the extent of relational capital shared between the investors and funded ventures had a positive effect on venture outcomes (De Clercq & Sapienza). In short, interpersonal relationships appear to be foundational for resolving issues without negative repercussions (Shah et al., 2006; Shah & Jehn, 1993), reducing the perceived threat that founders will act opportunistically (Shane & Stuart), and being more successful in ventures being funded (Shane & Cable, 2002; Shane & Stuart). So, we argue that strong preexisting ties among founders and investors tend to mitigate the strength of faultlines and result in greater cooperation among the NVT team.

Proposition 3: Strong preexisting ties between founders and investors will lessen the strength of the faultline between these subgroups.

Cognitive Dimension

Shared Mental Models of the Venture. An important foundation for a team coming together is to have consistent premises and knowledge structures as the basis for making decisions about the direction of the venture and the broader context in which it operates.

Such a shared mental model has been defined as a "shared, organized understanding and mental representation of knowledge about key elements of the team's relevant environment" (Mohammed & Dumville, 2001, p. 90). Shared mental models play an especially vital role in team functioning (Cannon-Bowers, Salas, & Converse, 1993), strategy formulation (Busenitz et al., 2004), environmental assessments (Kellermanns & Barnett, 2008; Lim & Klein, 2006), and hence venture success. For NVTs, the mental models involve contextual issues for the venture (West, 2007), resource distribution (Busenitz et al.), identification of venture-specific issues (Ferrary, 2010; West), competing strategically (Barney, 1991), and dealing with coordination and interaction behaviors internally (Cannon-Bowers et al.; Mohammed & Dumville). The assumption is that team members with shared mental models will be able to complement one another (Cannon-Bowers et al.) and improve venture performance.

In NVTs with widely varied mental models between founders and investors, we expect the faultlines to increase between them. When founders and investors differ widely in their viewpoints, the ensuing conflict may result in deep divisions, leading to poor performance (Li & Hambrick, 2005). At the other extreme, when founders and investors have closely overlapping mental models of the venture, the lack of challenging thought and the pushing of boundaries may also lead to poor performance (Cannon-Bowers et al., 1993). In his study of technology-based top management teams in new ventures, West (2007) found that the collective cognition characteristics of differentiation and integration impacted firm performance. Too much differentiation (too many different viewpoints) and too much integration (too many similar viewpoints) negatively influenced firm performance.

In the NVT context, venture capitalists are typically invited to join an NVT not just for financial capital but also for additional strategic inputs to a venture (Busenitz et al., 2004; Sapienza, 1992). Thus, to the extent that the perspectives of founders cannot be combined and integrated with those of the investors (i.e., highly inconsistent mental models between founders and investors), the mutual understanding needed to facilitate strategic implementation is impeded, driving founders and investors apart. While investors and founders can collect specialized information related to the venture to reduce misunderstanding, inconsistent mental models suggest that the information provided by one subgroup may not be deemed useful by the other, and vice versa. Such a mismatch is then likely to trigger social categorization processes between founders and investors and thereby exacerbate the faultline between them. Indeed, for founders to achieve a cooperative and mutually trusting relationship with investors requires shared mental models of the venture. These mental models, as mentioned earlier, do not have to be the same but need to have enough overlap such that these subgroups can forge forward with the venture. Thus, with consistent mental models, founders and investors are able to communicate more meaningfully and effectively with each other, leading to positive interpersonal relations and enhanced ability to cope with the complex and turbulent entrepreneurial environment (Cannon-Bowers et al., 1993; Lim & Klein, 2006; West, 2007).

Proposition 4: Greater shared mental models of the venture between founders and investors will lessen the strength of the faultline between the subgroups.

Impact of Faultlines on the Interaction Processes Between Founders and Investors

Research on group diversity has typically been based on demographic variables and implicitly assumes behavioral differences stemming from age, education, and so forth.

However, research to this point largely treats process issues as a black box (Clarysse & Moray, 2004). We argue that understanding how entrepreneurial teams think and function with the various relationships in an NVT will advance research on both subgroups and entrepreneurship.

While some may assume that individual entrepreneurial behavior is similar to team entrepreneurial behavior, research has demonstrated that the cognitive and social dynamics of group behavior and collective cognition are more complex in group settings (e.g., West, 2007). Furthermore, issues related to social aspects of group behaviors, such as social integration that influences group effectiveness need to be taken into account when investigating group-related entrepreneurial activities (West). Thus, the faultlines formed when founder and investor subgroups come together have a significant impact on how the NVT functions.

Faultline strength affects communication and group processes (Bezrukova et al., 2009; Lau & Murnighan, 1998). Strong faultlines give rise to investors and founders developing an "us-versus-them" dynamic (see Figure 1; as indicated by the jagged line), triggering social categorization processes (Lau & Murnighan, 1998, 2005). Thus, information may not flow easily between subgroups characterized with strong faultlines. In contrast, as noted earlier, NVTs characterized with weak faultlines indicate the presence of subgroups with overlapping membership (see Figure 2). The faultlines that are formed based on social entities (i.e., founders versus investors) tend to be at least partially diffused as a result of overlapping cognitive perspectives between the investors and founders. Further, members with overlapping membership across the subgroups may act as communication bridges, facilitating interaction. For example, group member 3 (an investor; beliefs w and z) can act as a communication bridge and communicate with group member 4 (an investor; beliefs w and y). The presence of such communication links enables greater integration and exploration of different perspectives across the investor and founder subgroups, facilitating idea sharing and cognitive stimulation (Gibson & Vermeulen, 2003; Nijstad et al., 2002). In essence, strong faultlines disrupt communication while partially overlapping faultlines enable more effective communication (Li & Hambrick, 2005). Given that research has shown that faultline strength affects communication dynamics and group processes (Li & Hambrick; Thatcher & Patel, 2012), we discuss below the differential influence of faultline strength between subgroups of founders and investors on three key interaction processes: relationship conflict, task conflict, and knowledge exchange.

Relationship Conflict. Members of groups characterized with strong faultlines tend to identify with their own subgroup rather than the entire group (Lau & Murnighan, 1998), leading to favoritism toward the in-group and prejudice against the out-group, triggering an in-group bias and increasing relational conflict (Jehn, Northcraft, & Neale, 1999; Lau & Murnighan). Members within a subgroup—say founders—may, as a result, be unwilling to participate and exchange opinions with members of the other subgroup—investors in this case (Gibson & Vermeulen, 2003). Indeed, prior research employing Social Identity Theory as the basis has offered support for this notion (Gibson & Vermeulen; Lau & Murnighan).

Further, the "us-versus-them" mentality strains the relationship between the subgroups and hostility begins to increase (Lau & Murnighan, 1998; Thatcher & Patel, 2012). Evaluations of contribution may be distorted since members are biased against opinions expressed by members of other subgroups (Lau & Murnighan; Li & Hambrick, 2005). Potential benefits of having diverse viewpoints are outweighed by process losses, including relationship conflict (Jehn et al., 1999; Li & Hambrick). As a consequence, much

effort is wasted on resolving interpersonal issues rather than focusing on the task at hand (Gibson & Vermeulen, 2003). Thus, we propose:

Proposition 5a. The strength of the faultline between the founder and investor subgroups will be positively related to the level of relationship conflict experienced by an NVT.

Task Conflict. When faultlines are partially overlapping, group members are more likely to express their thoughts and position with little likelihood of rejection resulting from the expression of spontaneous, and possibly divergent, thoughts and viewpoints (Lau & Murnighan, 2005). Indeed, strong psychological support is necessary in order for open discussion to take place more effectively (Gibson & Vermeulen, 2003).

Due to the open discussion and comfortable atmosphere enabled by the weak faultline, substantive task conflict and arguments that stem from differences in beliefs and knowledge are more likely to take place (Gibson & Vermeulen, 2003). Fundamentally, task conflict enables NVT members to consider a broader range of perspectives, options, and issues, leading to the exploration and consideration of new ideas and opportunities (Ensley et al., 2002; Miller, Burke, & Glick, 1998). While a meta-analysis by De Dreu and Weingart (2003) cautions that task conflict may not necessarily translate to better performance, there is evidence that it can serve as a resource for the team (Miller et al.) if it does not exceed certain threshold levels. Based on previous work (e.g., Gibson & Vermeulen), we argue that only moderate task conflict is likely to occur in weak subgroups. Based on the above discussion, we propose:

Proposition 5b. The strength of the faultline between the founder and investor subgroups will be negatively related to the level of task conflict experienced by an NVT.

Knowledge Exchange. In any NVT, given the different perspectives by the investors and founders, diverse interpretations of venture challenges are likely to emerge (Busenitz et al., 2004). Further, weak faultlines facilitate members to recognize ideas from others, regardless of subgroup affiliation as the subgroups are not highly differentiated from each other (Lau & Murnighan, 2005; Li & Hambrick, 2005). As such, ideas from members of other subgroup can serve as triggers for new ideas. Thus, the input generated by all members, regardless of subgroup affiliations, has the potential to contribute—a particularly valuable asset in entrepreneurship and the pursuit of new opportunities (Busenitz et al.; Miller et al., 1998). Moreover, members are more willing to voice their perspectives without the threat of rejection that may result from the expression of different viewpoints (Edmondson, 2002; Gibson & Vermeulen, 2003). Indeed, it is vital that members feel psychologically safe in order to ask questions, present feedback, and exchange ideas, enabling knowledge exchange (Edmondson).

In contrast, while the knowledge held by members of strong subgroups can be valuable, it may be difficult to disseminate outside the subgroup. Given the in-group versus out-group mentality, members are divided (Gibson & Vermeulen, 2003; Li & Hambrick, 2005). Inputs from members of another subgroup are viewed not based on merit but on negative stereotypes (Gibson & Vermeulen; Lau & Murnighan, 2005). As such, ideas tend to be ignored by members with a strong alliance to a particular subgroup (Gibson & Vermeulen). Moreover, stemming from social categorization, members tend to cast negative attitudes (e.g., mistrust) and attributions toward other subgroup members leading to strained relationships (Lau & Murnighan, 1998; Thatcher & Patel, 2012). In addition, members of strong subgroups tend to be less free in sharing their thoughts and

potential contributions (Gibson & Vermeulen; Lau & Murnighan, 1998). Good interpersonal relations between individuals facilitate knowledge flow (Reagans & McEvily, 2003). Consequently, strong subgroups are likely to experience dysfunctional processes such as reduced knowledge exchange, interaction problems (Li & Hambrick), and other process losses (Miller et al., 1998). Based on the above discussion, we propose:

Proposition 5c. The strength of the faultline between the founder and investor subgroups will be negatively related to the extent of knowledge exchanged in an NVT.

Impact of Interaction Processes on the Quality of Business Opportunities Identified

Impact of Relationship Conflict. Relationship conflict has been shown to reduce group effectiveness (Choi & Sy, 2010). When there is relationship conflict, differing task opinions voiced by other members tend to be viewed as personal attacks, deterring members from objectively processing and evaluating the information and thus preventing the information resources within the group from being effectively utilized, producing suboptimal decisions (De Dreu & Weingart, 2003; Ensley et al., 2002). Relationship conflict also lowers satisfaction, reduces cohesion, hampers cooperation, and increases resentment—all of which lead to ineffective decision-making processes (Choi & Sy; Ensley et al.; Thatcher & Patel, 2012).

In their study of top management teams involving a sample of 70 new ventures, Ensley et al. (2002) found that relationship conflict was negatively associated with cohesiveness, while cohesiveness was positively related to venture growth. There is also empirical evidence that conflict, manifested as personal friction, is detrimental to venture success (Higashide & Birley, 2002). The presence of relationship conflict between founder and investor subgroups will inhibit members from focusing on the task at hand (De Dreu & Weingart, 2003; Ensley et al.) and instead divert their attention toward reducing threats and expending effort on resolving differences (Amason et al., 2006; Thatcher & Patel, 2012), simultaneously distracting them from focusing on business opportunities. Thus, we propose:

Proposition 6a. The level of relationship conflict experienced by an NVT will be negatively related to the quality of business opportunities identified.

Impact of Task Conflict. Shared knowledge forms the basis for relevant cognitive structures, which are essential for the identification of new and higher quality business opportunities (Baron, 2006). Also, these cognitive capacities influence, at least partially, the alertness of NVT members and enable them to perceive links between disparate events, facilitating the discovery of new business opportunities (Baron; Baron & Ensley, 2006; Shane, 2000). However, as discussed above, extreme task conflict and other aspects of process losses (e.g., mistrust) are likely to deter constructive task discussions from taking place, thereby negatively affecting the identification of high-quality business opportunities.

In the absence of task conflict, members of the founding and investing subgroups may fail to identify the varied approaches needed to make meaningful sense among seemingly unconnected changes occurring in the external environment. In fact, empirical research has demonstrated that the exposure to the views of others can enable members to identify more unique approaches to problems (Latimer, 1998; Nijstad et al., 2002), thus increasing

members' abilities to cope with the volume and velocity of changes arising from a complex environment such as entrepreneurship. Given a rapidly changing environment, those who are able to react more quickly are more likely to identify high-quality business opportunities so as to ensure the survival and growth of the new venture. In short, members' cognitions may be changed because of exposure to the array of viewpoints from other members in weaker subgroups. In this sense, the founding and investing subgroups may be further equipped with the necessary information and prototypes (cognitive structures) essential for such activities as identifying changes in technologies, recognizing customers' evolving tastes and in short, increasing the alertness and the probability of *recognizing high quality business opportunities*.

While individual cognitions can enhance collective cognition, and such collective cognition, in turn, enhances the internal thought processes of individuals, social integration plays a vital role in enabling members to take advantage of the array of information and insights available to the entrepreneurial team (Miller et al., 1998; West, 2007). In his study of new venture teams, West showed that while the existence of divergent opinions within a team is important, social integration influences the extent to which executive teams converge on a set of strategies. NVTs who demonstrate appropriate degrees of integration and differentiation were found to achieve higher new venture performance. Simply put, too much task conflict clouds collective judgment and too little limits the options examined. Taking these extreme positions into account, we offer a nuanced view with the following:

Proposition 6b. The level of task conflict experienced by an NVT will have an inverted U-shaped relationship with the quality of business opportunities identified.

Impact of Knowledge Exchange. While investors and founders possess valuable, yet diverging insights that can be employed to manage a venture (Busenitz et al., 2004), such insights will remain hidden if there is little or no exchange of knowledge. Boone and Hendriks (2009) argued that functional diversity in the top management team itself is insufficient for improving firm performance. It is through the exchange of accurate information that the capability of the top management team is enhanced, thereby facilitating the process of dealing with complicated tasks and improving firm performance. Likewise, Dahlin, Weingart, and Hinds (2005) proposed that in addition to the retrieval of information from one another, members need to "exchange and structure the information . . ." and "discuss impressions and interpretations of the information at hand" (p. 1109).

When in-depth information is elaborated, members are better able to learn and acquire information from one another, integrate and act on the information, and develop knowledge that enhances coordination and communication processes (Boone & Hendriks, 2009; Dahlin et al., 2005). Indeed, as seen in a recent study by Boone and Hendriks, firm performance increased when functionally diverse top management team members engaged in the exchange of accurate information. In a similar vein, it is through the exchange of information between founders and investors that an NVT can effectively combine and integrate its critical resources, facilitating actions and enabling coordination (Busenitz et al., 2004).

Further, while goals between founders and investors may be aligned, information asymmetry between founders and investors leads to perceived misalignment of goals (Arthurs & Busenitz, 2003). Also, a lack of knowledge exchange will inhibit members from understanding the rationale behind one's decision (Boone & Hendriks, 2009). With greater exchange of knowledge, discrepancies in semantics and opinions can be clarified (Cronin & Weingart, 2007), reducing misunderstanding and enabling effective decision

making (Boone & Hendriks; Dahlin et al., 2005). Unique information is also more likely to be integrated into such decision-making processes (Dahlin et al.). Therefore, we hypothesize the following:

Proposition 6c. The extent of knowledge exchange by an NVT will be positively related to the quality of business opportunities identified.

Conclusion

Collective cognition represents a critical element that aids in encouraging entrepreneurial behaviors and venture success (Mitchell et al., 2007; West, 2007). Building on groups, diversity, and entrepreneurship research, we focused on NVT and its subgroups—founders and investors—as the units of our theoretical analyses. What is unique about the union of investors and founders in an NVT is that each party is aware of its status distinction. Also, with most new ventures, investors often come in multiples to work with a founding team forming two distinct subgroups within the NVT. It is therefore of paramount importance to consider the centrality of both founder and investor subgroups to more accurately understand phenomena associated with NVT functioning and success. As noted by Gartner, Shaver, Gatewood, and Katz (1994) and Lockett et al. (2006), entrepreneurship tends to take place in teams and hence, it is critically important to include the *team* notion in entrepreneurial research.

Given the unique experiences and strategic expertise that investors often have, it is puzzling why some studies yield nonsignificant effects when examining the value offered by investors to ventures. Our attention to faultlines (Lau & Murnighan, 1998; Li & Hambrick, 2005) represents new ground and moves us beyond the dominant approach of agency theory (Eisenhardt, 1989) in viewing the founders–investors relationship (Arthurs & Busenitz, 2003). In so doing, we address this surprisingly limited finding by calling attention to the faultlines arising from salient membership in an NVT by subgroups of founders and investors. We also argued that faultlines are magnified or mitigated due to structural and cognitive dimensions that define founders and investors. These faultlines entail the formation of in-groups/out-groups that can result in negative consequences on group functioning and subsequent performance (Thatcher & Patel, 2012).

We suggest that future work consider the founders–investors relationship using the faultline perspective. Viewing it from this perspective, we argue that the array of opinions and interactions among investors and founders jointly influence the quality of new business opportunities identified. Baron (2006) and Baron and Ensley (2006) have made important contributions to understanding the nature of opportunity recognition using a pattern recognition approach. They proposed that one implication of this perspective ("connecting the dots") is that entrepreneurs can be trained to be more adept at business opportunity discoveries. This paper offers another important contribution—that structural and cognitive dimensions of NVT, along with the presence of weak faultlines that demarcate subgroups of founders and investors, are likely to enhance the discovery of new opportunities. We extend entrepreneurial team research by proposing a theoretical model that examines how the quality of business opportunities identified may be influenced by using this perspective.

Our paper offers new ways of thinking about how differences in the way NVTs are formed and how they function affect their success in identifying new business opportunities. First, we argued the importance of having balanced ownership equity between founders and investors so that the faultlines between both subgroups decrease. While this

issue has been examined in the context of international joint ventures, it has not been examined in the context of NVTs. Second, despite the prevalence and reality of dynamic entrepreneurial groups, many prior studies tend to assume that groups are static in nature (Ucbasaran et al., 2003). Our research addresses this gap by incorporating the impact of member entry and replacement on faultline formation. Third, we proposed that the strength of preexisting ties between investors and founders plays an important role in determining faultline strength. Fourth, we articulated the importance of a shared mental model of the venture among the founder and investor subgroups in impacting faultline strength. Finally, we argued that the interaction processes (relationship conflict, task conflict, and knowledge exchange) are central to examining the eventual performance of the venture in identifying new business opportunities.

In sum, our theoretical model extends entrepreneurship literature by elucidating the complex relationship between the founding and investing subgroups and how it affects the quality of business opportunities identified. In so doing, we enhance our understanding of how the informational resources inherent in an NVT team, formed by the dynamic union of founders and investors, can be more effectively leveraged and more clearly studied.

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JoAnne Yong-Kwan Lim is an Assistant Professor at SKEMA (France).

Lowell W. Busenitz is the Michael F. Price Chair in Entrepreneurship at the University of Oklahoma Price College of Business.

Laku Chidambaram is the W.P. Wood Professor of MIS and the Director of the MIS Division at the University of Oklahoma's Michael F. Price College of Business.