

# **Entrepreneurial Decision-making:**



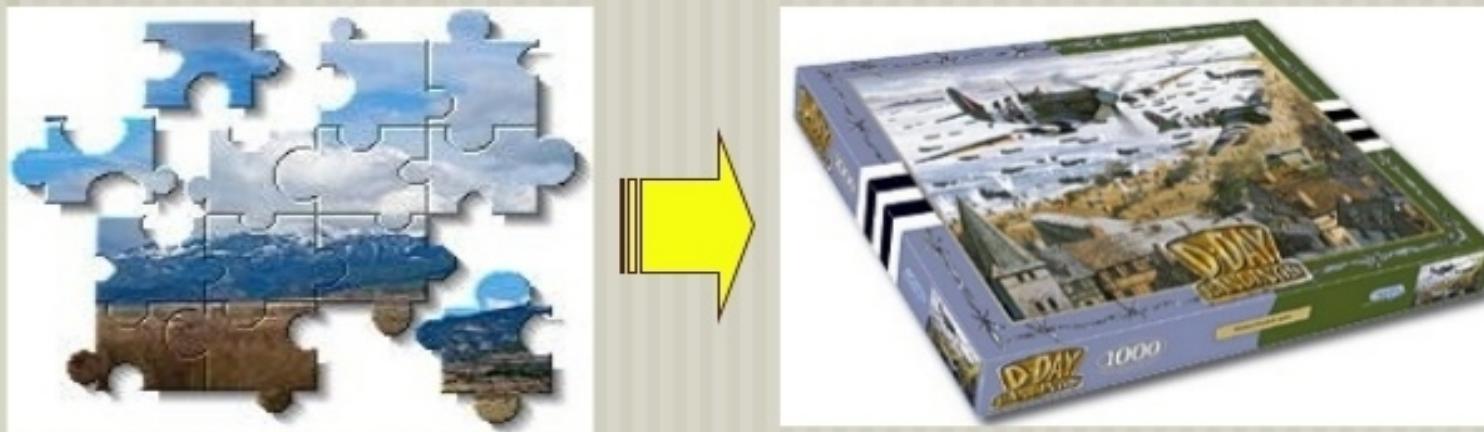
## Effectuation

## Causation

Source: Sarasvathy.S, (2001), "Causation and Effectuation: Towards a theoretical shift from economic inevitability to entrepreneurial contingency", Academy of Management Review, 26 (2), 243-263, 2001.

# Causation | Pictorially

“Causal Planning” is like building a Jig-Saw Puzzle...



The picture you will end up with is known (it is on the box),  
There is ONLY ONE SOLUTION !  
The pieces are all available (inside the box),  
What you do is: make them fit together...

Ziya G. Boyacigiller (c) 2008

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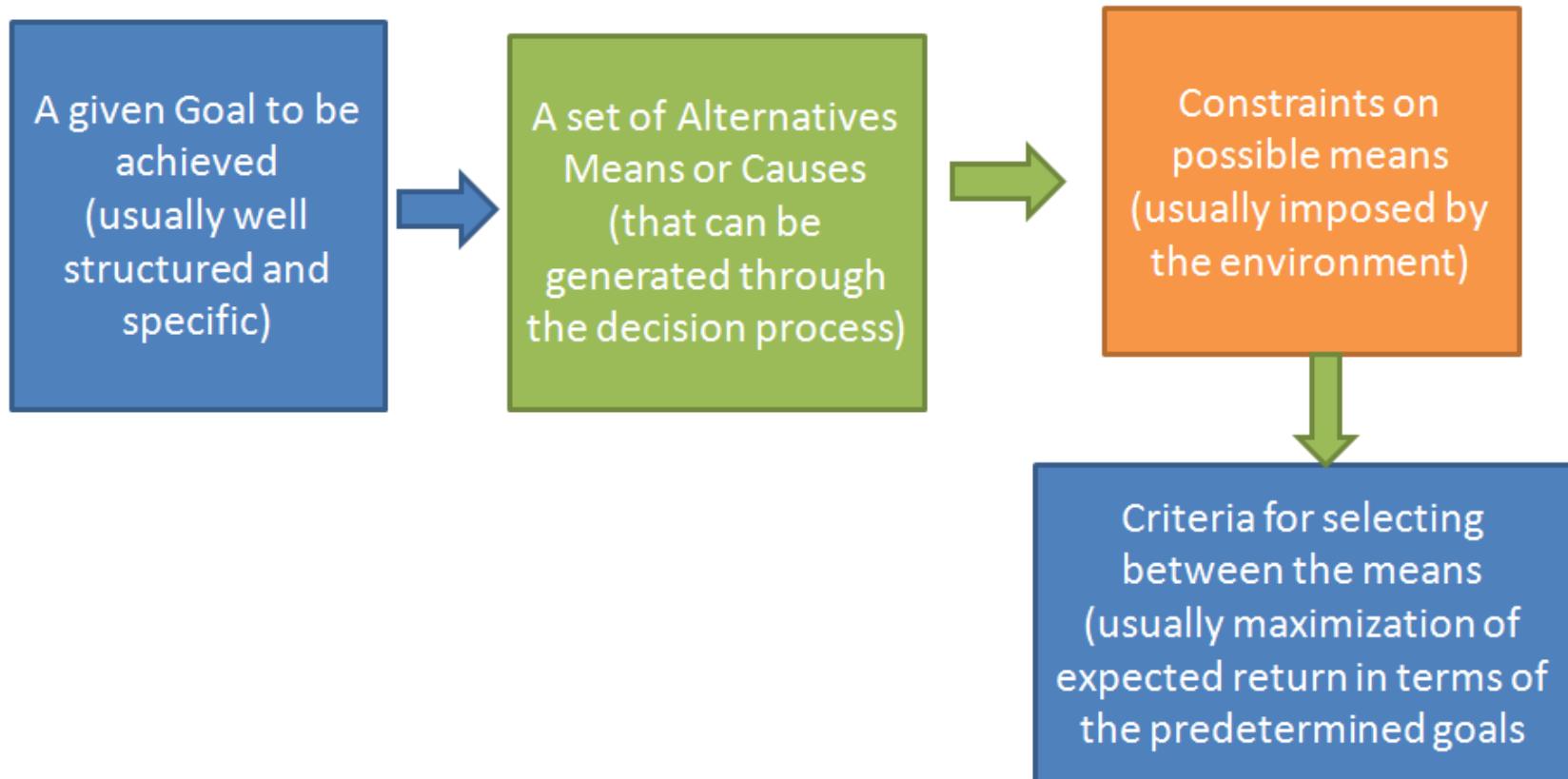
# Causation Processes....

....take a particular effect as given and focus on selecting between means to create that effect.

Causation models consist of many-to-one mappings.

Focus on *analysis and prediction*

# Decision process structure involved in Causation process



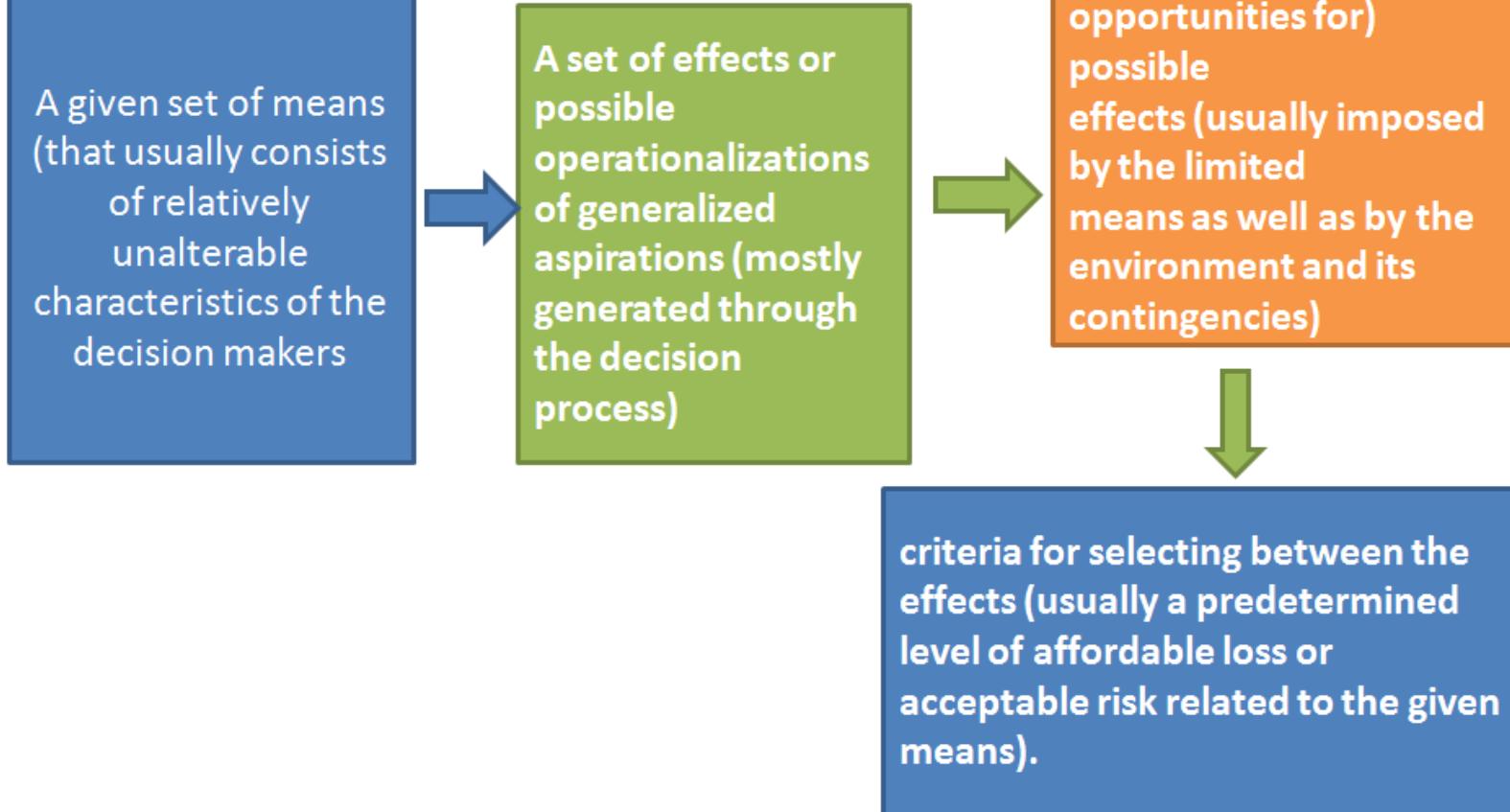
# Effectuation processes.....

....take a set of means as given and focus on selecting between possible effects that can be created with that set of means.

Effectuation models involve one-to-many mappings.

Focus on *synthesis and action*.

# Decision process structure involved in Effectuation process



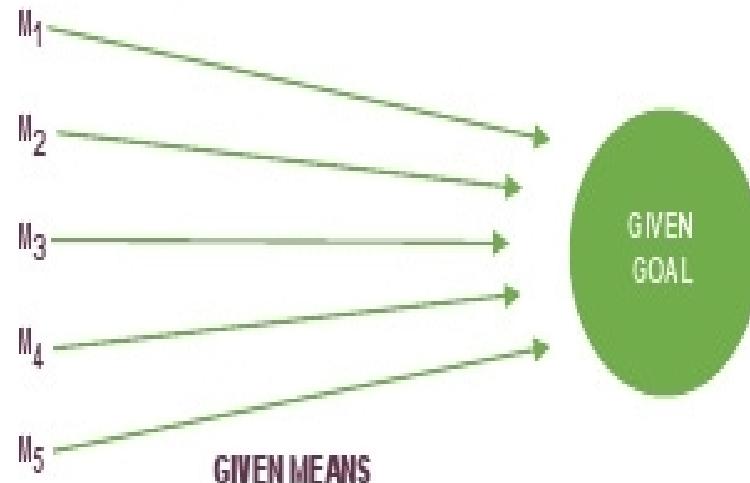
# Causal versus Effectual Reasoning

## CAUSAL vs. EFFECTUAL REASONING

### Managerial Thinking (Causal)

#### Distinguishing Characteristic

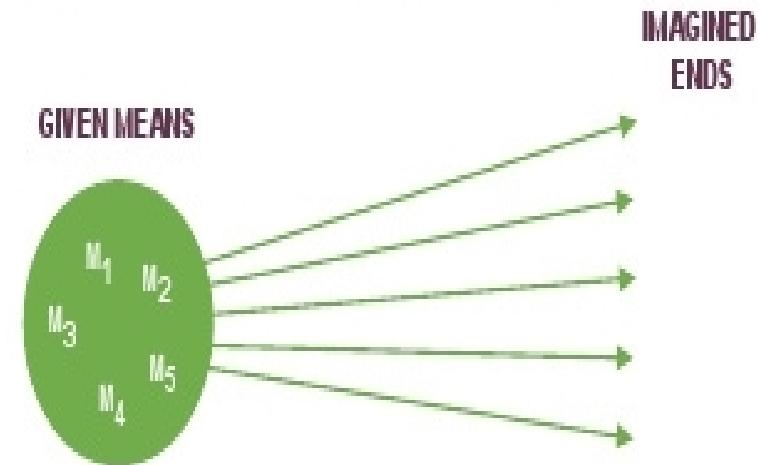
Selecting between given means to achieve a pre-determined goal



### Entrepreneurial Thinking (Effectual)

#### Distinguishing Characteristic

Imagining a possible new end using a given set of means



Source: ([www.futurelearn.com](http://www.futurelearn.com))

# Causation Vs Effectuations

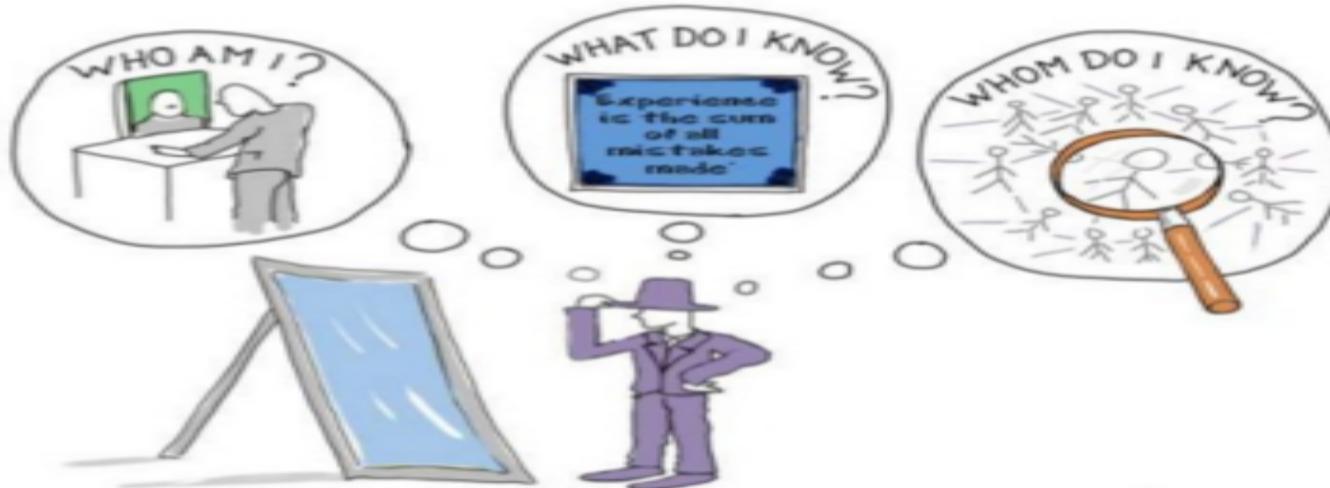
Means	Causation	Effectuations
		
		
		

# Principles of Effectuation as compared to those of Causation

# 1. The Bird in hand

Start with your means

- Don't wait for the perfect opportunity.
- *Start taking action, based on what you have readily available:*



## 2) Affordable loss, rather than expected returns;

Affordable loss: Effectuation argues that investing what you are willing to or can lose is the right mindset. Invest no more resources than stakeholders can afford to lose. Example *Reliance Power*



Expected returns: Causal entrepreneurs pursue new opportunities based on expected value (Dew et al. 2009, p. 3). The focus is on upside potential. Example *Expansion of Google in smart car*



### 3. Lemonade Principle



*Embrace surprises that arise from uncertain situations, remaining flexible rather than tethered to existing goals.*

Exploitation of contingencies, rather than exploitation of pre-existing knowledge

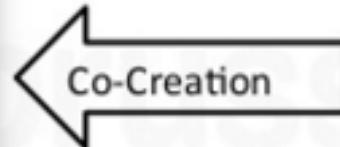
# 4. Crazy-Quilt Principle

Form partnerships/ Social Networking

- *Make partnerships with people and organizations willing to make a real commitment to jointly creating the future--product, firm, market--with you.*



Crazy quilt, not puzzle.



# Strategic alliances, rather than competitive analyses;

Use of alliances: A network of relations and partnerships are discussed and realized.

Competitive analysis:  
Relationships are driven by competitive analysis and possessions are protected.

# 5: Pilot in the Plane Principle



- Focus on activities within control
- The future is neither found nor predicted but rather made

Aligning with Unpredictable future, rather than prediction of an uncertain one.

Unpredictable future:

Effectual entrepreneurs focus on the extent to which people can control the future.

Prediction of future: Causal entrepreneurs frame the future as a continuation of the past. The future can be controlled by previously obtained knowledge.

# Role of Effectuation Processes in Businesses | Propositions

- **Proposition 1:** Very early stage firms created through processes of effectuation, if they fail, **will fail early and/or at lower levels of investment** than those created through processes of causation.
- Effectuation processes **allow experiment with more numbers of new ideas at lower costs.**

Source: Sarasvathy, S. D.(2001)

# Role of Effectuation Processes in Businesses | Propositions

**Proposition 2:** Successful early entrants in a new industry are more likely to have used effectuation processes than causation processes. With later entrants, the trend could be reversed.

- Source: Sarasvathy, S. D.(2001)

# Role of Effectuation Processes in Businesses | Propositions

**Proposition 3:** Successful firms, in their early stages, are more likely to have focused on **forming alliances and partnerships** than on other types of **competitive strategies**, such as **sophisticated market research and competitive analyses, long-term planning & forecasting, and formal management practices in recruitment and training of employees.**

Source: Sarasvathy, S. D.(2001)

# Role of Effectuation Processes in Businesses | Conjectures

**Conjecture 1:** In marketing decisions, in contrast to traditional decision makers, effectuators are less likely to use traditional types of market research, such as carefully designed surveys and test marketing; instead, they are likely to dive straight into seat-of-the-pants marketing/selling activities and alliances.

- Source: Sarasvathy, S. D.(2001)

# Role of Effectuation Processes in Businesses | Conjectures

**Conjecture 2:** In financial decisions, in contrast to traditional decision makers, effectuators are **less likely to use long-term planning or net present value (NPV) analyses**; instead, they are likely to be **focused on the short term** and, at most, to use **informal versions** of real options.

Source: Sarasvathy, S. D.(2001)

# Role of Effectuation Processes in Businesses | Conjectures

**Conjecture 3:** In organizational decisions, in contrast to traditional decision makers, effectuators are more likely to build strong **participatory cultures**, rather than **hierarchical, procedures-based ones**.

In fact, in contrast to traditional decision makers, effectuators are likely to be **less effective in running large organizations with well-oiled procedures**.

Source: Sarasvathy, S. D.(2001)

# Role of Effectuation Processes in Businesses | Conjectures

**Conjecture 4:** Effectuators are more likely to fail more often but are also more likely to **manage the failures more effectively** and to create larger, more successful firms in the long run (although they may need to hire professional COOs to actually run them!).

Source: Sarasvathy, S. D.(2001)

# Thus, an Effectuator is....

... an imaginative actor who seizes contingent opportunities and exploits any and all means at hand to fulfill a plurality of current & future aspirations, many of which are shaped and created through the very process of economic decision-making, and are not given *a priori*.

Source: Sarasvathy, S. D.(2001)

# References

- Sarasvathy, S. D., (2001), “Causation And Effectuation: Toward A Theoretical Shift From Economic Inevitability To Entrepreneurial Contingency”, *Academy of Management Review*, Vol. 26 (2), 243-263.
- [https://www.youtube.com/watch?v=oC-yWrCOP\\_E](https://www.youtube.com/watch?v=oC-yWrCOP_E)
- <https://www.youtube.com/watch?v=TIXVe4nEDEE>



Thank You

# Supplementary Material

# Simple Example | Cooking Dinner

Imagine that a chef is assigned the task of cooking dinner. There are two ways the task can be organized.

1. The host or the client picks out a **menu in advance**. All the chef needs to do is list the ingredients needed, shop for them, and then actually cook the meal.

**This is a process of causation.**

It begins with a given menu and focuses on selecting between effective ways to prepare the meal.

# Simple Example | Cooking Dinner

2. The host asks the chef to look through the cupboards in the kitchen for **available ingredients and utensils** and then cook a meal.

Here, the chef has to imagine possible menus based on the given ingredients and utensils, select the menu, and then prepare the meal.

This is a process of effectuation.

It begins with given ingredients and utensils and focuses on preparing one of many possible desirable meals with them.

# More Examples

- A carpenter who is asked to build a desk, versus one who is given a toolbox and some wood and asked to build whatever he or she chooses
- An artist who is asked to paint a portrait of a particular person, versus one who is given a blank canvas and some paints and required to paint anything he or she chooses.

# Causation versus Effectuation

Causation	Effectuation
<u>Prediction of the future</u>  Causal entrepreneurs frame the future as a continuation of the past. The future can be controlled by previously obtained knowledge.	<u>Creation of the future</u>  Effectual entrepreneurs focus on the extent to which people can control the future.
<u>Goal-driven action</u>  Causal entrepreneurs are goal-oriented, these goals determine the actions. The focus is on limiting downside potential.	<u>Means based action</u>  Effectual entrepreneurs start with the means. Goals emerge by imagining courses of action based on given means (Read, Dew et al. 2009, p. 3)
<u>Expected returns</u>  Causal entrepreneurs pursue new opportunities based on expected value (Read, Dew et al. 2009, p. 3). The focus is on upside potential.	<u>Affordable loss</u>  Effectuation argues that investing what you are willing to or can lose is the right mindset. Invest no more resources than stakeholders can afford to lose.
<u>Competitive analysis</u>  There should be a competitive attitude toward outsiders. Relationships are driven by competitive analysis and possessions should be protected.	<u>Use of alliances</u>  A network of relations and partnerships should be discussed and realized.

# Causation versus Effectuation (Continued)

<u>Avoid contingencies</u>	<u>Embrace contingencies</u>
Causal entrepreneurs do not prefer surprises. Careful planning and focus can minimize the impact of the contingencies.	Effectual entrepreneurs leverage contingencies, and see them as challenges. Contingencies should not be avoided.
Causation processes are effect dependent.	Effectuation processes are actor dependent.
Causation processes are excellent at exploiting knowledge.	Effectuation processes are excellent at exploiting contingencies.
Causation processes are better when dealing with natural phenomena	Human life abounds in contingencies that cannot easily be analyzed and predicted but can only be seized and exploited, and, therefore, effectuation processes are far more frequent and very much more useful in understanding and dealing with spheres of human action.

# Case Studies

## (To be discussed in lab. Session)

### 1. Curry in a hurry

Regarding setting up an Indian restaurant in USA.

### 2. U – Haul

Post world-war II, do-it-yourself moving equipment on a one-way nation-wide basis, in USA.

# Focus areas in effectuation

- We need to learn to deal with a rain forest of individuals and firms and markets and societies, intermeshed with completely coherent yet vastly diverse local patterns, that add up to a complex, interdependent ecology of human artifacts.
- We need to start researching "markets" as groups of individuals and communities developing a variety of gardens and parks based on their particular tastes in landscaping and architecture.
- The focus would shift from "how to build a successful firm" or "how to become a successful entrepreneur" to "What types of ideas and opportunities should you pursue?"
- We need to disconnect the success of the individual entrepreneur from the success of the firm he or she creates.

# Posits of Effectuation

- Concept of success/failure is not a 0-1 variable, that is, ‘success’ is not the logical equivalent of ‘not failing’ and vice versa.
- Plurality of ‘failed’ firms for any one or more ‘successful’ firms that actually get created by any given entrepreneur.
- Successful firms ‘manage’ failures rather than avoid them.
- A dynamic decision environment involving multiple interacting decision makers.

# CONNECTIONS WITH EXISTING THEORIES | James G. March

- Unknown future values, challenging the assumption of preexistent goals
- Exploration of new possibilities versus exploitation of old certainties
- Effectuation more suitable than causation, they are complimentary

# CONNECTIONS WITH EXISTING THEORIES | Henry Mintzberg

## Ignorance-based heuristics

- Sure things could fail disastrously
- Honda's success in capturing two-thirds of American motorcycle market belied the assumption that a market without small motorcycles would not buy them
- Polanyi – physicist – 'my ignorance of powerful, false objections protected my ideas from being nipped in the bud'
- Benetton's successful ad campaign – nothing about the product, only name (brand) recognition
- Gersick's discovery of a new model of group development adopted a mode of unconstrained curiosity and immersion in the phenomena, which led her to the element of surprise

# CONNECTIONS WITH EXISTING THEORIES | Karl E. Weick

- Living forward is a blend of thrownness, making do, journeys stitched together by faith, presumptions, expectations, alertness, and actions, as contrasted with living as settled and causally connected.
- In the theory of enactment, a nonlinear process that is strongly evocative of the ‘living forward’ model of effectuation is assumed.
- Actors in organizations are involved more in making retrospective sense of their actions than in acting based on predetermined goals and causal rationality.

# Integration of Theories of March, Mintzberg and Weick

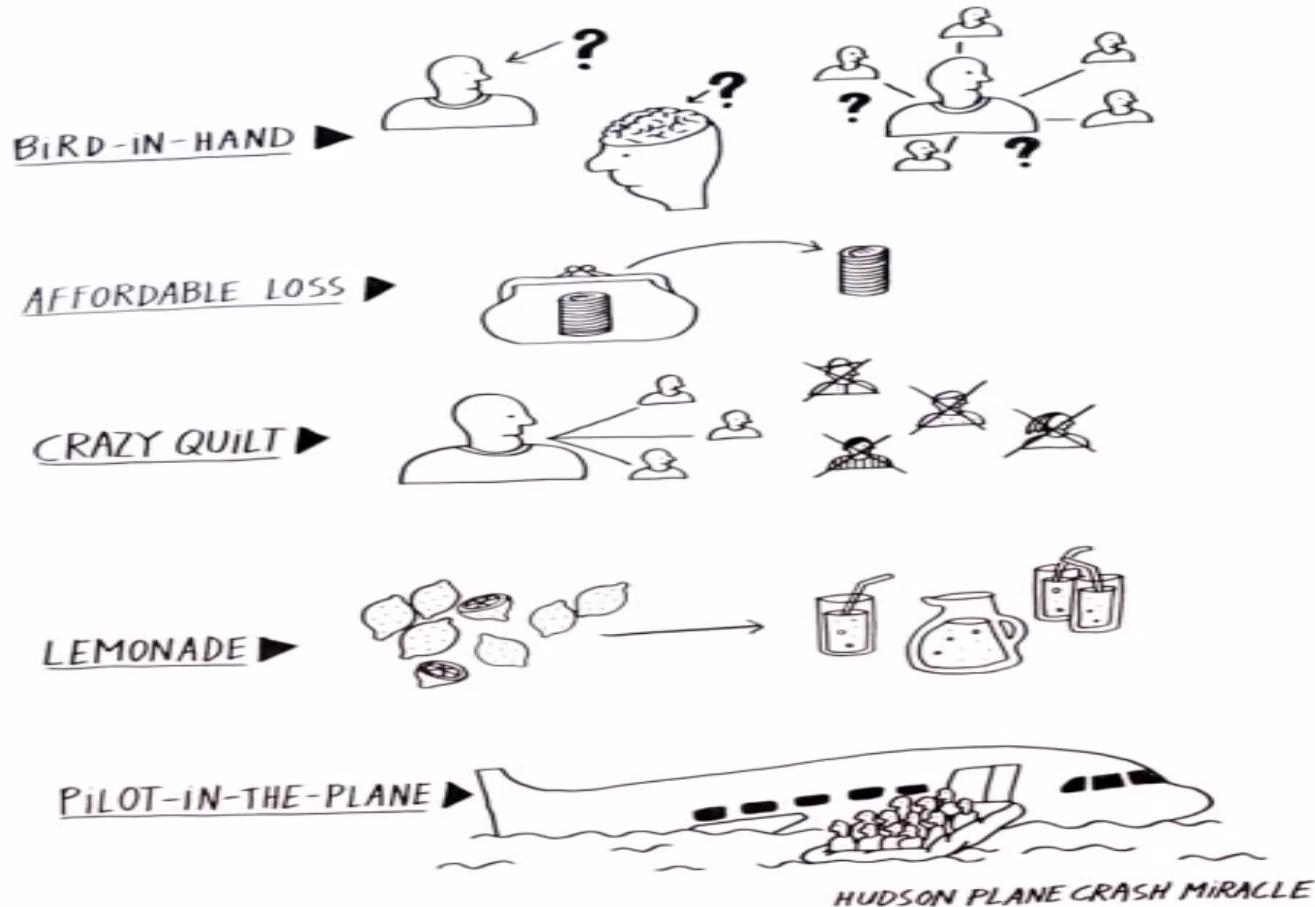
Model of effectual reasoning explicitly addresses :

- (1) a logic of control (rather than prediction),
- (2) endogenous goal creation, and,
- (3) a (partially) constructed environment

# Connections to some recent empirical findings

- Comparison of traits of successful and failed entrepreneurs did not give sure results.
- Formal strategic planning and lack of it seems to have worked.
- It seems that we need to give up the idea of successful personality or clearly superior characteristics of the successful firm or organization.
- Both the optimist and the pessimist contribute to successful inventions. The optimist invents the airplane; the pessimist, the parachute.

# Five Principles of Effectuation



Source: <https://www.youtube.com/watch?v=TIXVe4nEDEE>

# Five Principles of Effectuation

Continue...



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- Bird in the hand principle
  - Who I am
  - What I know
  - Whom I know
  - Start with your means; don't wait for the perfect opportunity



*Entrepreneurs start with what they have. They will look at who they are, what they know and who they know. Their education, tastes and experience are examples of factors which are important in this stage. Besides these examples, this is also the stage where entrepreneurs look at their 3Fs, better known as friends, family and fools. From this point, they will look at their abilities. So an entrepreneur does not start with a given goal, but with the tools he or she has.*

Source: <https://www.youtube.com/watch?v=TIXVe4nEDEE>

# Five Principles of Effectuation

Continue...

## Affordable loss principle

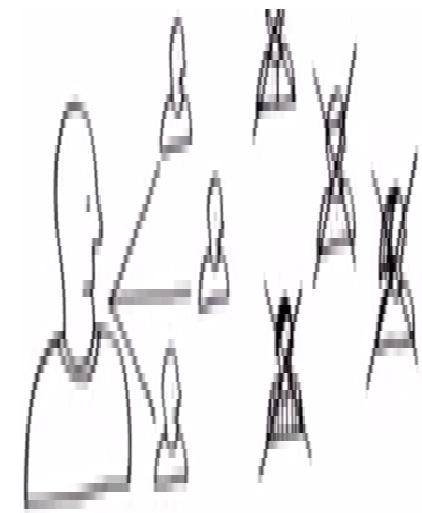
- Set affordable loss
- What is my threshold?
- Evaluate opportunities based on whether the downside is acceptable
- *An entrepreneur does not focus on possible profits, but on the possible losses and how they can minimize those losses.*
- Source: <https://www.youtube.com/watch?v=TIXVe4nEDEE>



# Five Principles of Effectuation

Continue...

- Crazy quilt principle
  - Build partnerships with people, industries and
  - How do I go about lack of strategic planning, uncertainties, and problems?
- *Entrepreneurs cooperate with parties they can trust. These parties can limit the affordable loss by giving pre-commitment.*

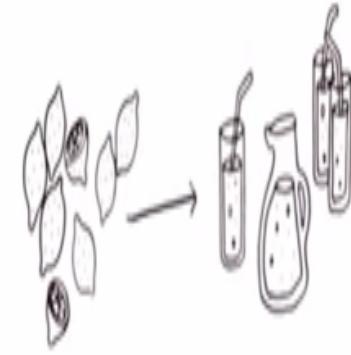


Source: <https://www.youtube.com/watch?v=TIXVe4nEDEE>

# Five Principles of Effectuation

Continue...

- Lemonade principle
  - Embrace surprises that come from uncertainties
  - Be flexible
  - Don't be tied down to your goals – ADJUST
  - Have a back up plan
- *Entrepreneurs will look at how to leave contingencies. Surprises are not necessarily as something bad, but as opportunities to find new markets.*



Source: <https://www.youtube.com/watch?v=TIXVe4nEDEE>

# Five Principles of Effectuation

Continue...

- Pilot in the plane principle
  - Focus on activities within your control
  - Control vs. predict
  - Believes that the future is neither found nor predicted
  - The future is made
- *In this stage, all the previous principles are put together. The future cannot be predicted, but entrepreneurs can control some of the factors which determine the future.*
- Source: <https://www.youtube.com/watch?v=TIXVe4nEDEE>

