



Mixing Business and Pleasure – Lessons for Optimizing Entrepreneurial Team Success

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Successfully navigating through critical uncertainties during the incipient stages requires new ventures to develop learning systems. Clearly, building the right team is a key in this process. In a new study, together with Gilad Chen, Brent Goldfarb, Miriam Erez and Rajshree Agarwal, we draw on prior research to suggest that a dual formation strategy in building the team may be critical.

An Opportunity to Improve New Venture Success

We draw on prior research to suggest that a dual formation strategy in building the team may be critical. This suggests a combination of two underlying strategies: First, an interpersonal-attraction strategy, meaning relationships with similar others in a close network; and second, a resource-seeking strategy, meaning instrumental focus on complementary skills.

While a dual formation strategy may be challenging to execute, such a strategy facilitates smooth coordination among founders specializing in complementary tasks, or so-called transactive memory systems. Transactive memory systems refer specifically to a shared system for encoding, storing, and retrieving information, which includes the knowledge of 'who knows and does what on the team' (Ren & Argote, 2011; Wegner, 1987). We posit that the emergence of such systems to navigate uncertainties experienced by new ventures is a key reason why teams using dual formation strategies from the onset achieve superior performance.

Findings from two field observational studies and a field intervention study ➔

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[Success]...depends on three things: the general qualities of the founders, their specific expertise in this domain, and the relationship between them

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support our theory. As described fully in our upcoming paper, teams formed based on a dual strategy raised greater seed funding on Kickstarter, were more successful in a prestigious entrepreneurial competition including by more effectively accessing mentorship, and gained more profits from selling their initial products.

We further incorporate insights from team-learning theory into entrepreneurial team formation research to posit that the initial formation strategy shapes team learning repertoires, and that these, in turn, impact early entrepreneurial success.

The Importance of Forming New Venture Teams for Success

Scholars increasingly acknowledge the importance of the initial phase of team formation, in which founders select partners and build their teams (Lazar et al., 2020). This decision is

particularly important because the founding team is the unit of individuals who pursue the new business idea, are involved in its subsequent management, and share ownership over the business from its initial to later stages (Bird, 1989). The initial partners define their roles in the new venture and establish communication systems that determine subsequent ability to learn, adapt, and navigate within a dynamic entrepreneurial environment (Cohen, 2013).

In this highly uncertain phase, new venture teams invest significant efforts in achieving initial milestones – each critical for their early success and survival – such as raising initial funds (Jiang, Yin, & Liu, 2019), winning entrepreneurial competitions and entering prestigious accelerator programs (Cohen & Hochberg, 2014), and cumulating initial profits from sales of their product (Camuffo et al., 2020; Shah et al., 2019). These milestones are not only critical for providing new ventures access to

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scarce resources during their nascent stage – they also serve as signals of legitimacy to facilitate scaling up for growth (Cohen et al., 2019).

To achieve these milestones, recent literature review notes that most studies identified one formation strategy or the other – interpersonal-attraction or resource-seeking – implicitly assuming that founders utilize a singular strategy without articulating reasons why (Lazar et al., 2020). We build on resource scarcity and bounded rationality to develop the theoretical rationale for why founders may engage in a singular strategy. We begin by noting that team formation faces challenges including the fact that it occurs within a highly uncertain setting that is fraught with resource scarcity even as resource needs and stakes are high (Wasserman, 2012).

Pursuing the dual formation strategy exacerbates the challenges because of inherent differences in network search and use of criteria in each component strategy. First, potential cofounders who embody strong pre-existing relationships and also possess requisite complementary resources may be rare, particularly if searching in a homogenous and/or limited network. Hence, a dual strategy is not necessarily feasible for all entrepreneurs if individuals with the best complementary skills are not present in their close network or they do not have access to such potential cofounders.

Second, founders may search for partners in both their immediate and distributed networks simultaneously; yet, when resources are limited, allocating resources toward achieving one strategy reduces available resources for pursuing the other strategy (Kanfer & Ackerman, 1989). Aspiring founders may simply not have the needed cognitive attention, time, and funding to search for and identify cofounders with attention to both interpersonal attraction and resource seeking. In these situations, inherent differences in goals and criteria involved in pursuing both strategies create competing demands.

Despite the above challenges, the use of dual formation strategies may be advantageous because it is more likely to ensure both interpersonal and complementary fit among founding members from the onset (Lazar et al., 2020). For example, Shah et al. (2019) documented potential benefits for employee spinouts (new ventures where founding teams draw from the established firms in the same industry) in the disk drive industry whose cofounders aligned on both workplace values and knowledge complementarities.

By contrast, compromise solutions – e.g., when new ventures switch strategies and eventually optimize their team composition – is a risky path that may impair success. Starting with one strategy alone may lead to group faultlines and deficiencies (Vohora et al., 2004). For example, when founding teams were initially formed using an interpersonal attraction strategy, they failed when experiencing crisis during critical milestones (Clarysse & Moray, 2004; Vohora et al., 2004).

Switching strategies additionally entails costs associated with redefining structural features (e.g., roles), work practices and processes, and socialization of new members into the shared system (Weber & Camerer, 2003), all of which have been documented to undermine performance within the teams literature (Rao & Argote, 2005). Thus, cofounder selection based on both demands is rare, difficult, and costly to achieve, and yet it is likely to be advantageous relative to relying solely on interpersonal attraction or complementary skills.

If instead founders consider both the instrumental and relational aspects when forming their team, the team will have a significant advantage from the onset. Related research outside of entrepreneurial contexts supports this premise. For example, scientific teams where members had prior collaborative relationships were better able to harness the benefits of their intellectual diversity, leading to higher acceptance rates of grant ☺

applications (Snellman, Dahlander, Askin, & Solal, 2020). This resonates with findings that multiplex ties in the workplace (i.e., capturing both mutual relations and unique expertise) can benefit performance (Methot, Lepine, Podsakoff, & Christian, 2016).

More broadly, team studies suggest that engaging in seemingly opposing strategies improves performance (Gebert, Boerner, & Kearney, 2010; Miron-Spektor & Paletz, 2020). For instance, teams that developed specialized roles and shared language from the initial work together outperformed teams that advanced one of these elements alone (Reagans, Miron-Spektor, & Argote, 2016). Building on these insights in the teams literature and extending work on entrepreneurial team formation (Lazar et al., 2020), we argue that combining both strategies early on will enhance entrepreneurial success relative to relying on one strategy alone. The dual strategy provides value, is rare and difficult to imitate (if not adopted at the onset), and thus a source of early competitive advantage.

Developing Transactive Memory Systems

While the above rationale suggests that the initial formation strategy is crucial to early performance, it does not fully develop the micro-mechanisms at play. Here, entrepreneurship scholars have recognized that new ventures have to learn and adapt to meet stakeholder needs for entrepreneurial success (Ott et al., 2017; Pillai et al., 2020). However, the literature is silent on how ventures helmed by teams (rather than solo founders) create learning systems to orchestrate their performance under conditions of resource scarcity and bounded rationality. We address this by explicitly linking

the initial formation strategies to the development of team learning systems.

Within the team-learning literature, scholars have highlighted transactive memory systems as a key driver for team learning. A specific type of team mental models, transactive memory systems include both a structural component reflecting the links between individual memories which create a collective knowledge network, and transactive processes to enable encoding, storing, and retrieving of team members' memories (Wegner, Giuliano, & Hertel, 1985).

These systems enable members to recognize their different expertise, accurately search for and locate required knowledge, and solve problems efficiently by matching tasks to members with relevant expertise (Moreland & Myaskovsky, 2000). They also permit members to develop deeper expertise in their specified areas so that as a collective, the team gains a larger pool of information for performing their various tasks (Lewis, 2003).



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Existing research on transactive memory systems notes that it emerges through the initial shared experience of working together as a team. Here, scholars have documented that initial experience allows members to determine the fit of expertise and ascertain how to work as a collective unit (Reagans et al., 2016). When trained together from initial stages, teams can learn from observing each other and develop communication channels to share different perspectives and knowledge. These allow them to specialize, trust each other's expertise, and coordinate their activities effectively (Liang, Moreland, & Argote, 1995).

We therefore argue that engaging in the dual formation strategy enables founders to leverage the selection criteria of each strategy in their initial interactions to create stronger structural and process components of transactive memory systems. When both interpersonal attraction and resource seeking strategies are used from the onset, initial experiences that are critical for transactive memory systems are jointly facilitated by complementary expertise and familiarity and shared understanding. During their initial experiences as a newly created founding team, members can leverage

their knowledge of proximate close others who bring complementary expertise to quickly establish the role structure and fruitful relationships, and develop processes that facilitate trust and coordination (Lewis, 2004).

Interpersonal attraction allows team members to share unique information and resolve potential conflicts in an environment of safety and trust, while resource seeking leverages expertise of the various team members for improved accuracy of knowledge identification and development of capabilities. Thus, interpersonal attraction and resource seeking become mutually reinforcing, leading to a virtuous spiral in initial experiences for the swift creation of stronger transactive memory systems. Based on the above reasoning, we posit that forming teams based on the dual strategy facilitates the emergence of stronger transactive memory systems.

Transactive memory systems enable teams to form distinct roles and accumulate deeper and broader knowledge, but also to integrate across members and tasks more effectively. This enables teams to better match members with tasks, thus utilizing members' unique contributions more effectively (Reagans et al., 2016). Teams with stronger transactive memory systems make fewer errors and better decisions, work faster, and find more creative solutions (Ren & Argote, 2011). Taken together, we suggest that teams with stronger transactive memory systems better utilize team members' expertise and coordinate their activities. As such, stronger transactive memory systems enable founding teams to strategize through an iteration between doing and thinking (Ott et al., 2017), so they can address challenges and leverage opportunities for early entrepreneurial success. ☺

Finally, a dual formation strategy further accelerates the emergence of stronger transactive memory systems. The speed and efficiency through which stronger transactive memories are created in turn enhance success of entrepreneurial teams, given that they operate in a context fraught with uncertainty and resource scarcity. Specifically, early development of stronger transactive memory systems through use of dual strategy enables founding teams to create legitimacy and garner support from critical stakeholders to acquire initial financing, as well as position themselves favorably for entry into and performance in accelerators (Mosey & Wright, 2007). Relative to founding teams that utilize *either* interpersonal attraction *or* resource seeking that spend costly time and effort responding to crisis, those formed with a dual strategy can capitalize on their transactive memory systems to evolve rapidly through the various stages of new venture development (Vohora et al., 2004).

Practical Implications

Even though new ventures represent engines of technological disruption and economic growth, they are also more likely to fail prematurely. Accordingly, our study of how and why formation strategies impact early entrepreneurial success has important practical implications. First, our study highlights that *aspiring entrepreneurs* must pay early and close attention to team assembly, rather than assuming that the benefits of attending to this issue at a later time will outweigh its costs. In doing so, founders need to overcome the tendency to engage in either a relational or a rational search for partners, and proactively address limitations in their existing networks to identify others who match both criteria. By combining the strategies, founders can facilitate learning and performance early on.

Second, we also inform practice for *educational programs* and *entrepreneurial platforms*, such as pre-seed hackathons and accelerators.

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Here, we suggest that in addition to traditional training that focuses on business models and customer discovery, programs should educate new venture teams about the process of partner selection, and integrate it with existing relevant endeavors, such as cofounder pair-up events. Such programs should also facilitate the development of learning processes.

Lastly, we offer insights to *investors* who wish to identify promising new ventures. Above and beyond the attention aimed at recognizing high-potential ideas, investors should carefully consider the way teams form, and prioritize those wherein members have both close relations and diverse knowledge, because these teams have the highest potential to learn and succeed as they encounter early milestones.

Theoretical Implications

Our research makes several meaningful contributions to the literature. First, we extend a recent framework proposed by Lazar et al. (2020) by developing and testing new theory on the challenges of new venture teams pursuing the dual vs. singular strategy, and the benefits of doing so for team learning. We suggest that although initially combining both formation strategies may be difficult to execute, the benefits of doing so are significant, as they allow for the emergence of team learning systems that foster early success. Importantly, by linking early formation strategies and venture performance, we answer a call for research (Agarwal, 2019) to address the limitations of prior work that primarily examined entrepreneurial team formation retrospectively, and thus may be subject to a significant selection and survivor bias.

Second, while extensive work has focused on strategic and resource-related factors influencing new venture performance (Camuffo et al., 2020; Pillai et al., 2020), budding research stresses the role of startup team dynamics and their effect on entrepreneurial success (Knight et al., 2020).



Here, we embrace the integration of micro and macro lenses to provide a novel explanation: we suggest that selecting cofounders using the dual strategy facilitates the emergence of transactive memory systems early on in the team's lifespan, which are crucial for early entrepreneurial success.

Lastly, we contribute to the broader research on the developmental process of new venture teams (Vohora, Wright, & Lockett, 2004). We establish that the benefits of the dual strategy to the emergence of transactive memory systems generate a competitive advantage in terms of critical milestones associated with early entrepreneurial success vis-a-vis other teams who use a singular strategy. We also show that transactive memory systems contribute to entrepreneurial success above and beyond affective and structural alternative mechanisms (i.e., entrepreneurial passion and power structure). Relatedly, our investigation suggests that although teams may switch from one formation strategy to another over time, the initial use of dual strategies matters for transactive memory systems and performance.

Conclusion

New ventures operate like an 'orchestra. They require an integrative system of specialized knowledge, skills, and capabilities coordinated and synthesized across multiple cofounders. While forming teams using the dual strategy was very rare, doing so had a significant impact on early venture success. In Kickstarter, only 17% of teams used the dual strategy, but these teams more than doubled their seed-funding. In the entrepreneurial competition, only 10% of teams were formed using the dual strategy, but these teams doubled their chance to enter the competition and had a four-times greater chance to survive the competition throughout elimination rounds.

Earlier research provides rather limited insights on how using single versus dual formation strategies may accelerate or impede the team's initial ability to develop learning systems for superior performance. Building on our understanding, we find that forming teams with attention to both interpersonal attraction and resource-seeking facilitated the development of transactive memory systems within the team, which enables continuous entrepreneurial success. Extending prior research, we illuminate the importance of the initial member-selection process to subsequent team learning and entrepreneurial performance. ■



About

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