
Entrepreneurial decision-makers and the use of biases and heuristics

Objectives

- Examine negative biases that can emerge in entrepreneurs and in entrepreneurial teams
 - Best practices for managing the representativeness & overconfidence
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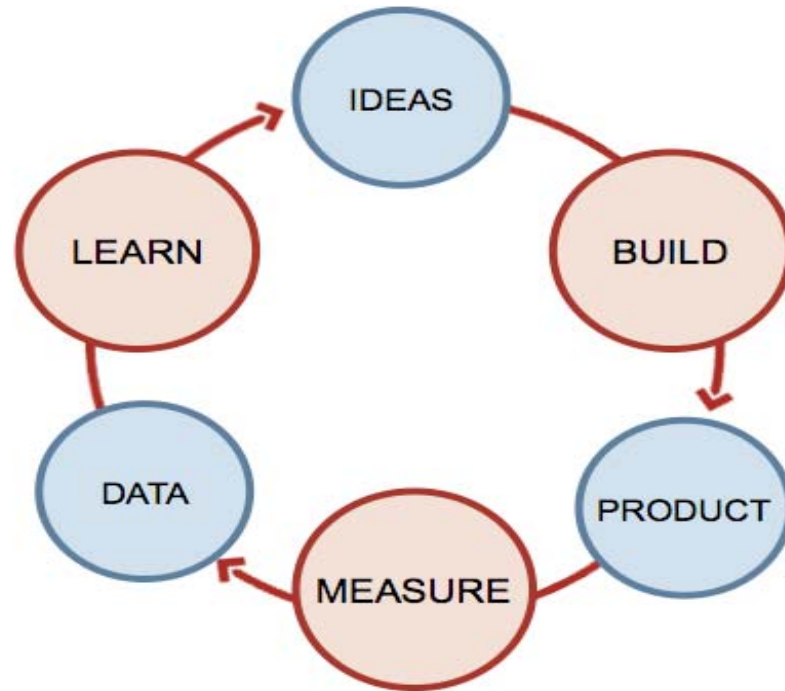
Entrepreneurs are more likely to use biases and heuristics

- Why do entrepreneurs more so than company managers use:
 - personal judgment,
 - cognitive mechanisms, and
 - subjective opinions?
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Benefits of using biases and heuristics?

- Working with incomplete data
 - Need to make faster and cheaper decisions
 - Less time spent = fewer opportunities missed
 - Less money spent = need to efficiently manage limited financial resources
 - Need to take decisive action
 - Capitalized on near-term opportunities
 - Lessen likelihood of missing opportunities
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Minimize the total time through the loop



Example: Software Development

THE LEAN STARTUP

Created by Eric Ries - startuplessonslearned.blogspot.com

Designed by  **KISSmetrics**

Learn Faster

LEARN

- Split Tests
- Customer Interviews
- Customer Development
- Five Whys Root Cause Analysis
- Customer Advisory Board
- Falsifiable Hypotheses
- Product Owner Accountability
- Custom Archetypes
- Cross-functional Teams
- Smoke Tests

IDEAS

BUILD

Code Faster

- Unit Tests
- Usability Tests
- Continuous Integration
- Incremental Deployment
- Free & Open-Source Components
- Cloud Computing
- Cluster Immune System
- Just-in-time Scalability
- Refactoring
- Developer Sandbox

DATA

CODE

Measure Faster

MEASURE

- Split Tests
- Clear Product Owner
- Continuous Deployment
- Usability Tests
- Real-time Monitoring
- Custom Liaison

- Funnel Analysis
- Cohort Analysis
- Net Promoter Score
- Search Engine Marketing
- Real-Time Alerting
- Predictive Monitoring

Dangers of using biases and heuristics?

- Hasty decisions
 - Incomplete analysis
 - Squander resources
 - New biases
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Negative biases that can emerge in entrepreneurs and in entrepreneurial teams

- Representativeness
 - Decision-making short cut by generalizing about a person or an event based on only a few attributes of that person or only a few observations of similar events
 - Overconfidence
 - Decision-making bias of over optimism in an initial solution and slowness to incorporate additional information about a situation into the solution because of initial confidence
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Why are entrepreneurs subject to “representativeness” heuristic?

- Not enough resources (time, money, knowledge, etc.) to systematically collect data
 - Not enough resources to analyze data
 - Fear is missing opportunities
 - Sense of urgency to make a decision
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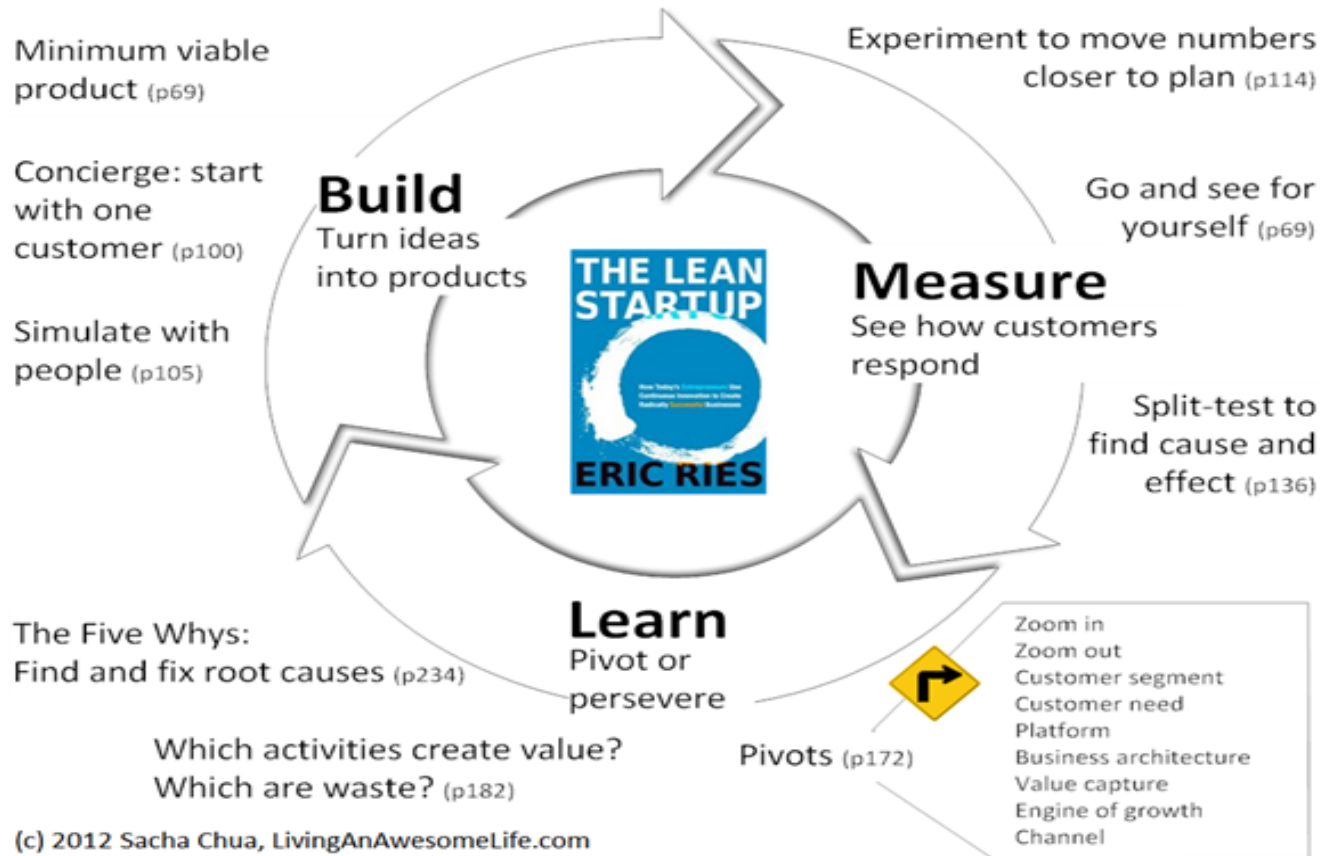
Why are entrepreneurs subject to “overconfidence” bias?

- Passion and belief that the *favored* outcome is the *likely* outcome
 - Overestimation of one’s own knowledge may be necessary to pursue innovative, uncertain opportunities
 - If the entrepreneur is not confident, the team, investors, etc. will not be confident
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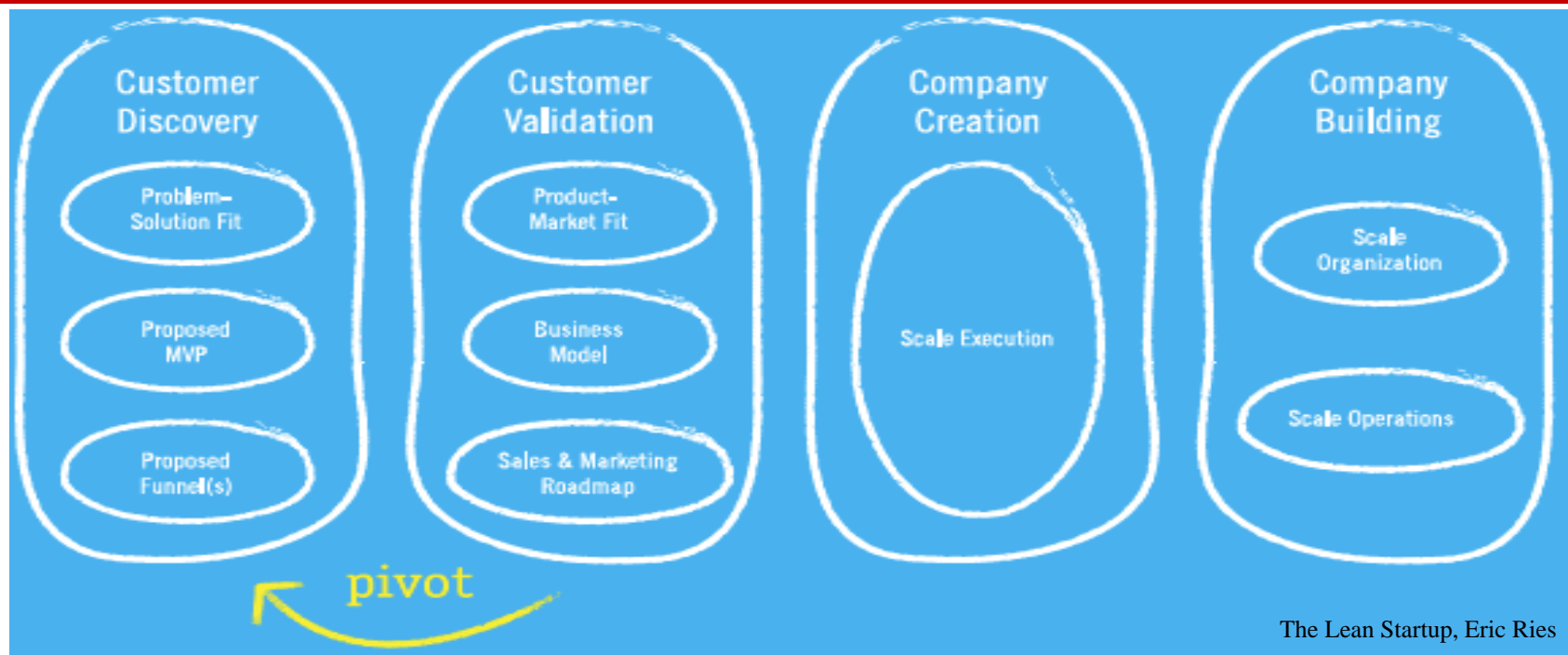
Best practices for managing the representativeness & overconfidence

- Actively search for information
 - Define assumptions
 - Consider alternatives
 - Estimate the consequences
 - Work as a team
 - Ask for advice
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Accelerate this feedback loop!



Customer discovery and validation is central to the decision to launch the firm.



Summary

- Negative biases can emerge in entrepreneurs and in entrepreneurial teams
 - Use best practices for managing representativeness overconfidence
 - Customer discovery and validation is central to the decision to launch the firm
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