

# What is effectuation?

Entrepreneurs constantly **make decisions** and **take action**.

How do they do that?

Are there any universal methods or principles they use?

## \*RESEARCH EXPERIMENT

### SUBJECTS

27 Expert Entrepreneurs  
{founders of companies from \$200M to \$6.5B}

### METHOD

Protocol Analysis  
{80 hours of tape, 500 pages of data}

### THEORY

*Effectuation: Elements of Entrepreneurial Expertise*, 2005

To answer these questions, Dr. Saras Sarasvathy, a cognitive scientist, conducted a study\* of expert entrepreneurs.

## The result? **Effectuation**

### DEFINITION

A logic of thinking that uniquely serves entrepreneurs in starting businesses

Provides a way to control a future that is inherently unpredictable

develop specialized mental framework



THE EXPERT ENTREPRENEUR

### WHAT DOES EFFECTUATION DO?



**Ideas** - Effectuation advances ideas toward sellable products and services with proven customers.



**Stakeholder Commitments** - Using effectuation, the entrepreneur interacts in search of self-selecting partners to co-create the venture with.



**Decisions** - Experts entrepreneurs use a set of techniques that serve as the foundation for making decisions about what to do next.



EFFECTUAL LOGIC IS LIKE 1ST & 2ND GEAR



You need them to start your business but eventually you shift away from effectual logic.

## effectuation IS

A thinking framework  
a set of heuristics  
doing the do-able  
how to get the sellable products and services established

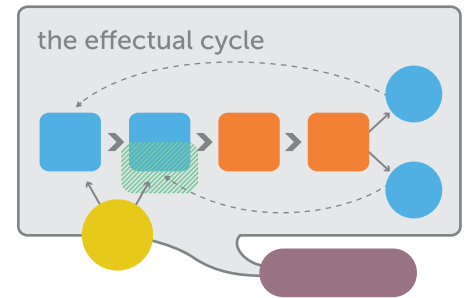


## effectuation IS NOT

a system to tell you what to do  
an algorithm  
"not planning"  
a way to launch an entire business

# Principles of Effectuation

Expert entrepreneurs have learned the hard way that the most interesting ventures are built in a space in which the future is not only unknown, but unknowable. Still yet, entrepreneurs do shape this unpredictable future. They use techniques which minimize the use of prediction and allows them to shape the future. These five principles, listed below, make up effectual logic.



## Bird-in-hand {START WITH YOUR MEANS}

When expert entrepreneurs set out to build a new venture, they start with their means: who I am, what I know, and whom I know. Then, the entrepreneurs imagine possibilities that originate from their means.

*contrasts with...*

Pre-set goals or opportunities

Causal reasoning works inversely by assembling means after a goal is set.



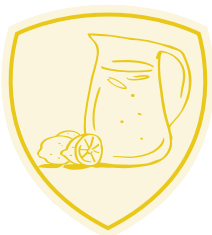
## Affordable Loss {FOCUS ON THE DOWNSIDE RISK}

Expert entrepreneurs limit risk by understanding what they can afford to lose at each step, instead of seeking large all-or-nothing opportunities. They choose goals and actions where there is upside even if the downside ends up happening.

*contrasts with...*

Expected return

Causal reasoning first targets a return, then works to minimize associated risk.



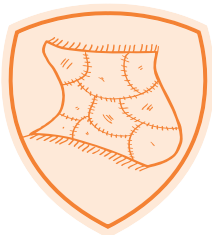
## Lemonade {LEVERAGE CONTINGENCIES}

Expert entrepreneurs invite the surprise factor. Instead of making "what-if" scenarios to deal with worst-case scenarios, experts interpret "bad" news and surprises as potential clues to create new markets.

*contrasts with...*

Avoiding surprises

Causal reasoning works to minimize the probability of unexpected outcomes.



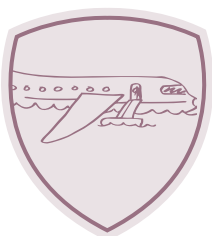
## Patchwork Quilt {FORM PARTNERSHIPS}

Expert entrepreneurs build partnerships with self-selecting stakeholders. By obtaining pre-commitments from these key partners early on in the venture, experts reduce uncertainty and co-create the new market with its interested participants.

*contrasts with...*

Competitive analysis

Causal reasoning presumes that competitors are rivals to contend with.



## Pilot-in-the-plane {CONTROL V. PREDICT}

By focusing on activities within their control, expert entrepreneurs know their actions will result in the desired outcomes. An effectual worldview is rooted in the belief that the future is neither found nor predicted, but rather made.

*contrasts with...*

Inevitable trends

Causal reasoning accepts that established market forces will cause the future unfold.

# The Effectual Cycle

## Overview of Effectuation in Action

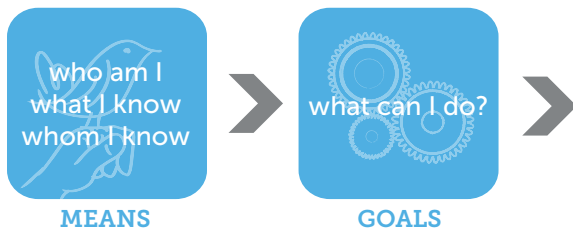
Effectual logic happens in mind of an individual, where it provides a way of thinking about making decisions when non-predictive control is required. The effectual cycle represents the thinking process in a form used in creating products, markets, and ventures. It's not a prescriptive "do this, do that" algorithm, but rather a set of heuristics\* that uniquely and universally apply to the challenges that entrepreneurs are bound to face.

### \*HEURISTIC VS. ALGORITHM

An **ALGORITHM** is a step-by-step procedure with a finite number of steps that seeks a specific outcome. It's recursive.

A **HEURISTIC** is a problem-solving technique that involves creating a speculative formulation and self-led investigation to reach some desired outcome. The most quintessential heuristic is "trial and error."

## The cycle always starts here



The individual begins with an inventory of his/her means, from which s/he imagines goals. The goals s/he chooses to pursue are within his/her affordable loss. Goal construction and goal achievement are different sides to the same coin.

## Next, interact with people to gather stakeholder commitments



Next, interactions drive the process of enlisting others to join in co-creating the new venture. Committed stakeholders will influence the entrepreneur by morphing and appending the original idea into one that a whole network of stakeholders are committed to.

## Putting it all together...

The cycle continues as the effectual entrepreneur grows closer and closer to a defined, sellable product(s), complete with committed customers and stakeholders comprising the new market.

