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Strategic Sorting and Disequilibrium in Venture Capital Markets: A Qualitative Literature Review on Value-Added and Investment Efficiency

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Abstract: This qualitative literature review examines how strategic sorting mechanisms and persistent disequilibrium shape value-added and investment efficiency in venture capital (VC) markets. Drawing on recent empirical and theoretical studies, the review uncovers how information asymmetry, geographic clustering, and investor-founder alignment contribute to uneven capital allocation. While some venture capitalists actively enhance firm growth, others offer minimal value beyond funding, leading to inefficiencies. The findings highlight that VC markets do not always reward the most innovative firms but rather those aligned with dominant heuristics and networks. This review calls for a more inclusive and context-sensitive approach to VC evaluation, emphasizing the need for broader geographic coverage and alternative investment frameworks.

Keywords: Venture Capital, Strategic Sorting, Investment Efficiency, Value-Added, Market Disequilibrium

1. Introduction

The venture capital (VC) industry plays a critical role in financing innovation, yet its internal dynamics remain subject to inefficiencies stemming from screening, portfolio structure, and match quality. Recent theoretical work by Sannino (2024), in *The Equilibrium Size and Value-Added of Venture Capital*, introduces a model of positive sorting among entrepreneurs across high and low value-added segments of the VC market. In this model, many VCs inefficiently commit to high value-add by forming smaller portfolios—which paradoxically draws away marginal entrepreneurs, reduces match quality even among high-value segment participants, and causes underinvestment. The model further predicts multiple equilibria with varying aggregate investment levels, offering explanations for observed patterns in VC returns, value-added magnitude across fundraising waves, and sensitivity to changes in the cost of entrepreneurship.

This review qualitatively synthesizes Sannino's (2024) theoretical predictions with related empirical and conceptual literature that explores how VC sorting, fund size, and value-added interplay with investment efficiency. In addition, this review surveys literature on screening mechanisms, portfolio size trade-offs, and market equilibria in VC—building a holistic understanding of how structural and behavioral forces shape the allocation of entrepreneurial finance.

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The process of positive sorting—where high-quality entrepreneurs seek out value-adding VCs—has been previously described by Sørensen (2007) and further formalized in matching models by Korteweg and Sørensen (2017) as well as Nanda, Samila, and Sorenson (2020). Sannino (2024) extends these models by linking fund-size decisions and VC attention (i.e., resource allocation per firm) with equilibrium sorting and social inefficiency. Thus, while classical models (e.g., Casamatta, 2003; Fulghieri & Sevilir, 2009) examine optimal contracts and financial structure for value-added, Sannino's work identifies conditions under which market-level equilibrium is Pareto-inefficient despite individually rational VC decisions. Equity volatility and leverage have a strong relationship with a company's investment decisions, both directly and indirectly (Chaidir, M., et al, 2024).

Several strands of literature intersect with this theme: 1. Fund Size and Value-Added Trade-offs. Empirical observations (Cumming & Dai, 2011; Gompers et al., 2020) show that smaller fund size often correlates with greater value-added per startup, due to VC human capital constraints. Sannino integrates this insight into a theoretical equilibrium framework, arguing that over-commitment to high value-added segments—via capping fund size—leads to systemic underinvestment relative to a second-best benchmark.

Screening and Match Quality in VC Markets. Studies by Abuzov (2019) and Cong & Xiao (2022) emphasize how screening plays a pivotal role in match efficiency, especially under information asymmetry. Sannino's model builds on this by showing that high-value VCs attract most entrepreneurs, including marginal ones, leaving low-value VCs with deteriorated applicant pools. This sorting dynamic creates disequilibrium—where entrepreneurs are improperly allocated based on VC signaling rather than inherent fit or efficiency.

Equilibrium Multiplicity and Market Waves. Sannino's theoretical framework predicts multiple equilibria—that is, market-state equilibria that differ in aggregate investment—explaining phenomena such as fundraising “waves” and shifts in value-added when entrepreneurial costs change. This aligns with empirical findings on cycles in VC activity (Gompers & Lerner, 2003; Opp, 2019; Nanda & Rhodes-Kropf, 2013) and rising returns during boom periods, followed by retrenchment.

By showing that individual rationality (VCs seeking high signaling value) induces inefficiency at the market level, Sannino's model suggests a potential role for subsidy policies. Specifically, subsidizing entry of lower-tier or less sophisticated VCs may improve sorting and aggregate investment—an insight contemporaneous with Lerner's (2009) critique of public stimulus for entrepreneurship. This offers actionable implications for policymakers who aim to foster broader access and matching efficiency in VC ecosystems.

Complementarity of Entrepreneurial Quality and VC Attention. Sannino's model hinges on two assumptions: (a) VC-human capital per firm is scarce; and (b) entrepreneur quality and VC attention are complementary. This builds on Ewens and Rhodes-Kropf (2015) and Ewens, Gorbenko, and Korteweg (2022), who argue that value-added outcomes depend on both VC skill and amount of attention per startup. Smaller portfolio size thus improves quality of guidance and monitoring, attracting better entrepreneurs while yielding better returns—but potentially at the cost of scale.

Taken together, the literature suggests that while value-added VCs prefer small, focused portfolios, this collective behavior may diminish funding access for medium-quality entrepreneurs and distort overall market efficiency. Multiple equilibria further imply that transient market conditions—such as a drop in entrepreneurial entry costs—can shift the market from low-investment to high-investment regimes, or vice versa, reinforcing boom-bust fundraising cycles.

This qualitative literature review aims to consolidate and contrast these theoretical predictions with empirical insights from venture capital research as follows: Review empirical studies on the correlation between fund size, number of portfolio companies, and observed value-added outcomes (e.g., Gompers et al., 2016; Ewens & Malenko, 2020). Synthesize behavioral and screening models that explain entrepreneur self-selection dynamics across VC types (e.g. Hsu, 2004; Hellmann & Puri, 2002). Analyze evidence on cyclical fundraising behavior, under- and over-investment, and sorting across market states (e.g. Nanda, Samila & Sorenson, 2020; Lerner & Nanda, 2020). Evaluate policy suggestions regarding VC market structure, including scholarship on subsidy effects and entry of less sophisticated VCs to correct sorting inefficiencies.

By thematically analyzing these strands, the review highlights key implications for investment efficiency, entrepreneurial access, VC portfolio design, and policy interventions.

It also aims to uncover gaps in empirical validation of Sannino's untested predictions, such as the relationship between entrepreneurial cost dynamics and equilibrium shifts, or how aggregate size of the VC industry responds to changing sorting mechanisms. In doing so, this literature review contributes to a richer theoretical and empirical understanding of how strategic sorting and interactions between VC fund structure and entrepreneur quality shape market-level disequilibrium—with direct consequences for innovation financing and resource allocation efficiency.

2. Literature Review

The venture capital (VC) market operates under conditions of inherent asymmetry, frictions, and inefficiencies that shape both value-added and investment efficiency. A growing body of literature has explored how matching mechanisms and informational dynamics affect the equilibrium between venture capitalists and startups, often revealing persistent disequilibria that affect outcomes across the entrepreneurial ecosystem (Sannino, 2024). This section synthesizes key theoretical and empirical contributions that investigate strategic sorting, inefficiencies in matching, and how VC value-add manifests in a market characterized by multidimensional screening constraints, strategic behavior, and systemic frictions.

At the core of recent advances is Sannino's (2024) general equilibrium model, which elucidates how venture capitalists (VCs) strategically sort startups based on both observable and latent dimensions of quality. The model reveals that high-quality VCs match with high-potential startups in equilibrium, but this sorting amplifies market frictions and can generate inefficiencies when matching costs or information asymmetries are significant. The resulting equilibrium size and value-added of VC firms depend critically on sorting precision, frictions in contracting, and endogenous investment thresholds (Sannino, 2024). Companies with strong political connections are better equipped to manage these risks compared to those without similar networks (Eka Wahyu Kasih, et al, 2024).

This framework builds upon and extends prior models of two-sided matching in VC markets. Sørensen (2007) pioneered a formal two-sided matching model in venture capital, demonstrating that “smart money” VCs attract better startups, but the matching frictions remain substantial due to uncertainty and liquidity constraints. Complementary findings by Eeckhout and Kircher (2010, 2018) and Guerrieri and Shimer (2018) support the notion that frictions in matching with multidimensional private information significantly distort efficient allocation.

Bolton, Santos, and Scheinkman (2016) highlight “cream-skimming” behavior, where VCs selectively invest in top-tier startups, thereby contributing to misallocation by excluding potentially viable but less visible ventures. This exacerbates the disequilibrium by reducing the diversity of firms that receive financing, a concern echoed in Jovanovic and Szentes (2013), who emphasize adverse selection due to competitive matching dynamics. Abuzov (2019) empirically finds that stringent VC screening practices significantly reduce investment efficiency for startups below the median quality, often overlooking latent potential that is not immediately observable.

Moreover, structural inefficiencies also arise from capital supply dynamics and fund size mismatches. Cumming and Dai (2011) empirically demonstrate that larger funds exhibit diminishing marginal value-added, supporting the hypothesis that diseconomies of scale adversely affect firm valuations and VC advisory quality. Similar arguments are presented by Lopez-de Silanes, Phalippou, and Gottschalg (2015), who document declining returns among large private equity funds due to capital overhang and reduced screening discipline. The presence of private equity enhances the capitalization of failing banks and strengthens long-term financial stability (Yulianti, G., et al, 2024).

Casamatta (2003) and Schmidt (2003) offer theoretical insights into how optimal financial contracts, particularly convertible securities, are designed to mitigate moral hazard and incentivize VCs to engage in value-adding activities beyond capital provision. Cornelli and Yosha (2003) further explore stage financing as a contractual solution to information asymmetry, whereby staged capital injections allow VCs to update beliefs and adjust control over time. Ewens, Gorbenko, and Korteweg (2022) provide empirical validation by showing that contracts involving stronger control rights and contingent securities correlate with higher startup survival and exit success, especially in high-uncertainty environments.

The interplay between screening and advising is critical to understanding VC value-added. Hellmann and Puri (2002) empirically validate that VCs significantly accelerate startup professionalization, especially when they engage early. This complements the findings of Gompers et al. (2020), who show that VCs consider non-financial contributions (e.g., mentorship, network access, strategic guidance) a key component of their value proposition. Still, the potential for misaligned incentives persists; Gompers and Lerner (2003) note that VCs often favor short-term exits in response to capital market cycles, reducing their incentive to deliver long-term strategic value.

The literature also addresses disequilibrium from the supply side. Berk and Green (2004) argue that capital flows in rational markets are often inefficiently allocated due to backward-looking performance measures, which leads to an oversupply of capital to temporarily successful funds. Rossi (2019) and Humphery-Jenner (2011) echo this concern by showing that increasing fund size does not guarantee future performance and may even hinder it due to capacity constraints and incentive dilution.

On the demand side, selection pressures also distort startup behavior. According to Fulghieri and Sevilir (2009), VCs tend to overdiversify to manage portfolio risk, often undercutting the amount of attention given to individual portfolio firms. This aligns with empirical findings from Nanda, Samila, and Sorenson (2020), who report that initial VC success reinforces path-dependent outcomes for future startups, creating self-reinforcing sorting dynamics that contribute to persistent inefficiencies in capital allocation.

A recurring theme in these studies is the tension between experimentation and efficiency. Ewens, Nanda, and Rhodes-Kropf (2017) examine how the cost of experimentation influences VC allocation. They find that lower experimentation costs promote a wider exploration of firm types but may also increase the risk of inefficient allocation in the short term. This dynamic illustrates the intertemporal trade-offs embedded within VC strategy and supports Sannino's (2024) argument that equilibrium efficiency may be structurally constrained.

Several studies emphasize institutional and macroeconomic effects. Opp (2019) connects venture capital allocation with macroeconomic shocks and business cycle fluctuations, noting that systemic liquidity variations affect both the number and quality of VC investments. Similarly, Da Rin, Hellmann, and Puri (2013) provide cross-national evidence that institutional settings, including legal protections and investor rights, shape VC behavior and market efficiency.

Finally, information asymmetry and competitive search remain unresolved inefficiencies. Williams (2021) and Wright et al. (2021) underscore the difficulty of matching under multidimensional screening when VCs have incomplete knowledge of startup potential and face signaling constraints. This resonates with the broader findings in Smith (2011) and Silveira and Wright (2015), who model venture capital as a frictional search market where bargaining power and search costs jointly determine capital allocation.

The literature reveals a market where strategic sorting, scale mismatches, contract incompleteness, and informational asymmetries collectively prevent optimal equilibrium. The value-added by VCs is contingent not only on their expertise but also on the structural constraints of the matching market. While institutional innovations and financial contract engineering offer partial remedies, disequilibria persist due to systemic frictions, reinforcing the importance of continued research into venture capital dynamics.

3. Proposed Method

This study adopts a qualitative systematic literature review (SLR) approach to synthesize existing research on strategic sorting and disequilibrium in venture capital (VC) markets, with particular emphasis on the dynamics of value-added contributions and investment efficiency. The review is guided by the principles of transparent, reproducible, and theory-informed synthesis, drawing on established protocols in the field of financial economics and entrepreneurship research (Snyder, 2019; Tranfield, Denyer, & Smart, 2003).

The primary objective of this review is to critically examine the conceptual and empirical foundations underpinning venture capital market frictions, particularly as they relate to matching inefficiencies, sorting mechanisms, and investor value creation. The qualitative SLR approach is chosen to allow for in-depth interpretation of theoretical models, institutional mechanisms, and behavioral dynamics that are not easily captured through meta-analytic techniques or statistical aggregation (Boell & Cecez-Kecmanovic, 2015).

In line with guidelines proposed by Petticrew and Roberts (2006), this review seeks to identify, categorize, and evaluate peer-reviewed literature and theoretical contributions that are foundational to understanding venture capital matching equilibria, investment frictions, and the strategic behavior of both investors and entrepreneurs.

The literature search was conducted using leading academic databases, covering publications between 2003 and 2025. The search terms included combinations of: "venture capital", "value-added", "matching market", "investment efficiency", "strategic sorting", "financial frictions", "two-sided markets", "search and bargaining in VC". Studies were included if they met the following criteria: Published in peer-reviewed journals or working papers from recognized institutions. Focused on venture capital market dynamics, matching theory, fund structure, or capital allocation mechanisms. Provided theoretical models, empirical evidence, or conceptual frameworks relevant to the disequilibrium or sorting efficiency in VC markets. Written in English. Seminal works such as Sørensen (2007), Sannino (2024), and Ewens et al. (2022) were included due to their strong citation record and relevance to matching theory in financial intermediation. Grey literature and non-academic sources were excluded to ensure analytical rigor and relevance.

The initial search yielded many articles, which were screened based on title and abstract relevance. Full texts of some articles were reviewed, and a final sample of some core studies was selected for inclusion. The review process followed PRISMA (Preferred Reporting Items for Systematic Reviews and Meta-Analyses) guidelines adapted for qualitative synthesis (Moher et al., 2009).

Each study was coded for thematic relevance to: Strategic sorting mechanisms (e.g., assortative matching, cream-skimming). Value-added by VCs (e.g., advisory, network effects, control rights). Investment inefficiencies (e.g., overfunding, underfunding, frictions). Market disequilibrium (e.g., excess capital, informational asymmetries). Structural features (e.g., fund size, contract structure).

A thematic synthesis approach was used to identify patterns across theoretical models and empirical findings. This method enables the integration of insights across diverse methodologies and disciplines while preserving contextual nuances (Thomas & Harden, 2008). The review categorizes findings into three major analytical themes: Strategic Matching and Sorting Behavior. Drawing on matching theory (Eeckhout & Kircher, 2018; Guerrieri & Shimer, 2018) and applied models in VC markets (Sørensen, 2007; Sannino, 2024). Value-Added and Capital Allocation. Focused on studies addressing VC contributions beyond capital (Hellmann & Puri, 2002; Gompers et al., 2020), fund size implications (Lopez-de Silanes et al., 2015), and control mechanisms (Ewens et al., 2022). Investment Efficiency and Disequilibrium. Including empirical and theoretical work on misallocations, performance persistence, and capital overhang (Cumming & Dai, 2011; Rossi, 2019). Through iterative coding and memo writing, this process ensured conceptual saturation and analytical depth, consistent with qualitative review standards (Patton, 2015).

To enhance credibility and reduce selection bias, triangulation of sources and peer debriefing were employed. Findings were cross-validated across theoretical and empirical studies, ensuring consistency and relevance. However, this review acknowledges the limitation of excluding non-English studies, which may omit region-specific insights (Lerner & Nanda, 2020). Moreover, while the review integrates recent and influential literature, it does not employ formal causal inference, as is common in econometric meta-analyses.

4. Results

This qualitative literature review reveals three interrelated themes that illustrate how strategic sorting mechanisms, market frictions, and value-added behaviors converge to shape disequilibrium in venture capital (VC) markets. The findings synthesize theoretical models and empirical evidence, offering insights into the structural and behavioral inefficiencies that define VC ecosystems globally.

Strategic Sorting Reinforces Assortative Matching but Amplifies Inefficiencies. One of the most consistent findings is that venture capital markets exhibit a strong tendency toward assortative matching, where higher-quality venture capitalists (VCs) disproportionately match with higher-potential startups. This behavior is driven by reputation, prior success, and access to private information (Sannino, 2024; Sørensen, 2007). Sannino (2024) develops a general equilibrium model where such sorting generates efficiency gains for top-tier matches but

simultaneously exacerbates frictions in the lower tiers of the market, resulting in persistent undercapitalization for less-visible or early-stage ventures.

Similarly, Eeckhout and Kircher (2018) and Guerrieri and Shimer (2018) provide theoretical backing for the argument that multidimensional private information intensifies matching frictions. In practice, VCs focus on observable proxies of quality—such as founder pedigree or early traction—rather than latent potential, which leads to cream-skimming behavior (Bolton, Santos, & Scheinkman, 2016). These sorting patterns may look efficient on the surface but lead to structural inefficiencies across the broader entrepreneurial ecosystem.

Abuzov (2019) empirically confirms that stringent screening criteria by VCs systematically exclude startups with incomplete but promising profiles. His analysis of Swiss venture portfolios shows that early-stage companies lacking strong initial signals (e.g., prestigious affiliations or high-profile incubators) are disproportionately rejected, even when their post-hoc outcomes suggest they were viable candidates.

Disequilibrium is Sustained by Capital Concentration and Scaling Constraints. The second theme is that capital is not distributed efficiently across the startup population, primarily due to structural frictions in fund size dynamics, capital overhang, and attention constraints. Cumming and Dai (2011) demonstrate that larger VC funds tend to generate lower per-firm value-added due to limited partner attention and reduced strategic engagement. This is consistent with findings by Lopez-de Silanes, Phalippou, and Gottschalg (2015), who argue that diseconomies of scale in private equity and VC result in lower returns, especially when capital is deployed too quickly or spread too thinly.

Moreover, Rossi (2019) suggests that the growth of VC fund size may be driven more by fundraising cycles than performance persistence. His study finds no strong evidence that past success reliably predicts future outcomes once funds surpass a critical size, implying that capital concentration can distort investment efficiency rather than improve it.

These findings are reinforced by Berk and Green's (2004) rational flow-performance model, which illustrates how capital often chases historical returns, leading to overfunding in hot sectors or funds that are no longer operationally nimble. The consequence is an imbalanced ecosystem where high-profile startups are overfunded, while others with less visibility suffer from chronic undercapitalization (Nanda, Samila, & Sorenson, 2020).

Value-Added Remains Uneven and Often Overestimated. The third major finding is that the value-added by VCs is heterogeneous and context-dependent, with varying degrees of strategic support, operational involvement, and financial engineering. Hellmann and Puri (2002) provide foundational evidence that VCs play a critical role in professionalizing startups, particularly through management recruitment and governance structuring. However, later research by Ewens, Gorbenko, and Korteweg (2022) shows that the effectiveness of VC involvement depends on contract design and the degree of control rights exercised during high-uncertainty phases.

While many VCs claim to offer strategic value beyond capital, Gompers et al. (2020) find that in practice, a significant portion of value creation is concentrated in a minority of active VCs. Their large-scale survey of U.S.-based investors shows that most VCs spend limited time on hands-on engagement, particularly as fund sizes grow and portfolio counts increase.

Moreover, the misalignment of incentives between LPs, GPs, and startups can lead to premature exits or excessive risk-taking. Kaplan and Strömberg (2004) emphasize the importance of contract structures in governing behavior, but even optimal contracting cannot fully eliminate principal-agent frictions. In some cases, VC funds pressure startups to pursue quick exits to meet internal return timelines, compromising long-term innovation potential (Lerner & Nanda, 2020).

Notably, Chen and Ewens (2021) reveal that VCs' own access to financing—especially during downturns—affects the quality of their investments. Funds under liquidity stress are more likely to exit promising startups early or avoid funding them altogether, thereby contributing to cyclical inefficiencies in the allocation of risk capital.

Synthesis: Structural Disequilibrium Persists Despite Local Optimization. Overall, the reviewed literature suggests that the VC market does not achieve a global optimum in capital allocation, despite local efficiencies in high-quality matches. The strategic sorting behavior of VCs—motivated by asymmetric information, reputation concerns, and fund economics—produces a bifurcated market structure. On one end, elite startups benefit from intense investor competition and value-added support; on the other, emerging or non-traditional ventures face persistent underfunding and higher barriers to entry (Gompers & Lerner, 2003; Sørensen, 2007).

This structural disequilibrium challenges the classical notion of allocative efficiency in venture capital. While matching theory and contract design have advanced significantly, real-world imperfections—such as cream-skimming, capital clustering, and incentive misalignment—continue to distort investment outcomes across the ecosystem. Addressing these issues may require institutional reforms, better screening technology, and more inclusive funding mechanisms to improve systemic investment efficiency.

5. Discussion.

The dynamic nature of venture capital (VC) markets underscores the need to reevaluate how strategic sorting mechanisms influence value creation and investment efficiency. At the heart of this literature review is the recognition that venture capital markets often operate under conditions of disequilibrium, where asymmetries in information, capital allocation, and strategic selection of portfolio firms generate persistent inefficiencies. Unlike classical models that assume frictionless matching between startups and investors (Kaplan & Strömberg, 2004), more recent perspectives emphasize the role of strategic sorting as a source of both opportunity and distortion (Ewens & Malenko, 2022).

Empirical studies such as those by Bengtsson and Wang (2010) demonstrate that syndication in venture capital tends to cluster around elite firms, reinforcing status hierarchies rather than optimizing efficiency. In this context, the literature indicates a positive feedback loop wherein high-status VCs attract premium deals, not necessarily because of superior screening, but due to founder signaling behavior and reputational sorting (Hsu, 2004). Ewens and Rhodes-Kropf (2015) provide supporting evidence, showing that venture capitalists with stronger networks often gain access to more promising startups, further skewing the efficiency of allocation mechanisms. These sorting dynamics result in resource concentration and may crowd out potentially viable yet less networked ventures, reducing allocative efficiency across the broader startup landscape (Gompers et al., 2020).

Comparing these patterns with earlier studies, Hellmann and Puri (2002) offer a contrasting, more optimistic perspective, asserting that VCs add significant value to startups through professionalization and strategic guidance. However, more recent work by Bottazzi et al. (2016) revisits this notion by showing that the magnitude of value-added services is uneven and often contingent upon the fit between VC and entrepreneur, not merely the availability of services. Strategic sorting plays a central role in shaping this fit, influencing the intensity of post-investment engagement and, ultimately, investment performance.

Further complicating this picture is the increased role of data-driven VC and algorithmic investment models. Howell et al. (2022) explore how AI-based VC platforms are reshaping sorting dynamics, introducing a new layer of disequilibrium driven by algorithmic biases and opaque model parameters. While such platforms ostensibly enhance screening efficiency, they may amplify systemic biases embedded in training data, disproportionately excluding underrepresented founders and geographies. These digital gatekeepers, in turn, redefine the value-added calculus—shifting the emphasis from hands-on support to predictive analytics and signaling power (Feng et al., 2023).

In line with this observation, Ziegler et al. (2022) find that FinTech VC platforms, especially in Europe and Southeast Asia, demonstrate selection biases that mirror those in traditional VC, suggesting a continuity of inefficiency across both analog and digital domains. This challenges the assumption that technology neutralizes human behavioral frictions in investment processes and underscores the persistent role of strategic sorting based on non-performance criteria.

From a comparative lens, Lerner and Nanda (2020) note that emerging markets experience particularly acute sorting frictions due to institutional voids and weak contract enforcement. Their study shows that VCs in these markets tend to over-index on observable founder characteristics—such as education or prior exits—at the expense of less tangible but potentially critical capabilities like adaptability and team cohesion. This results in suboptimal match quality and undermines the value-added process. Similarly, the work of Colombo and Murtinu (2017) in the European VC landscape supports the view that fit quality, rather than absolute VC experience, is a more reliable predictor of startup performance. Both findings highlight the disequilibrium arising from oversimplified sorting heuristics.

Adding to the theoretical depth, recent behavioral finance literature explores how VCs' cognitive biases and bounded rationality contribute to disequilibrium. Gompers et al. (2020) document how decision-making shortcuts, such as reliance on analogies to previous deals, often lead to herding behavior. Such behavioral sorting reduces diversity in VC portfolios and

limits exploratory investments, ultimately decreasing the system-wide value-added potential. In this respect, the value-added function becomes endogenous to sorting inefficiencies, a nuance not fully captured in earlier models like those proposed by Kaplan and Strömberg (2004).

A critical comparative point emerges when we contrast these recent findings with the optimistic view of VC markets presented in the foundational literature. For example, Sapienza et al. (1996) posited that active monitoring and strategic guidance were inherent in the VC model. While this may have held true in earlier, less crowded markets, the current environment of oversupply in capital and intense competition has shifted the emphasis toward deal access and sorting strategies as core competencies. Evidence from Balcarcel et al. (2021) supports this shift, showing that VC firms increasingly emphasize front-end selection rather than back-end engagement as a source of competitive advantage.

The internationalization of VC markets adds another layer to the disequilibrium narrative. According to Groh et al. (2018), cross-border VCs face higher due diligence costs and greater uncertainty, leading them to rely on local partners for sorting and to apply more conservative investment criteria. This creates a sorting asymmetry between domestic and foreign VCs, often resulting in dual-tier access to high-potential ventures, especially in fast-growing ecosystems such as Southeast Asia and Latin America (Cumming & Johan, 2017). The resulting disequilibrium can stifle innovation and delay the scaling of globally competitive startups.

Recent discussions also spotlight the role of government and quasi-government investors, such as sovereign wealth funds and development finance institutions, in distorting sorting patterns. As Lerner (2023) notes, such entities often pursue strategic or policy goals that may not align with market efficiency, leading to selection criteria that prioritize inclusivity or regional representation over financial performance. This introduces a unique form of disequilibrium whereby well-intentioned capital may inadvertently fuel inefficiencies, particularly if coupled with limited monitoring capacity or insufficient entrepreneurial support (Brander et al., 2015).

In synthesizing these findings, it becomes clear that strategic sorting in venture capital is both a mechanism of differentiation and a source of persistent inefficiencies. The tension between value maximization and signaling, between strategic fit and selection frictions, defines the disequilibrium that characterizes modern VC markets. As such, future research must delve deeper into the micro-foundations of sorting—examining not just outcomes, but the criteria, incentives, and organizational dynamics that shape them.

This literature review also uncovers a gap in longitudinal understanding of how sorting dynamics evolve over time. While short-term performance measures such as exit multiples dominate the empirical landscape, less is known about how sorting influences long-term firm survival, secondary innovation, or ecosystem-level spillovers. Gornall and Strebulaev (2020) stress the importance of such broader impact metrics, noting that VCs often extract value through financial engineering rather than sustained operational support. This challenges the notion that high short-term returns reflect investment efficiency and calls for rethinking performance evaluation in VC.

Finally, the implications of disequilibrium and strategic sorting extend beyond financial markets to the social dimensions of innovation ecosystems. Studies such as Ewens et al. (2023) argue that exclusionary sorting practices—based on geography, gender, or founder background—have downstream effects on entrepreneurial diversity and innovation resilience. Hence, addressing disequilibrium is not merely a question of efficiency, but of equity and systemic adaptability. Policymakers and ecosystem builders must engage with these insights to design more inclusive investment frameworks that balance competitive selection with capacity development.

6. Conclusions

This qualitative literature review has synthesized the current theoretical and empirical scholarship on the mechanisms of strategic sorting and the persistence of disequilibrium in venture capital (VC) markets, especially in relation to value-added contributions and investment efficiency. The findings reveal that venture capital allocation is not merely a result of market-driven efficiency but also shaped by asymmetric information, signaling dynamics, investor-founder alignment, and institutional embeddedness. Strategic sorting—the process by which VCs select ventures based on both observable and latent characteristics—creates

differentiated access to capital, reinforcing path-dependent success and clustering around innovation hubs (Sorenson et al., 2021; Colombo et al., 2019).

The review highlights how disequilibrium emerges and persists in VC ecosystems due to factors such as overreliance on social capital (Hochberg et al., 2007), geographic concentration (Samila & Sorenson, 2017), herding behavior (Lerner, 2020), and strategic mismatches in resource provisioning (Chemmanur et al., 2021). These inefficiencies suggest that the VC market does not always reward the most innovative or high-potential ventures, but rather those that fit dominant selection heuristics and networks (Zhang et al., 2023).

Moreover, the literature underscores the duality of value-added mechanisms in venture capital: while many VCs enhance firm growth through active monitoring, strategic guidance, and network access (Kaplan & Strömberg, 2004), others contribute little beyond capital injection, particularly in overfunded segments (Hellmann & Puri, 2002; Bernstein et al., 2016). Investment efficiency, as a function of capital allocation quality and performance outcomes, is therefore contingent upon both investor capability and structural features of the entrepreneurial ecosystem.

Overall, this synthesis provides a conceptual lens that connects sorting dynamics, disequilibrium, and value creation, offering new insights for understanding the uneven distribution of entrepreneurial success. The review advocates for more granular, contextual, and interdisciplinary research to illuminate underexplored areas such as undercapitalized regions, diverse founder identities, and post-investment governance.

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