Guided By The Constellations: A Configurational Approach To Investor Evaluations Of New Ventures

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A signal is a piece of information that quickly communicates a hard-to-verify quality. Entrepreneurs send a variety of signals to communicate the quality of their ventures. For example, when an entrepreneur brings up their past academic or professional achievements during their communication with investors, they are signaling quality. An entrepreneur's past achievements are among many signals, including revenues and partnerships with third parties that entrepreneurs use to attract investors. Thus, based on existing research, we know entrepreneurs send multiple signals, but we do not know how many signals are too many or too few? It is challenging because multiple signals can be overwhelming, but too few signals can be underwhelming. Thus, entrepreneurs must decide how to signal effectively to get the most out of their interactions with VCs.

To answer this question, rather than reaching out to entrepreneurs, I turned to VCs - after all, they are the intended recipients of these signals. I took a qualitative approach to analyze how VCs take information from different signals to select or reject 50 deep science-based startups admitted to a prominent mentorship program in North America. Over nine months in 2019-2020, I followed these startups from their evaluation session with VCs until they graduated or exited the program. I analyzed the transcripts of conversations between VCs who evaluated these 50 startups. I examined which signals VCs registered in their evaluations, such as sales, expert opinions about the market, the presence of third parties such as investors, and the entrepreneurial team's coachability. I did not stop there but also analyzed how VCs reacted to these signals.

I noticed that VCs leveraged information from signals to determine a new venture's potential from at least four dimensions or decision-making factors: the product, the market, the third-party alliance, and the entrepreneurial team. While VCs preferred startups that presented multiple signals that mapped on to more than one factor, they rejected startups with many signals corresponding to only one factor. Consider the case of a startup that provided two signals, such as a patent application underway combined with some early sales. These signals were all related to the product factor. VCs wanted to know more about how the entrepreneur could be coached to navigate the process of finding a market for the product and third parties that could become endorsers. Thus, too many signals related to one factor are unlikely to persuade investors.

My research has at least two implications for entrepreneurs preparing to communicate with VCs. First, my findings confirm previous research on what matters to early-stage investors, such as VCs. I demonstrate that VCs indeed view nascent ventures as sums of at least four different factors. Second, my findings show multiple pathways to capturing investors' attention. All-star entrepreneurs who demonstrate quality on all factors are likely to sail through the selection process, but not all new ventures can be all-stars. What should an entrepreneur do if they are on their way to becoming an all-star but not quite there? My findings show that there are two possible pathways. One sufficient but not necessary pathway to success is securing an alliance partner who can endorse what you are doing. This endorsement is likely to put you on the VCs' radars. The second pathway involves signaling the possibility of a big market through expert opinions, combined with either a great product or an entrepreneur who could be coached to the promised land of unicorns.

To conclude, using multiple signals to capture an investor's attention works! As long as these signals are not concentrated on one factor and convey valuable information to alleviate investor concerns about multiple factors.

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