Acting like an expert even without experience can help secure venture capital funding

January 26 2022, by Avery Ruxer Franklin

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What matters more to venture capitalists: a slick presentation or the company founder's actual experience and expertise?

A report from Alessandro Piazza, assistant professor of strategic management at Rice University's Jones Graduate School of Business; Brian Chung, doctoral candidate at Rice Business; and Dortmund University's Daniel Reese analyzed data on 4,190 new ventures and their founders. They found that "expertise signaling" by founders—self-presentation that might not align with reality when it comes to their experience, skills or background—played a significant role in their companies' success.

Raising capital is usually the single biggest challenge for early-stage companies, and assembling a founding team capable of persuading funders to get on board is increasingly seen as indispensable. Securing capital can trigger even more funding from other venture capitalists or even liquidity events such as a merger or acquisition.

"When predicting (an acquisition or merger), actual expertise was still the strongest predictor. But when it came to raising funds, we were surprised to discover that founders' expertise signaling was actually a more powerful predictor than their actual background and experience," the authors wrote. "Our findings have important practical implications and highlight the need for better theories of the role of the founding team in entrepreneurship and venture financing."

Corporate collapses caused by founders' promises diverging dramatically from what they are able to deliver occur often, such as in the cases of Theranos and WeWork.

On the flip side, there's the case of Zoom—now a public company with a market capitalization of $88 billion—being unable to secure early funding because its founder, Eric Yuan, did not "look the part."

"In other words, he did not fit the mold of a stereotypical young tech founder, despite his track record and extensive experience," the authors wrote. "As a result, Zoom had to raise funds from friends and family before being able to bring VCs on board."

Because a successful business venture requires a diverse set of skills, the research team focused its analysis of founders on three different types of expertise: entrepreneurial, managerial and technical.

"When we looked at whether startups were acquired or went public—one of our two measures of success—we found that expertise signaling wielded a sizeable influence, even though actual expertise narrowly carried the day," the authors wrote. "But when we looked at how much money new ventures were able to raise, the effect of expertise signaling exceeded that of actual expertise for both the entrepreneurial and the managerial component.

"In other words, for founding teams, showing off appears to pay off to a greater degree than having the goods when it comes to raising capital, while longer-term outcomes such as acquisitions and IPOs are less sensitive to expertise signaling," they continued.

More information: Alessandro Piazza et al, Discoveries-through-Prose: Venturing through the Doors of Perception, *Academy of Management Discoveries* (2022). DOI: 10.5465/amd.2021.0046

Provided by Rice University