SMARTER SYSTEMS:

How Tweaking Your Diligence Process Can Unlock Overlooked Opportunities

INVESTOR IMPLEMENTATION GUIDE

village capital

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About the Guide

We found that there are discrepancies in how investors evaluate men-led and women-led startups, potentially leading them to overlook promising startups and overestimate less promising startups. This implementation guide outlines three steps we found that institutional and individual investors* can incorporate into their evaluation processes to consistently evaluate all startups more accurately.

Specifically, these steps aim to reduce discrepancies and inconsistencies in assessments and increase their objectivity and accuracy when evaluating all startups by adding structure to areas that lack it in the evaluation process, and mitigating investor over-reliance on "gut instinct" when evaluating the founding team.

Mitigating inconsistencies in evaluation processes prevents investors from overlooking opportunities with high potential and consequently can help them achieve greater financial returns.

For more information on how startups are evaluated inconsistently, why we designed these steps and what we found when testing their effectiveness, visit our Key Insights Report. You can find details of how we tested these steps in our Methodology Report.

* E.g. Venture capital firms, angel groups, etc.

Contents

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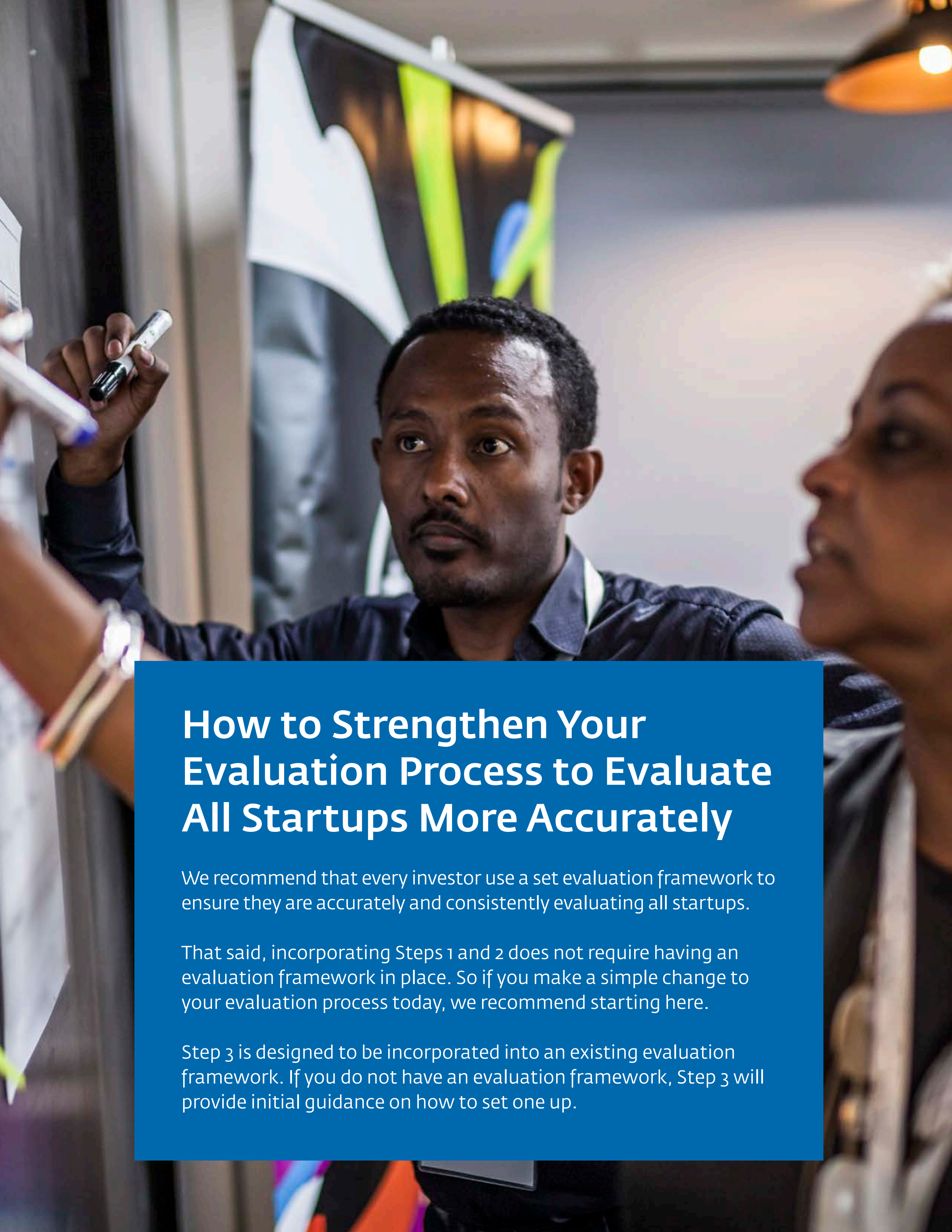
Context: Targeting Discrepancies in the Evaluation Process

The issue: Evaluating startups inconsistently narrows an investor's field of vision leading them to overlook startups with high potential. As a result, investors miss out on promising opportunities, and high potential women-led startups do not get the funding they need to scale.

Identifying discrepancies in assessments	Three steps to increase consistency in the evaluation process
Investors ask women-led startups significantly more risk-related questions, and men-led startups more growth-related questions.[1] This imbalance can lead investors to overlook key risks or growth opportunities for a startup.	**1) Collect information on each startup's risk and growth opportunities to ensure you have a comprehensive understanding of both.** Prompting investors to think about **both risk- and growth-related** questions helps prevent them from focusing disproportionately on either, and therefore leads to more consistent evaluations.
Lack of information on business trajectory leads investors to focus heavily on evaluating the founding team's potential to grow the startup. Yet evaluating a founder's "potential" results in more favorable outcomes for men, likely due to gender bias.[2] Investors possibly associate men with "potential" more often than women because: 1) Attributes typically associated with women are perceived as incongruent with those required to be a competent entrepreneur who shows potential for success[3] and 2) To replicate past success, investors may often seek out entrepreneurs who are similar to those they have previously invested in and have been successful with — which are most often men.	**2) Assess a team's potential by evaluating how much they have demonstrated an ability to improve their startup** *(e.g. acquiring new customers, identifying and addressing risks in their business model, securing new partnerships, etc).* A startup has potential if it seems likely they will be able to grow. To do so, the startup must be able to continually make improvements that allow it to grow. Consequently, evaluating how a founding team improves their startup in the short-term helps the investor make a more accurate, performance-based assessment of the startup's future potential, by creating new data to assess how well the team will be able to continue making improvements to their company in the future.
Research has also found that evaluators adjust the characteristics they initially wanted to see in a successful candidate to fit the characteristics displayed by candidates of their preferred gender.[4]	**3) Pre-define which evaluation criteria will most heavily influence your scoring and decisions**. Predefining the weight of each evaluation criterion on the final score, by giving it a specific number, increases the likelihood that the evaluator will apply the framework consistently.[5] This simple strategy prevents the investor from redefining criteria for success.



How to Strengthen Your Evaluation Process to Evaluate All Startups More Accurately

We recommend that every investor use a set evaluation framework to ensure they are accurately and consistently evaluating all startups.

That said, incorporating Steps 1 and 2 does not require having an evaluation framework in place. So if you make a simple change to your evaluation process today, we recommend starting here.

Step 3 is designed to be incorporated into an existing evaluation framework. If you do not have an evaluation framework, Step 3 will provide initial guidance on how to set one up.

Step #1

Collect information on both risk and growth opportunities for each startup to ensure you have a comprehensive understanding of both

Build the following checkpoints into your evaluation process to ensure you have a comprehensive understanding of a startup's risks AND growth opportunities:

1. **Include the following questions in your evaluation framework to remind the investor to seek information on both areas:**

- *Do you have a sound understanding of the startup's risks?*
- *Do you have a sound understanding of the startup's growth opportunities?*

2. **Incorporate a space within the evaluation framework to keep track of the startup's risks and growth opportunities, and any additional questions regarding each area.**

This may help you see if you have overlooked one of the two areas. See page 11 for a sample question bank and page 12 for a template you can use to keep track of the information you've gathered and any remaining questions you have.

In investment committees, it might be helpful to dedicate time to question if the committee has a comprehensive understanding of the startup's risks and growth opportunities. Investment committee members could ask each other if there are any remaining questions on either of the two areas. This "checkpoint" could serve as an additional layer to prevent under or overestimating a startup.

Step #2

Assess a team's potential by evaluating how much they have demonstrated an ability to improve their startup

What Does It Mean to Evaluate Improvement Over Time?

By improvement, we mean any meaningful progress the team has made in changing, adapting, strengthening, or adjusting their course of action in a way that keeps them on a path towards continual growth. It also means providing better explanations for why a company made those specific changes. Over time, companies that show improvement should be able to answer some investor questions about strategic decisions made with more data.

Importantly, founders can show improvement even if what they have done looks different to what was recommended by others. Startups often receive feedback from multiple channels, and will therefore have to decide on the best course of action for the growth of their company. When evaluating improvement, you should focus on evaluating a team's demonstrated ability to continually improve.

In your own evaluation process, you should evaluate improvement in the key area(s) that you consider most important for a startup's success and future growth.

In our experiment, for example, we evaluated a team's demonstrated ability to improve and execute its company's risk mitigation and growth strategies for two reasons: 1) these strategies are key for startups' future success, and 2) they were broad enough to be applicable to startups from different sectors. As an example, the categories and guiding questions we used in the experiment can be found in the table below:

Category:	Understanding potential for growth	Demonstrating potential for growth	Understanding risks	Demonstrating risk mitigation
Guiding questions to evaluate category:	*How much has this company **improved in understanding** its path to growth?*	*How much has this company **improved in executing** its path to growth?*	*How much has this company **improved in understanding** its risks?*	*How much has this company **improved in executing** on risk mitigation?*

How Can You Measure Improvement Over Time?

1 Identify key area(s) in which to evaluate improvement and incorporate a category(ies) for it in your evaluation framework

First, identify which area(s) you consider key for a startup's success and future growth. Then, add a category(ies) into your evaluation framework to assess improvement in each area.

2 Use a simple scale(s) that reflect(s) how you would define improvement in your selected key area(s)

Creating a scale(s) will allow you to both consistently evaluate improvement across all startups and measure how much each team has improved in the given area(s).

For example, in our experiment we used the scales below to measure how much a team had improved in understanding and executing their growth strategy:

Example of measuring improvement in ***understanding*** *the company's path to growth:*

1. No Improvement	2. Slight Improvement	3. Moderate Improvement	4. Strong Improvement
This company is thinking about their business in the exact same way from when I first met them.	This company has been thinking about how they should grow since I last spoke to them.	This company has explained how they changed their thinking about growth following an interaction or gathering more data.	This company has explained both how they changed their thinking about growth and why their current choice is the best option.

Example of measuring improvement in ***executing*** *its growth strategy:*

1. No Improvement	2. Slight Improvement	3. Moderate Improvement	4. Strong Improvement
This company does not clearly present new data or insight on how it will grow.	This company has made some initial progress towards executing their growth path (e.g. interviewed a few stakeholders for initial insights).	This company has taken several actions towards executing their improved growth strategy (e.g. did market testing and learned whether or not to pursue an opportunity further).	This company has implemented substantive improvements in their growth strategy (e.g. new partnerships/channels to reach more customers and markets; sales growth).

3 Evaluate the founding team's demonstrated ability to make improvements when conducting due diligence:

- **When meeting with the founding team, ask:** *What progress have you made since you first pitched to us/we last met?*

Other general questions you can ask the founding team include:

- *Have you made any changes since you first pitched to us/we last met? Why did you make those changes?*
- *Have you reached new milestones? How did you reach them?*
- *Have you changed the way you think about your startup's future and path to get there? Why and how?*

Pages 12 and 13 include question banks with sample questions to evaluate improvement in the categories we used in the experiment (understanding and executing company strategies). You can also draft (and consistently use) questions more specific to the key area(s) you are evaluating improvement in. The question banks also include questions you could use to evaluate how the startup has made improvements before meeting you.

▶ **Use the scale(s) you created to evaluate their improvement.** Ask yourself: *Does this team's progress demonstrate improvement in this area? and/or Does the team demonstrate that they will be able to continually improve in this area?*

Page 14 includes a template you can use to both track the risk- and growth-related information you are collecting, and evaluate the startup's demonstrated ability to improve in your key areas. If you meet with the startup more than once, track their improvements over time using the same template.

4 When adding startups to the watchlist:

Collect all necessary baseline data on the startup and the team's proven abilities that will allow you to accurately measure their improvement in the future. You can use the template on page 14 to collect and store this information. When you revisit the startup and assess them in the future, evaluate how much the startup has improved in your key area(s).

Added benefits of measuring improvement:

A) Assess the team's ability to listen to feedback, adapt, and make changes when appropriate.
Observing and evaluating how a team has improved can give investors insights on how the team has listened to feedback (from them or other investors or mentors), how easily they adapt, and how well they judge what they believe would or would not be beneficial for the startup's growth.

B) It should help the investor determine if the team will be able to collaborate with them to develop new strategies in the future.
The information a team shares each time they make changes and improve their strategies could give investors a glimpse into how well the team works together, their thought processes, and early organizational culture.

Question Banks and Template to Incorporate Steps 1 and 2 Into Your Evaluation Process

Question Banks

The table below provides examples of growth- and risk-related questions:

Growth	Risk
What makes you unique?	What potential regulatory issues or future government mandates are possible?
How do you plan to increase sales?	How long do users stay on the platform before leaving?
How much can revenue increase by expanding into new markets?	What prevents the competition from starting to offer similar services?
Does the company have plans to work with channel partners?	What is the proof of impact? What actually changes in the lives of the customers, and how do you know?
What is the opportunity to upsell or cross-sell in your customer base?	What is your timeline to break even?
How are you going to acquire new customers?	How are you going to protect your IP?
What strategy do you have in place to enter markets with similar offerings?	How will you ensure quality as you scale?
What is the current split between local customers and those in international markets?	Are you able to produce your product overseas?

The question banks below provide sample questions you can use to evaluate improvement in the categories we used in our experiment (growth and risk mitigation strategies). If you are going to develop questions for other key areas, you can adapt these questions accordingly.

Ability to Understand *Potential* for Growth	
Main guiding question: How much has this company improved in understanding its path to growth?	
Guiding questions for first/singular meetings	**Guiding questions for repeat meetings**
• How has your growth strategy evolved? Why did you choose the growth path you are taking?	• Have they made any updates to their growth strategy based on feedback you or others at the organization gave them? • Has this company presented more data or details explaining their overall venture growth strategy (e.g. the choices they made to pursue specific markets, partners, team members, etc?) • Has this company reworked or restructured the presentation of their company's strategy to better explain their path to growth, and why they chose the growth path they are taking?

Ability to *Execute* Growth Strategy	
Main guiding question: How much has this company improved in executing its path to growth?	
Guiding questions for first/singular meetings	**Guiding questions for repeat meetings**
• What is the most material change to your business model you have made? • What hypothesis testing or market research have you done to better demonstrate your path to growth i.e., with new markets, products, or partnerships? • What other paths to growth did you consider? How did you decide executing on your current growth strategy was most relevant right now?	• Have they made progress on executing their goals in any investment criteria category? • Has this company done any new hypothesis testing or market research to better demonstrate its path to growth (e.g. with new markets, products, or partnerships?) • Has this company demonstrated that it has considered multiple paths to growth and chosen to execute in the most relevant path right now?

Ability to *Understand* Risks	
Main guiding question: How much has this company improved in understanding its risks?	
Guiding questions for first/singular meetings	**Guiding questions for repeat meetings**
• How has your understanding of your company's risks evolved? • What risks did you identify and how might they affect the company's strategy? How did you prioritize the most important ones to mitigate for right now and in the future?	• Have they explicitly listed more and more relevant risks for their company than previously? • Has this company added more nuance or data to their existing risks to acknowledge the needs their company may have to overcome them? • Has this company mapped multiple risks, how they might affect the whole company strategy, and prioritized the most important for them right now and in the future?

Ability to *Execute* Risk Mitigation Strategy	
Main guiding question: How much has this company improved in executing on risk mitigation?	
Guiding questions for first/singular meetings	**Guiding questions for repeat meetings**
• What is the most material change you have made to mitigate risk in your business model? • What risk prevention strategies have you tested/piloted/launched? (e.g. adding a new supplier, adding a board or team member to help with risks?)	• Have they taken steps to synthesize data on how they might mitigate their risks i.e., talking to potential suppliers or different partners for potential market channels? • Has this company tested/piloted/launched some risk prevention strategies, i.e., adding a new supplier, adding a board or team member to help with risks? • Has this company prioritized dealing with the most concerning risks that it can right now?

Template

Use this template to help you ensure you have a sound understanding of a startup's risks and growth opportunities, as well as to evaluate the founding team's demonstrated ability to improve in the key area(s) you consider the most important for a startup's success and future growth.

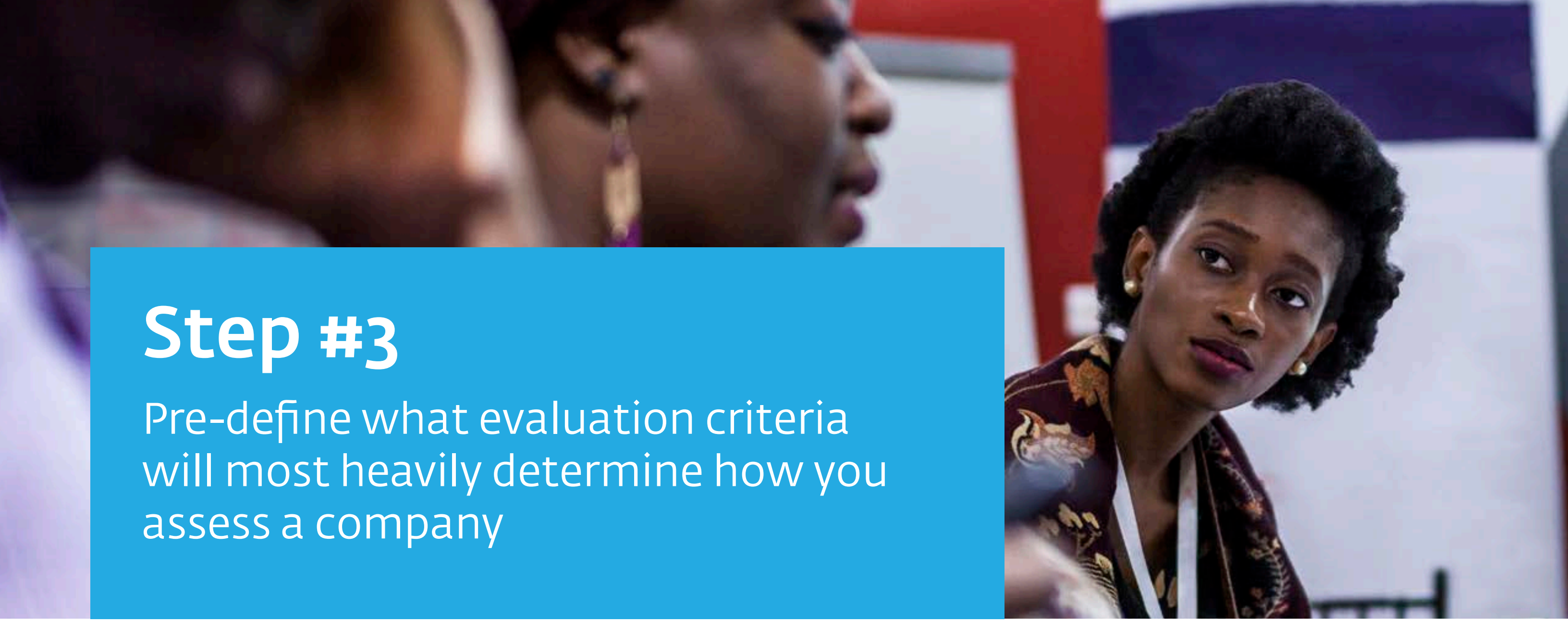
Identifying Risks and Growth Opportunities:	
Growth Opportunities	**Risks**
Do you have a sound understanding of their growth opportunities? What additional information would you need to have a comprehensive understanding of their growth opportunities? List questions:	*Do you have a sound understanding of their risks? What additional information would you need to have a comprehensive understanding of their risks? List questions:*
List identified growth opportunities:	*List identified risks:*

Evaluating Ability to Improve in Understanding [key area]:	
Timeframe 1 - List how they have improved in understanding [key area]:	Improvement Score (1-4)
Timeframe 2 - List how they have improved in understanding [key area]:	Improvement Score (1-4)

Evaluating Ability to Improve in Executing [key area]:	
Timeframe 1 - List how they have improved in executing [key area]:	Improvement Score (1-4)
Timeframe 2 - List how they have improved in executing [key area]:	Improvement Score (1-4)

Note:

Duplicate the section on Evaluating Improvement if you are evaluating improvement in more than one area.



Step #3

Pre-define what evaluation criteria will most heavily determine how you assess a company

Before pre-defining what evaluation criteria will determine how you assess a company, it is important to first ensure your evaluation framework allows you to consistently and comprehensively evaluate ALL of the categories that are important to you when evaluating a startup.

Evaluation processes are less objective when they lack comprehensive criteria because investors can easily adapt how they evaluate depending, among other things, on the gender composition of the founding team.

If you do not already have set evaluation criteria, check out Village Capital's VIRAL framework as an example. Having set criteria will help ensure your assessments are accurate and consistent.

Look back on your investments over the past six months to identify the most common key factors in your decision-making. In the table on the next page are examples of questions that can help you to determine if your evaluation framework comprehensively captures the elements that influence your decision-making, and identify what is missing.

Guiding questions to identify key evaluation criteria	Using your answers in the first column, list the key evaluation criteria you identified:	List your current evaluation criteria. Compare it to your list in the second column. Are your current evaluation criteria comprehensive? Highlight missing criteria.
Think about two or more startups in which you seemed almost equally inclined to invest, but ended up investing in only one. What was the key differentiating factor?		
What important milestones does a startup need to have met for you to invest in them? What is one key characteristic or milestone shared by all of the startups you have invested in recently?		
What traits, abilities, and knowledge do you most often look for and value in a team? For example: coachability, grit or perseverance, ability to hold one's own, or alignment in values.		
Among the startups you have invested in over the last six months, what characteristic(s) most appealed to you from each?		

How to Predefine Which Criteria Will Most Heavily Determine the Score or Assessment of a Startup:

1. **Add a question at the beginning of the scorecard asking the investor to predefine the weight that they will apply to each criterion when evaluating startups.** The template below illustrates how to do this.

2. **If you invest in startups in different sectors the weight you apply to each criterion may vary by sector.** If so, consistently pre-weigh your criteria for each sector. It is important to evaluate startups within each sector consistently.

Criteria		
Think about how you will make your decisions and weigh each of the criteria below by importance in percentages terms. Make sure it adds up to 100%. Keep this distribution in mind when scoring each startup.		
Insert Criterion 1 (%)	Does the startup [insert guiding question]?	Score:
Insert Criterion 2 (%)	Does the startup [insert guiding question]?	Score:
Insert Criterion 3 (%)	Does the startup [insert guiding question]?	Score:
Insert Criterion 4 (%)	Does the startup [insert guiding question]?	Score:
Insert Criterion 5 (%)	Does the startup [insert guiding question]?	Score:

The table on the next page provides an example using Village Capital's standard evaluation categories.

Note:

We include the percentages below not as a recommended weighting but to illustrate how you can pre-define and weigh the criteria in your own evaluation process. Doing so will ensure that you think ahead of time about which criteria are most important to you.

Criteria/Categories		
Think about how you will make your decisions and weigh each of the criteria below by importance in percentages terms. Make sure it adds up to 100%. Keep this distribution in mind when scoring each startup.		
Team (15%)	How confident are you that this team will deliver results and can make the right hires as it grows?	Score:
Vision (15%)	How confident are you that this vision is big enough to continue to scale and take on new challenges in the next decade?	Score:
Value Proposition (20%)	How confident are you that the company's solution solves a major pain point and will continue to deliver specific, measurable value to delight customers?	Score:
Product (10%)	How confident are you that the product can expand to multiple offerings and outpace the market on innovation?	Score:
Market (10%)	How confident are you that this company's target market is viable enough to build a profitable company?	Score:
Business Model (10%)	How confident are you that the company's business model is viable and that it can make money?	Score:
Scale (10%)	As this company scales, are you confident that it can become or remain the number one or number two in the market?	Score:
Investor Exit (10%)	How confident are you that the company will be able to grow large enough to meet its investor or other capital commitments?	Score:

If you do not use scorecards you should minimally weigh your criteria so that it is codified and known what is guiding your investment decisions, and by how much.

3. **Review predefined criteria every time you evaluate a startup:** Before completing an evaluation rubric (or other assessment), review your evaluation criteria and the weight you had assigned to each criterion. Reminding yourself of the defined criteria reduces room for bias to subconsciously enter their evaluation and helps ensure you evaluate all startups consistently[6].

4. **After selecting startups for investment, cross-check your picks against your pre-defined evaluation criteria:** At the end of every investment committee meeting, revisit the criteria. Ask yourself: Are the startups we are putting forward to be invested in still the top startups according to the criteria we set? Are there any inconsistencies? If so, why?

   Double checking that the startups selected are the best according to your pre defined criteria ensures you are making investment decisions aligned with the "north stars" you had originally defined, and builds in a checkpoint to see if factors such as gender bias may be influencing the final decision.

ENDNOTES

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