

HOW EARLY STAGE ENTREPRENEURS EVALUATE VENTURE CAPITALISTS

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ABSTRACT

This paper is the first attempt to study the process and criteria used by entrepreneurs in evaluating venture capitalists. Selection process involves issues such as the time invested in gathering information, the sources of information, and the number of venture capitalists considered. Selection criteria are split into four groups: (1) Valuation; (2) Value-Added Services; (3) Reputational Factors; and (4) Venture Capitalist Attributes. The paper presents results for all respondents and compares results when the respondents are sorted by geographic region, industry, experience, and age. The paper also examines satisfaction, sorting respondents by geographic region, industry, experience, age, time devoted to the search, and criteria ranking.

INTRODUCTION

One of the most important projects in venture capital research over the past two decades has been to determine how venture capitalists select entrepreneurs. This paper looks at the other side of the venture capital mating process: how entrepreneurs select venture capitalists. Although several studies have examined the relationship between venture capitalists and entrepreneurs from the perspective of the entrepreneur, the *entrepreneur's selection process and criteria* have largely been ignored in the venture capital literature.

DO ENTREPRENEURS HAVE A CHOICE?

One of the fundamental assumptions underlying this study is that entrepreneurs have a meaningful choice about which venture capitalists invest in their companies. The results of the survey show that entrepreneurs often are able to choose among venture capitalists. Of the 136 firms that responded to a question regarding the number of offers to invest that were received from venture capitalists, 97 (71.32%) said they had received more than one offer to invest. Moreover, 73 firms (53.68%) received three or more offers. The mean number of offers was 3.18. Certainly, the firms that received multiple offers would be those most inclined to respond to a survey regarding criteria used in the selection of a venture capitalist. This result, therefore, is not necessarily generalizable to the entire population of entrepreneurs. Nevertheless, it appears that a substantial number of entrepreneurs have the ability to choose among venture capitalists.

SURVEY METHODOLOGY

The survey was sent to 415 firms and 143 responded, for a response rate of 34.5%. Given the length and complexity of the survey instrument (described below), the response rate appears to be quite high.

Survey Instrument

The survey instrument consisted of 12 categories of questions comprising 64 data points. Initial design of some of the survey questions relied on prior surveys of entrepreneurs and venture capitalists. Other questions were designed based on existing research literature or original research. The questions were of four general types:

(1) Attributes of the company or the entrepreneur. With respect to the companies, respondents were asked to identify their industry and to state the amount of venture financing they had received (Question 1). With respect to themselves, respondents were asked to describe their prior new venture experience (Question 2), their motivation for becoming an entrepreneur (Question 3), and their age, gender, and racial or ethnic background (Question 12).

(2) Process for selecting a venture capitalist. Respondents were asked to state the number of hours they personally devoted to gathering information about venture capitalists and the number of people besides themselves who were involved in the selection process (Question 4). Respondents were also asked to rate the importance of various sources of information about venture capitalists (Question 5). Finally, respondents were asked to state the number of offers to invest that they received from venture capitalists and whether they accepted the highest offer (Question 6A & B).

(3) Criteria for selecting a venture capitalist. Respondents were asked to rate the importance of 29 criteria in their selection of a venture capitalist on a scale from 0 to 10, where 8, 9, and 10 were very important or essential; 0, 1, and 2 were irrelevant or somewhat important; and 3 through 7 were in between. The criteria were split into four groups: Valuation (Question 6C), Value-Added Services (Question 7), Reputational Factors (Question 8), and Venture Capitalist Attributes (Question 9). Respondents were also asked to rank the relative importance of each group.

(4) Satisfaction with choice of venture capitalist. Respondents were asked to rate their level of satisfaction with the non-financial contributions of their venture capitalist.

Sample

The sample was comprised of 415 companies listed in the Price Waterhouse National Venture Capital Survey (now known as the "PricewaterhouseCoopers Venture Capital BestPractices Survey" and found at <http://www.opinion2.com/pwc/vcpract.htm>) as being in the "start-up/seed" or "early" stage of development and as having received "initial/seed" or "first stage" venture funding during the last three quarters of 1997 and the first quarter of 1998. The companies selected were limited by stage of development and type of investment to companies that were thought to be those most likely to have recently gone through the process of selecting a venture capitalist.

THE SELECTION PROCESS

The process used by entrepreneurs to select venture capitalists has not been the focus of academic research. With the exception of anecdotal accounts, therefore, little is known of the process used by entrepreneurs. Despite the absence of information on this issue, scholars frequently make assumptions about the nature of the selection process. The present study begins to fill the void by focusing on three questions: (1) How much time do entrepreneurs devote to their search for a venture capitalist? (2) Where do entrepreneurs obtain information regarding venture capitalists? (3) How many venture capitalists do entrepreneurs consider?

Time Devoted to the Search

Many entrepreneurs invest considerable time in the selection process. Of those responding to the question, 28.7% (38 of 132) reported spending 100 or more hours of their own time gathering information about venture capitalists. The median number of hours reported was 40. In addition, while 42 respondents selected their venture capitalist by themselves, over 70% of respondents (101 of 143) indicated that the selection was made by a team of two or more people. Moreover, many of those (69) stated that the team was comprised of three or more people.

Accessibility and Reliability of Information Sources

The survey asked respondents to rate the importance of eight possible sources of information regarding venture capitalists, using a scale from 0 to 10, where 8, 9, and 10 are very important or essential; 0, 1, and 2 are irrelevant or somewhat important; and 3 through 7 are in between. The sources listed in the survey instrument were: Accountants, Consultants, Entrepreneurs, Lawyers, News Media, Venture Capitalists, World Wide Web, Entrepreneur's Prior Experience.

The results indicate that respondents typically gathered information from various sources. Six respondents used only one source (for four of them, that source was their own prior experience, and for the other two that source was venture capitalists), but 24 gathered information from all eight. The mean number of sources used was 5.31, with 133 of the 143 respondents relying on three or more sources of information.

The responses reveal a heavy reliance on three sources: other entrepreneurs (mean = 6.58), venture capitalists (mean = 6.54), and the entrepreneur's own experience (mean = 6.01). Interestingly, these sources are likely to provide a rather limited picture of a venture capitalist. Even the most active serial entrepreneur will have, at most, a handful of experiences with venture capitalists. Admittedly, those experiences will be highly relevant to the selection process, but they are nevertheless limited. Moreover, the venture capitalists are unlikely to provide negative information about themselves, so the quality of that information is suspect.

The sources that would have the broadest and most independent view of venture capitalists were not heavily relied upon by the respondents. Accountants (mean = 2.06), consultants (mean = 2.84), and lawyers (mean = 4.40) are classic information intermediaries, but respondents did not value their input as highly as other sources. Even though a large number of entrepreneurs gathered information from lawyers (107 of 143), the value of that information was rated relatively low in comparison with information gathered from the three primary sources.

Number of Venture Capitalists Considered

The survey was directed at the question of how entrepreneurs select venture capitalists, so it is perhaps not surprising that most of the respondents gathered information about more than one venture capitalist before making their choice. Entrepreneurs who had no choice among venture capitalists would have been less likely to respond. Nevertheless, the findings (noted above) that 97 of 136 respondents had received more than one offer to invest and that 73 had received three or more offers may be significant in understanding the process used by entrepreneurs to select venture capitalists. These numbers suggest that entrepreneurs do not stop soliciting interest from venture capitalists after receiving one offer, but rather attempt to establish a market for their companies shares.

THE SELECTION CRITERIA

From a review of the literature on venture capital investing as well as popular accounts of the venture capital investment process, it appears that entrepreneurs generally consider four types of criteria in evaluating an offer to invest from a venture capitalist: (1) valuation; (2) value-added services; (3) venture capitalist reputation; and (4) venture capitalist attributes, such as industry specialization and prior operational experience. It is nearly impossible to measure directly the trade-offs that entrepreneurs would be willing to make among various criteria, and survey evidence regarding tradeoffs would require an extended journey into hypothetical questions, which are notoriously untrustworthy assessment devices. Nevertheless, the results of this survey strongly suggest that most entrepreneurs seek a balance among the various criteria. The following sections describe the results of the survey for each of the selection criteria in more detail.

Valuation (Price)

It is generally assumed that entrepreneurs are willing to trade off valuation for value-added services or venture capitalist reputation (Sapienza 1992). Measuring the extent of that tradeoff is nearly impossible, however, since venture capital valuations are notoriously amorphous. Valuations are not made as multiples of sales or income or by reference to tangible assets because the value of most firms simply is not adequately reflected in such measures. As a result, meaningful comparisons among valuations received by entrepreneurial companies are very difficult, if not impossible, to make.

Despite this uncertainty regarding valuation, the results of this survey support the widely held belief that valuation is extremely important to an entrepreneur's decision to accept venture financing. Valuation received a mean score of 7.32, fourth highest among all attributes. See Appendix 1. Perhaps more importantly, however, valuation was not the most important factor in the selection. Entrepreneurs assigned higher mean ratings to three other criteria, two reputational factors and one value-added service. Moreover, of the 97 firms that received more than one offer to invest, 36 did not accept the highest offer.

The responses were examined further for evidence of attitudes about valuation by comparing the mean ratings of the importance of valuation for three groups of respondents: those who received one offer to invest (mean = 7.05), those who received multiple offers to invest, but did not accept the highest valuation (mean = 7.08), and those who received multiple offers to invest, but accepted the highest valuation (mean = 7.64). The differences between respondents who received multiple offers to invest and accepted the highest valuation and each of the other groups are significant ($p < .10$) using a one-tailed *t*-test. Each group gave valuation a high rating in comparison with other criteria, but the differences suggest that the relationship between valuation and other criteria is more complex than usually assumed.

Value-Added Services

Researchers have attempted to describe in some detail the value-added services that venture capitalists provide to their portfolio companies. Surveys of entrepreneurs and venture capitalists have provided useful information about which value-added services venture capitalists actually perform. This survey takes a different tack, asking entrepreneurs to specify the importance of various value-added services to their selection of a venture capitalist.

Several studies of the level of venture capitalist involvement in the management of portfolio companies have used the survey instrument created by MacMillan (1988) (Rosenstein 1993; Ehrlich 1994). This survey uses an adapted version of the MacMillan (1988) list of value-added services.

The results of studies of value-added services exhibit a high degree of consistency, which may be more significant than it first appears because the studies were not asking the same questions. This survey asked entrepreneurs to rate the importance of the various services to their selection of a venture capitalist. Obviously, their answers may have been influenced by their subsequent experiences, but this *ex ante* perspective produced very similar results to the other studies, each of which inquired about actual participation by venture capitalists. The *importance* of venture capitalist participation also was the focus of Gorman & Sahlman (1989), who surveyed venture capitalists, and Rosenstein et al. (1993), who questioned entrepreneurs. Ehrlich et al. (1994) and MacMillan et al. (1988) took a different approach, however, inquiring about *amount* of venture capitalist participation by surveying entrepreneurs and venture capitalists, respectively. Despite the variations in the approach of these studies, the results of each confirms the importance of a few tasks performed by venture capitalists.

Venture Capitalist Reputation

Venture capitalist reputation has been studied in the fundraising and exiting contexts, but the investing context has been largely ignored in the academic literature on venture capital. This survey is the first attempt to identify and analyze the factors that comprise venture capitalist reputation. The results of the survey show that reputational factors are disproportionately represented among the most important criteria influencing the entrepreneur's selection of a venture capitalist. Appendix 1 shows that the most important selection criterion was a venture capitalist's reputation for investing in successful companies, and three of the top five criteria are reputational factors. In addition to reputation for investing in successful companies, entrepreneurs were interested in a reputation for having a personality that is compatible with the culture of the company and a reputation for following through with staged investments.

Venture Capitalist Attributes

Venture capitalists have many attributes that may be important to entrepreneurs but cannot rightly be classified as value-added services or reputational factors. For example, a venture capitalist's industry specialization does not necessarily indicate anything about the value-added services the venture capitalist will perform, nor does it necessarily signal anything about the quality of the venture capitalist or the venture capitalist's method of operation. Nevertheless, each of these other attributes would seem to derive most of its value from the fact that it sends certain signals to entrepreneurs about the level or quality of participation the entrepreneur can expect from the venture capitalist.

Because the value of these other attributes is largely derivative from the value of some underlying services or reputational factors, one might expect the attributes to obtain a lower rating from entrepreneurs. The results of the survey certainly reflect this possibility for the most important criteria. Nevertheless, several attributes obtained strong rankings and comprise two of the First Quartile and four of the top 11 criteria. See Appendix 1.

FACTORS INFLUENCING SELECTION CRITERIA

The results discussed in the previous section reveal the importance of the venture capitalist's reputation and have many interesting implications. Nevertheless, they paint a limited picture because they describe the preferences of entrepreneurs generally. Because entrepreneurs are not homogeneous, four potential sources of differences among entrepreneurs were also examined: geographic region, industry, prior new venture experience, and age. Means were computed for each group within a category and an analysis of variance was computed to test for differences in the means. In many instances, a *t*-test was also used to evaluate differences between the high and low means. Generally speaking, there were no significant variations in the ratings assigned to Valuation. Most entrepreneurs considered Valuation important (though, as shown above, it was not the most important factor). With respect to Value-Added Services, Reputational Factors, and Venture Capitalist Attributes, the tests revealed significant variations among entrepreneurs depending on geographic region, industry, prior new venture experience, and age. See Appendices 2-5.

Variations among entrepreneurs by geographic region, industry, prior new venture experience, and age are not always easy to explain. For example, one suspects that cultural differences among regions and industries are likely to play an important role in determining attitudes about venture capital, but such differences are often difficult to identify. Even more difficult is the task of linking cultural differences to differences in the selection process. For present purposes, at least, that level of exactitude is unnecessary. The primary goal of this section is to show that entrepreneurs are not homogeneous in their selection criteria for a venture capitalist. Such differences should reflect (or be reflected in) other aspects of the venture capital process, including the terms on which venture capital investments are concluded, the types of firms engaging in venture investing, and the nonfinancial attributes of venture capital complexes.

Geographic Region of the Entrepreneur

Respondents were divided into eight geographic regions: New England (includes respondents from Connecticut, Massachusetts, and New Hampshire); Atlantic (includes respondents from Pennsylvania and Virginia); South (includes respondents from Alabama, Florida, Georgia, North Carolina, and Tennessee); Midwest (includes respondents from Illinois, Iowa, Michigan, Minnesota, and Ohio); Texas & Colorado; Southern California (includes respondents from areas surrounding Los Angeles and San Diego); Northern California (include respondents from San Francisco and Silicon Valley); and Northwest (includes respondents from Oregon and Washington).

Value-Added Services. Of the five most important value-added services, "Formulating business strategy" and "Serving as a sounding board to entrepreneur team" had significant differences among the means of different geographic regions using ANOVA. See Appendix 2. In both instances, Southern California entrepreneurs achieved the highest mean ratings. Entrepreneurs in Southern California also gave the highest mean rating to "Formulating, testing, or evaluating marketing plans," and ANOVA revealed significant differences among the means.

Reputational Factors. Entrepreneurs in Southern California also weighed in heavily on reputational factors, assigning the highest mean ratings to six of the nine factors listed. See Appendix 2. With respect to "Investing even when management team is incomplete," ANOVA showed significant differences in the means of the various regions. More importantly, however, Southern California differed significantly from other regions in *t*-tests for five of the reputational factors: competence in performing value-added services; exiting through public offerings rather than acquisitions; following through with staged investments;

investing in successful companies; investing even when management team is incomplete; and personality that is compatible with the culture of the company.

Venture Capitalist Attributes. Although none of the venture capitalist attributes listed in the survey instrument showed significant differences under ANOVA, the *t*-tests yielded interesting results. For example, entrepreneurs in Texas/Colorado were significantly more interested ($p < .01$) in the amount of capital available to the venture capitalist than entrepreneurs in Northern California. One suspects that the wide availability of venture capital in Northern California causes entrepreneurs to be less concerned about funding future stages of development. In addition, entrepreneurs in the Atlantic region had a set of particular concerns. They are significantly more interested in the investment-stage specialization ($p < .01$), number of years in the venture capital industry ($p < .01$), and physical location of the venture capitalist ($p < .05$) than entrepreneurs in the regions with the lowest median rating. These differences are probably at least partially attributable to the relative newness of the venture capital industry in the Atlantic region. Finally, it appears that entrepreneurs in the Northwest are significantly more interested in the prior operational experience of the venture capitalist than entrepreneurs in New England. Although this study does not tackle the issue, the difference looks like something with cultural roots.

Industry of the Entrepreneur

Entrepreneurs were asked to classify their companies in one of seven industries, derived from categories used by VentureOne Corporation: (1) Biotechnology & Pharmaceuticals; (2) Communications & Networking; (3) Electronics & Computer Hardware; (4) Healthcare Services; (5) Medical Devices & Equipment; (6) Retailing & Consumer Products; and (7) Software & Information Services.

Value-Added Services. The most interesting difference among industries lies in the attitudes of entrepreneurs toward value-added services. In half of the value-added services listed (6), ANOVA showed significant variations in the means. See Appendix 3. Respondents in Biotechnology & Pharmaceuticals were significantly more interested in the venture capitalist's assistance with developing the actual product or service, formulating a business strategy, and interfacing with the investor group than entrepreneurs in other industries. Entrepreneurs in Retailing & Consumer Products were significantly more interested in having the venture capitalist obtain alternate sources of financing and solicit customers and distributors than entrepreneurs in other industries. Entrepreneurs in Electronics & Computer Hardware were significantly more interested in having the venture capitalist formulate, test, or evaluate marketing plans, monitor the company's performance, and recruit managers (the last two differences were found using *t*-tests with the industry achieving the lowest mean rating) than entrepreneurs in other industries.

Reputational Factors. The most surprising aspect of the results relating to reputational factors is that entrepreneurs in Biotechnology & Pharmaceuticals achieved the highest mean rating in six of nine factors. With respect to five of those six factors, *t*-tests showed significant differences between entrepreneurs in Biotechnology & Pharmaceuticals and entrepreneurs in the industry with the lowest ranking.

Venture Capitalist Attributes. ANOVA revealed significant results with respect to two attributes: amount of capital available to the venture capitalist and number of years in the venture capital industry. See Appendix 3. Results of the *t*-tests were quite dramatic. Entrepreneurs in Communications & Networking assigning significantly greater importance ($p < .01$) to industry specialization and physical location than entrepreneurs in those industries that ranked these factors lowest. Also, entrepreneurs in Biotechnology & Pharmaceuticals found investment stage specialization significantly ($p < .05$) more important

than entrepreneurs in Electronics & Computer Hardware.

Experience of the Entrepreneur

Recent research in venture capitalist has focused more attention on entrepreneurs who have started more than one venture, referred to as “habitual” entrepreneurs (Birley and Westhead 1994; Wright 1997; Westhead 1998). Habitual entrepreneurs account for a large proportion of startup ventures. Birley and Westhead (1994) surveyed business founders and found that approximately one-third were habitual entrepreneurs. Respondents in this survey were divided into three groups based on their prior entrepreneurial experiences: (1) no prior new venture experience; (2) worked in at least one new venture before present company but was not involved in the selection of a venture capitalist; and (3) worked in at least one new venture before present company and was involved in the selection of a venture capitalist.

Value-Added Services. The limited number of groups in this category makes for sharper distinctions than in comparisons based on geographic regions or industries. Although generalization about value-added services are usually not helpful, one surprising result was that entrepreneurs who had previously been involved in the selection of a venture capitalist rated all but three of the value-added services lower than the other two groups, and respondents with prior new venture experience but no experience selecting a venture capitalist rated all but one of the value-added services highest. See Appendix 4.

Reputational Factors. Results with respect to reputational factors are equally lopsided, with those entrepreneurs who had previously participated in the selection of a venture capitalist rating all reputational factors except one (“Investing in successful companies”) lower than the other two groups. See Appendix 4.

Venture Capitalist Attributes. ANOVA produced no significant differences among the means in this category, and the *t*-tests were only slightly more revealing. Among the most important of the venture capitalist attributes — industry specialization and investment stage specialization — *t*-tests showed significant differences ($p < .10$). In both instances, entrepreneurs with prior new venture experience but no experience selecting a venture capitalist rated these factors highest. Entrepreneurs with no new venture experience were least interested in industry specialization, and entrepreneur who had previously selected a venture capitalist were least interested in investment-stage specialization.

Age of the Entrepreneur

Of the three personal characteristics surveyed — age, gender, and race — only the first produced sufficient diversity to merit analysis. Entrepreneurs were divided into three groups based on age: those born before 1950, those born during the 1950s, and those born in 1960 or later.

Value-Added Services. The youngest entrepreneurs are most interested in value-added services, achieving the highest mean rating in eight of the 12 services listed. Moreover, ANOVA showed significant differences in the means in four of those services. See Appendix 5. Results of the *t*-tests on the other factors showed no significant differences among the high and low means.

Reputational Factors. Results for the reputational factors reveal a surprising pattern: the middle-aged entrepreneurs were most interested in reputational factors generally, and they were significantly more interested than one or both of the other groups of entrepreneurs with respect to five of those factors. Particularly worthy of note is that fact that the youngest entrepreneurs are significantly less interested in the venture capitalist’s reputation for

following through with staged financing than either of the other groups of entrepreneurs. Also important is that the oldest entrepreneurs are significantly less interested in whether the venture capitalist is willing to invest when the management team is incomplete than either of the other groups of entrepreneurs.

Venture Capitalist Attributes. Perhaps reflecting the greater desire to obtain value-added services, the youngest entrepreneurs were significantly more interested in the physical location of their venture capitalist than either of the other groups. The youngest entrepreneurs were also significantly ($p < .10$) more interested in the prior operational experience of their venture capitalist than the oldest entrepreneurs, again probably reflecting a desire to lean on the experience of the entrepreneur in the absence of personal experience. Given these results, it seems somewhat strange that the oldest entrepreneurs were significantly ($p < .10$) more interested in the number of years in the venture capital industry than either of the other groups of entrepreneurs. The oldest entrepreneurs were also significantly ($p < .10$) more interested in the amount of capital available to the venture capitalist than were the youngest entrepreneurs.

SUCCESSFUL SELECTIONS

Each respondent was asked to rate the level of satisfaction with the non-financial contributions of the venture investor on a scale from 0 to 10. The responses were then compared across the following dimensions: geographic region; industry; prior new venture experience; age; time devoted to the search for a venture capitalist; and criteria ranking. No significant variations were observed when entrepreneurs were divided by geographic region, industry, and age, but significant variations emerged in the other dimensions.

As noted above, respondents were divided into three groups based on prior new venture experience. Responses for these three groups suggest that experience is a good teacher. In t -tests ($p < .05$), entrepreneurs who had previous experience selecting a venture capitalist (mean = 7.86) were significantly more satisfied with their choice of venture capitalist than entrepreneurs who had no prior new venture experience (mean = 7.06). Although the mean score for the former group was higher than for entrepreneurs who had prior new venture experience but had not participated in the selection of a venture capitalist (mean = 7.31), the t -test revealed no significant difference in the responses of these two groups.

Respondents were also divided into three groups based on the amount of time they devoted to gathering information about venture capitalists: (1) 0 to 39 hours; (2) 40 to 80 hours; and (3) over 80 hours. The results show that satisfaction is inversely proportional to time invested in the selection process, with entrepreneurs spending 0 to 39 hours (mean = 7.69) significantly more satisfied with their selection than entrepreneurs spending over 80 hours (mean = 6.68). These results are easy to explain in light of the prior findings regarding the effect of prior experience on satisfaction levels. Entrepreneurs who have experience selecting a venture capitalist would likely devote less time to the process, having already invested time in a prior selection process.

Perhaps the most provocative results of the satisfaction survey are those associated with criteria ranking. Respondents were asked to rank each of the four categories of criteria — valuation, value-added service, reputational factors, and venture capitalist attributes — from 1 to 4, with 1 being the most important and 4 being the least important. For purposes of analyzing satisfaction, respondents were divided into four groups based on the category assigned the highest ranking (those who ranked valuation first were in one group, those who ranked value-added services first were in another group, and so on). Although ANOVA revealed no significant differences in the means of the four groups, a t -test showed a significant difference ($p < .05$) between entrepreneurs who favored valuation (mean = 7.00)

and entrepreneurs who relied on reputational factors (mean = 7.87), with the latter achieving higher levels of satisfaction than the former.

CONCLUSION: PRACTICAL EFFECT

The results of this study have important implications for both venture capitalists and entrepreneurs. Venture capitalists will benefit from better understanding how entrepreneurs weigh various criteria in the selection process. Such information is particularly useful to the extent that entrepreneurs vary systematically by geographic region, industry, new venture experience, age, and other factors. Entrepreneurs benefit from understanding the criteria used by other entrepreneurs, particularly those entrepreneurs who are very satisfied with their choices. Finally, any systematic variations based on geographic region, industry, new venture experience, age, and other factors may assist all parties to venture capital negotiations (including the lawyers) in understanding how various criteria for venture capitalist selection might affect the terms of the contracts between venture capitalists and entrepreneurs.

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Appendix 1 Results for Full Sample Sorted by Mean

	Mean	Standard Deviation
First Quartile		
Reputational Factor: Investing in successful companies	8.03	2.33
Value-Added Service: Serving as a sounding board to entrepreneur team	7.90	1.86
Reputational Factor: Personality that is compatible with the culture of the company	7.83	2.67
Valuation	7.32	1.98
Reputational Factor: Following through with staged investments	7.24	2.66
Other Venture Capitalist Attribute: Industry specialization of the venture capitalist	7.09	2.71
Other Venture Capitalist Attribute: Investment-stage specialization of the venture capitalist	6.93	2.61
Second Quartile		
Reputational Factor: Competence in performing value-added services	6.63	2.79
Other Venture Capitalist Attribute: Amount of capital available to the venture capitalist	6.45	2.74
Value-Added Service: Obtaining alternate sources of financing	6.38	2.85
Other Venture Capitalist Attribute: Prior operational experience of the venture capitalist	6.15	2.84
Value-Added Service: Recruiting management personnel	6.13	2.85
Reputational Factor: Co-investing with other venture capitalists	6.12	2.96
Value-Added Service: Interfacing with investor group	5.96	2.98
Reputational Factor: Allowing entrepreneurs to retain managerial positions	5.96	3.23
Third Quartile		
Value-Added Service: Formulating business strategy	5.78	2.54
Reputational Factor: Allowing entrepreneurs to retain large ownership share	5.62	3.21
Value-Added Service: Monitoring the company's performance	5.52	2.77
Other Venture Capitalist Attribute: Number of years in the venture capital industry	5.46	2.89
Reputational Factor: Investing even when management team is incomplete	5.34	3.42
Value-Added Service: Managing crises or problems	4.60	2.83
Value-Added Service: Soliciting customers or distributors	4.41	3.26
Fourth Quartile		
Reputational Factor: Exiting through public offerings rather than acquisitions	4.35	3.20
Other Venture Capitalist Attribute: Physical location of the venture capitalist	4.22	3.20
Value-Added Service: Formulating, testing, or evaluating marketing plans	4.08	2.66
Value-Added Service: Motivating personnel	2.99	2.65
Value-Added Service: Developing actual product or service	1.73	2.23
Value-Added Service: Selecting vendors and equipment	1.66	2.06
Other Venture Capitalist Attribute: Whether venture capitalist is SBIC	1.20	2.07

Appendix 2 Test Results With Sample Split by Geographic Region

	New England (n = 25)	Atlantic (n = 10)	South (n = 15)	Midwest (n = 13)	Texas & Colorado (n = 12)	Southern California (n = 15)	Northern California (n = 39)	Northwest (n = 8)	Results of ANOVA
Valuation	7.22	6.20	7.80	6.92	7.75	6.80	7.49	7.63	
Value-Added Services:									
Developing actual product or service	1.76	1.40	1.33	2.92	1.75	2.20	1.51	2.25	
Formulating business strategy	6.56	4.80	4.27	6.08	6.17	6.93	5.69	5.63	<i>a</i>
Formulating, testing, or evaluating marketing plans	4.38	2.40	2.20	5.08	4.67	5.47	4.13	4.13	<i>c</i>
Interfacing with investor group	7.16	5.70	6.13	6.23	6.42	5.73	5.26	4.25	
Managing crises or problems	5.00	3.60	3.60	4.46	4.58	4.93	5.15	3.50	
Monitoring the company's performance	5.44	5.00	5.20	6.31	5.50	5.60	5.51	5.50	
Motivating personnel	3.60	1.80	2.60	3.08	2.67	3.40	3.36	1.88	
Obtaining alternate sources of financing	6.48	6.70	7.20	7.46	6.50	7.13	5.21	6.50	
Recruiting management personnel	6.36	4.60	5.73	5.46	5.42	7.40	6.72	7.25	
Selecting vendors and equipment	1.12	1.60	1.47	1.62	1.25	2.80	1.79	1.88	
Serving as a sounding board to entrepreneur team	8.08	8.60	8.07	7.15	8.50	8.67	7.54	6.63	<i>a</i>
Soliciting customers or distributors	3.60	3.50	3.67	4.31	4.42	5.53	5.77	2.50	<i>b</i>
Reputational Factors:									
Allowing entrepreneurs to retain large ownership share	4.80	7.10	6.40	5.92	6.42	5.60	5.26	3.38	
Allowing entrepreneurs to retain managerial positions	6.12	6.60	6.13	6.08	6.17	6.53	5.49	3.38	
Co-investing with other venture capitalists	6.96	5.80	5.60	7.08	6.83	6.27	5.59	5.25	
Competence in performing value-added services	6.16	6.20	5.53	6.46	6.92	8.07	6.87	6.25	

Exiting through public offerings rather than acquisitions	3.60	4.70	4.73	5.15	3.92	5.53	3.87	5.38	
Following through with staged investments	7.60	7.70	6.93	7.38	8.17	8.87	6.26	7.13	
Investing in successful companies	8.28	7.50	7.80	8.31	8.17	8.53	7.90	8.13	
Investing even when management team is incomplete	4.52	4.70	5.93	5.92	4.33	8.00	5.23	5.75	<i>a</i>
Personality that is compatible with the culture of the company	7.96	8.80	7.80	7.00	8.50	9.40	7.28	8.00	
Other Venture Capitalist Attributes:									
Amount of capital available to the venture capitalist	7.12	6.90	6.40	7.31	7.50	6.50	5.36	5.75	
Industry specialization of the venture capitalist	7.36	6.40	6.73	7.31	6.25	7.64	7.33	7.38	
Investment-stage specialization of the venture capitalist	7.76	8.20	6.93	7.23	7.17	7.07	6.10	6.88	
Number of years in the venture capital industry	5.84	7.70	4.73	4.92	5.50	6.29	5.44	4.50	
Physical location of the venture capitalist	4.56	5.30	4.07	4.92	2.58	4.36	4.13	4.50	
Prior operational experience of the venture capitalist	5.20	6.11	5.87	7.00	6.58	7.00	5.95	7.88	
Whether venture capitalist is SBIC	1.12	1.70	1.00	1.69	1.83	1.93	0.79	0.88	

^a p<.10, ^b p<.05, ^c p<.01

Appendix 3 Test Results With Sample Split by Industry

	Biotechnolo- gy & Pharmaceutic als (n = 10)	Communica- tions & Networking (n = 29)	Electronics & Computer Hardware (n = 12)	Heathcare Services (n= 13)	Medical Devices & Equipment (n = 14)	Retailing & Consumer Products (n = 5)	Software & Information Services (n = 52)	Results of ANOVA
Valuation	8.11	7.66	6.92	7.15	6.64	7.80	7.28	
Value-Added Services:								
Developing actual product or service	3.50	1.45	2.00	2.00	2.57	1.20	1.13	<i>b</i>
Formulating business strategy	7.80	5.76	6.75	5.15	6.36	5.00	5.46	<i>a</i>
Formulating, testing, or evaluating marketing plans	5.22	4.45	5.67	2.77	4.14	4.80	3.77	<i>a</i>
Interfacing with investor group	8.50	6.55	5.83	5.54	6.43	6.40	4.98	<i>b</i>
Managing crises or problems	4.70	5.28	4.83	3.23	5.00	4.40	4.52	
Monitoring the company's performance	6.50	5.66	6.75	3.77	5.07	5.20	5.54	
Motivating personnel	3.30	3.55	4.08	3.08	2.57	2.40	2.63	
Obtaining alternate sources of financing	8.10	6.66	6.83	7.92	6.07	8.40	5.21	<i>c</i>
Recruiting management personnel	6.40	5.90	7.25	6.77	6.50	6.40	6.06	
Selecting vendors and equipment	0.80	2.07	2.33	2.85	1.07	1.80	1.38	
Serving as a sounding board to entrepreneur team	7.60	7.86	7.83	7.69	7.79	8.40	7.96	
Soliciting customers or distributors	2.90	4.59	3.92	5.23	2.21	6.00	5.15	<i>b</i>
Reputational Factors:								
Allowing entrepreneurs to retain large ownership share	6.90	5.72	4.33	6.23	4.36	6.40	5.63	
Allowing entrepreneurs to retain managerial positions	7.40	6.00	5.00	6.15	5.00	6.60	6.00	
Co-investing with other venture capitalists	8.50	6.17	5.67	5.62	6.07	7.80	5.71	

Competence in performing value-added services	6.80	7.24	7.25	6.31	5.50	6.80	6.42
Exiting through public offerings rather than acquisitions	4.80	4.55	5.58	4.38	3.57	4.80	4.10
Following through with staged investments	8.70	7.62	6.75	7.62	7.07	6.60	6.94
Investing in successful companies	9.20	8.17	8.33	7.15	8.21	9.00	7.79
Investing even when management team is incomplete	7.00	5.93	5.58	5.62	5.57	5.80	4.90
Personality that is compatible with the culture of the company	7.50	7.48	7.17	8.46	8.43	8.40	7.81

Other Venture Capitalist Attributes:

Amount of capital available to the venture capitalist	8.30	6.21	4.75	7.17	7.00	8.00	6.04	<i>b</i>
Industry specialization of the venture capitalist	7.50	8.00	6.83	7.25	7.64	6.00	6.69	
Investment-stage specialization of the venture capitalist	8.20	7.24	5.92	7.00	7.50	8.00	6.60	
Number of years in the venture capital industry	6.10	6.34	6.08	6.00	4.64	7.40	4.56	<i>a</i>
Physical location of the venture capitalist	4.50	4.66	4.42	4.42	3.86	1.00	4.50	
Prior operational experience of the venture capitalist	6.10	6.52	5.92	7.08	6.79	4.80	5.84	
Whether venture capitalist is SBIC	1.80	1.52	1.58	0.92	0.29	2.40	0.88	

^a $p < .10$, ^b $p < .05$, ^c $p < .01$

Appendix 4 Test Results With Sample Split by Prior New Venture Experience of Entrepreneur

	No Prior New Venture Experience (n =56)	Prior New Venture Experience; No Experience Selecting Venture Capitalist (n = 37)	Prior New Venture Experience; Experience Selecting Venture Capitalist (n = 50)	Results of ANOVA
Valuation	7.33	7.44	7.22	
Value-Added Services:				
Developing actual product or service	1.66	1.81	1.76	
Formulating business strategy	5.38	6.76	5.52	<i>b</i>
Formulating, testing, or evaluating marketing plans	3.91	4.57	3.90	
Interfacing with investor group	6.18	6.35	5.42	
Managing crises or problems	4.53	5.17	4.37	
Monitoring the company's performance	5.61	6.00	5.08	
Motivating personnel	2.91	3.97	2.36	<i>b</i>
Obtaining alternate sources of financing	6.89	6.03	6.06	
Recruiting management personnel	6.09	6.51	5.90	
Selecting vendors and equipment	1.73	2.03	1.32	
Serving as a sounding board to entrepreneur team	7.88	8.22	7.70	
Soliciting customers or distributors	4.41	4.68	4.22	
Reputational Factors:				
Allowing entrepreneurs to retain large ownership share	6.25	5.97	4.66	<i>b</i>
Allowing entrepreneurs to retain managerial positions	6.80	5.86	5.08	<i>b</i>
Co-investing with other venture capitalists	5.96	6.73	5.84	
Competence in performing value-added services	6.73	7.70	5.72	<i>c</i>
Exiting through public offerings rather than acquisitions	4.68	4.46	3.90	
Following through with staged investments	7.18	7.57	7.06	
Investing in successful companies	8.11	7.95	8.00	
Investing even when management team is incomplete	5.39	5.54	5.14	
Personality that is compatible with the culture of the company	7.89	8.19	7.50	
Other Venture Capitalist Attributes:				
Amount of capital available to the venture capitalist	6.47	6.38	6.48	

Industry specialization of the venture capitalist	6.71	7.59	7.14
Investment-stage specialization of the venture capitalist	6.71	7.59	6.68
Number of years in the venture capital industry	5.27	5.49	5.64
Physical location of the venture capitalist	3.58	4.57	4.66
Prior operational experience of the venture capitalist	5.98	6.14	6.34
Whether venture capitalist is SBIC	1.25	1.32	1.04

^a p<.10, ^b p<.05, ^c p<.01

Appendix 5 Test Results With Sample Split by Entrepreneur's Age

	Born Before 1950 (n = 32)	Born During the 1950s (n = 61)	Born in 1960 or Later (n = 45)	Results of ANOVA
Valuation	7.35	7.25	7.58	
Value-Added Services:				
Developing actual product or service	1.09	1.75	2.09	
Formulating business strategy	5.38	5.80	5.98	
Formulating, testing, or evaluating marketing plans	4.19	4.10	4.02	
Interfacing with investor group	6.13	5.61	6.38	
Managing crises or problems	4.13	4.28	5.49	<i>b</i>
Monitoring the company's performance	5.63	5.43	5.76	
Motivating personnel	2.63	2.43	4.09	<i>c</i>
Obtaining alternate sources of financing	6.31	6.43	6.40	
Recruiting management personnel	4.63	5.87	7.49	<i>d</i>
Selecting vendors and equipment	1.19	1.82	1.69	
Serving as a sounding board to entrepreneur team	8.16	7.95	7.67	
Soliciting customers or distributors	3.31	4.44	5.00	<i>a</i>
Reputational Factors:				
Allowing entrepreneurs to retain large ownership share	4.88	6.10	5.51	
Allowing entrepreneurs to retain managerial positions	5.44	6.25	5.98	
Co-investing with other venture capitalists	5.84	6.54	5.80	
Competence in performing value-added services	6.00	6.41	7.20	
Exiting through public offerings rather than acquisitions	4.31	4.38	4.29	

Following through with staged investments	7.56	7.62	6.31	<i>b</i>
Investing in successful companies	7.69	8.33	7.93	
Investing even when management team is incomplete	4.00	5.77	5.60	<i>b</i>
Personality that is compatible with the culture of the company	7.66	7.69	8.11	
Other Venture Capitalist Attributes:				
Amount of capital available to the venture capitalist	7.00	6.30	6.13	
Industry specialization of the venture capitalist	6.63	7.26	7.11	
Investment-stage specialization of the venture capitalist	6.56	6.95	7.04	
Number of years in the venture capital industry	6.13	5.16	5.33	
Physical location of the venture capitalist	4.09	3.62	5.09	<i>a</i>
Prior operational experience of the venture capitalist	5.66	6.10	6.53	
Whether venture capitalist is SBIC	1.53	1.13	1.07	

^a $p < .10$, ^b $p < .05$, ^c $p < .01$ ^d $p < .001$