



Founder Evaluation from VCs' Perspective: Emphasizing Grit and Moderate Optimism and Gauging Them Scientifically

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Abstract. The element “people” has become increasingly essential among the criteria VCs evaluate before making an investment decision. Nevertheless, aside from the readily available information such as educational background and prior entrepreneurial or professional experience, some characteristics of founders are challenging to observe in the short term but can be equally or even more critical to the success of ventures. Through a review of the relevant literature, this paper highlights grit and moderate optimism as crucial qualities for VCs to consider when evaluating founders and examines evidence that these traits make founders more likely to succeed in their ventures. Additionally, it seeks to advise novice or less experienced VCs to employ scientifically validated approaches to gain insight into the attributes of founders that are not readily observable before making a funding decision. Instruments such as the Short Grit (Grit-S) Scale constructed by Duckworth and Quinn and the Revised Life Orientation Test (LOT-R) developed by Scheier et al. to gauge founders’ level of grittiness and optimism are suggested to be incorporated into the founder evaluation process.

Keywords: Venture capital · founders · grit · passion · optimism · venture success

1 Introduction

According to a study by Shikhar Ghosh, a professor at Harvard Business School, around 75% of venture-backed start-ups in the United States fail to repay their investors [1]. The general norm is that out of ten investments, three or four start-ups fail altogether; another three or four recoup the initial investment; only one or two generate significant returns [1]. Furthermore, according to Ghosh’s research, over 95% of start-ups fail if failure means not seeing the anticipated return on investment [1]. Due to the substantial risks associated with investing in start-ups, VCs are cautious when reviewing venture proposals before making investment choices. Among all the factors that VCs consider before making an investment decision, the aspect of “people” (founders and the founding team for early-stage start-ups) has become increasingly important [2, 3]. The study by MacMillan et al. (1985) reveals direct validation of the VC community’s widely held belief that the quality of the entrepreneur, above all else, affects the investment decision

[2]. According to Gompers et al. (2019), VCs place higher importance on the management/founding team than on business-related criteria like product or technology when making investment decisions and tend to ascribe the investment outcome to the team rather than the business [3]. Some facets of people are apparent and quantifiable, such as educational background, professional experience, prior entrepreneurial experience, management skills, and technical/industry skills. Gompers et al. (2016), for example, suggest that “skill” plays a critical role in entrepreneurial success, demonstrating that entrepreneurs with successful track records have a better likelihood of succeeding than those who are embarking on their first endeavours or have previously failed [4]. Interestingly, even though researchers claim that founders’ education is a crucial indicator of a start-up’s potential, varied statistical evidence reveals that investors do not necessarily perceive higher education levels favourably when it comes to founding team selection [5]. Pinelli et al. (2020) find that investors prefer start-ups with co-founders who have either a high level of education or a high degree of educational heterogeneity, but not both [5]. Specifically, when co-founders have advanced degrees in different fields, investors are concerned that antagonism, friction, and poor coordination would hinder them from fulfilling the start-ups’ full potential [5]. Apart from the readily available qualities of founders mentioned above, some other characteristics are more difficult to observe in the short term, particularly the founders’ true personality traits and mindsets but are equally, if not more, critical to the success of ventures. Researchers have used meta-analyses to determine which personality traits of entrepreneurs are associated with venture success. According to Rauch and Frese (2007), the attributes positively connected with business success include the desire for accomplishment, risk-taking, creativeness, autonomy, locus of control, and self-efficacy [6]. Zhao et al. (2009) discover that openness to experience, conscientiousness, emotional stability, and extraversion are positively correlated with venture performance in terms of firm survival, growth, and profitability [7]. Risk-taking, on the contrary, is positively related to entrepreneurial intentions but not venture performance [7]. Leutner et al. (2014) find “incremental validity” that a set of specific traits, including “need for achievement, self-confidence, innovativeness, stress tolerance, need for autonomy, and proactive personality”, provides discrete variance that helps predict entrepreneurial success [8].

This paper will focus on the latter, the less obvious attributes of founders. Rather than exploring a wide range of personality attributes that can contribute to venture success, this paper will focus on two traits: grit and moderate optimism. The remainder of this paper is organized as follows: first, why are grit and moderate optimism essential attributes to consider when evaluating founders, or what evidence indicates that these qualities are linked to entrepreneurial success; and second, advice for VCs on founder selection, specifically, measure grit and optimism using scientifically validated approaches. Furthermore, because this paper examines ventures in their initial stages of the start-up lifecycle, it focuses on the quality of founders (and co-founders) rather than the broader team developed afterwards.

2 Why Are Grit and Moderate Optimism Important to Consider When Evaluating Founders?

Early-stage businesses are prone to setbacks and failures. Founders possessing high levels of grit are better at dealing with setbacks and challenges and do not give up when confronted with adversity; consequently, they have a higher chance of thriving and leading their ventures to success. This is because, according to Duckworth et al. (2007), grit involves persevering in the face of hardship and retaining hard work and passion until the end, notwithstanding setbacks, difficulties, and growth plateaus [9]. The gritty individuals view success as a “marathon”, and stamina is their greatest asset [9]. While some might see frustration or monotony as a sign that it is time to shift direction and reduce losses, the person with grit carries on trying [9]. As such, despite hurdles, hardship, and setbacks, founders with high levels of grit may stay focused on their goals for extensive stretches of time. As a result, while grit does not guarantee success, it may be a powerful predictor of success that distinguishes founders who possess a high level of it from those who do not, particularly in the face of setbacks. Indeed, the empirical study by Mueller et al. (2017) uncovers a positive link between grit and venture success, revealing grit “as one of the significant conduits of a set of pathways leading from entrepreneurial passion to new venture performance” and an essential “predictor” of venture success [10].

Similarly, optimism is a valuable trait that may assist people in overcoming difficulties and obstacles, whereas in the entrepreneurial context, only a moderate or managed level of optimism may be constructive to venture performance [11]. Improved capability to create coalitions, increased tolerance to stress, more tenacity when faced with hardship, and increased ability to develop vast social networks are some benefits of high optimism levels [11]. Several of these abilities or talents, particularly the capability to build large social networks, have been demonstrated to be significant determinants of entrepreneurial achievement [11]. Nevertheless, according to research findings, highly optimistic individuals tend to set unrealistically high goals and discount negative information [11]. These tendencies often interfere with people’s judgment and decision-making [11]. Given the consistency of such research findings, highly optimistic entrepreneurs are more likely to make poor strategic judgments [11]. Conversely, individuals with low optimism have a proclivity for focusing on negative information and are less likely to be motivated since they presume that they will fail regardless of all their efforts; as a result, they typically produce subpar results [11]. Moderate optimists, on the contrary, are more pragmatic in their decisions and pursuits of opportunities [11]. This moderation is critical in the entrepreneurial context because entrepreneurs need to determine which goals they can realistically achieve in the early stages of venture development to optimize their ventures’ chances of survival and long-term success [11].

2.1 Grit

Grit, defined as “perseverance and passion for long-term goals”, has been linked to success in a range of disciplines and involves two parameters: Consistency of Interests and Perseverance of Effort [9]. A distinction between grit and conscientiousness is made. While the two constructs have some overlap, grit emphasizes “long-term stamina”

instead of “short-term intensity”; the gritty person not only completes tasks at hand but also devotes years to achieving a specific goal [9]. Nevertheless, more recent research by Jachimowicz et al. (2018) finds that previous analyses of grit are inadequate in predicting success because they put more emphasis on perseverance while undervaluing the “critical role of passion” [12]. According to Jachimowicz et al. (2018), the assessment of grit developed by Duckworth et al. does not fit its definition [12]. While the concept of grit comprises both perseverance and passion, the scale designed to measure grit only captures perseverance and not passion [12]. They find a link between grit and future performance by more explicitly including passion in the notion of grit and its measurement [12].

Indeed, grit is especially important in the context of entrepreneurship because it entails “passion”, which is essential for founders to have in steering venture success. With “passion”, founders will have complete faith in their inner vision and carry it out day by day, always keeping the big picture in mind, and they will be motivated to sustain the venture. The study by Fisher et al. (2018) investigates the relationship between entrepreneurial passion and entrepreneurial success [13]. The researchers discover that harmonious passion, which evolves from an autonomous internalization of the activity into one’s identity and motivates people to freely partake in what they love while generating “flexible persistence”, leads to entrepreneurial success both directly and indirectly via resilience. In contrast, obsessive passion, which arises from a controlled internalization of the activity into one’s identity and compels people to partake in the pursuit, produces “rigid persistence” and contributes to sustained entrepreneurial commitment, which in turn contributes to entrepreneurial success through resilience [13].

2.2 Optimism

Optimism is another crucial personality attribute to consider when evaluating founders. Just as grit breeds tenacity for long-term goals, optimism fosters persistence in an arduous path of action. Optimism, according to Dholakia, helps entrepreneurs succeed in their endeavours in four ways: it encourages creative thinking and the production of new ideas; it generates a propensity to act; it supports tenacity in a difficult path of action; it helps entrepreneurs bounce back after a setback [14]. With optimism, founders possess positive energy and do not get discouraged or give up when faced with setbacks and challenges. Optimistic founders adopt a proactive approach to overcoming challenges and solving problems, enhancing ventures’ chances of survival and success.

Furthermore, evidence reveals that optimistic entrepreneurs have easier access to credit and are charged reduced interest rates on their loans [15]. Using the SSBF data from the US Federal Reserve Board (a sample consisting of 815 new loan applications by small businesses operating in the US), Dai et al. (2017) investigate the role of entrepreneurial optimism in small business lending [15]. They discover that banks are more ready to lend to optimistic entrepreneurs, who are less likely to be asked to offer guarantees or collateral and pay lower interest rates than their less optimistic counterparts [15]. These data imply that optimistic entrepreneurs are seen positively by lenders, bolstering the favourable perspective of optimism [15]. The availability of extra funds obtained at a cheaper cost of financing may accelerate venture development and perhaps boost VC returns.

Entrepreneurial optimism that leads to venture success, according to research findings, is not excessive or unrealistic [16]. Counterfactual thinking, or envisioning alternate outcomes or events than those that transpired, is less common among successful entrepreneurs than among ordinary people [17]. Indeed, as psychologists point out, “optimism can have costs if it is too unrealistic” [16]. The link between optimism and new venture success can be positive up to a certain degree, but then it can turn negative [11]. This reverse might happen because, when optimism hits extreme levels, entrepreneurs might become overconfident and fail to examine potential opportunities thoroughly [11].

3 Suggestions

Despite the difficulties in observing founders' personality traits on the spot, VCs are suggested to pay attention to and try seeking evidence in the traits discussed above as they might be closely related to ventures' future success (thus the return on their potential investments), in addition to evaluating other important yet more obvious or quantifiable aspects of the founders, such as skills, experience, and educational background. When it comes to assessing grit and optimism, instruments designed to gauge the founders' grit and optimism levels can be incorporated and interview questions specifically aimed at testing those traits can be tailored when evaluating founders. Evidence showing whether and the degree to which they possess those traits may surface in their answers.

VCs may incorporate The Short Grit (Grit-S) Scale constructed by Duckworth and Quinn (2009) into the founder evaluation process to gauge the grittiness of founders. The 8-item Grit-S scale is a refinement of Duckworth et al. (2007)'s original 12-item grit scale [18]. Grit-S scale preserves the previous scale's two-factor structure (Consistency of Interest and Perseverance of Effort) but has better psychometric qualities and has been proved to be a more efficient measure of grit than the original scale with internal consistency, test-retest stability, and consensual and predictive validity [18]. The instrument uses a 5-point Likert ranging from 1 (“not like me at all”) to 5 (“very much like me”) [18]. Example statements include, “I often set a goal but later choose to pursue a different one” and “I finish whatever I begin” [18]. The assessment might be administered to founders as an additional data point during the interview. However, because everyone wants to put their best foot forward in interviews, obtaining a reliable score might be difficult. Instead, VCs may check the questions on the scale, tweak the interview questions accordingly, and ask those questions separately or in conjunction with the assessment. For instance, “Setbacks don't discourage me” [18] on the assessment can be rephrased as “When was the last time you confronted a challenge and how did you handle it?” during the interview. If entrepreneurs struggle to come up with stories and examples in their answers, or if the stories and examples sound generic, they may not be the best people to lead venture success and hence to invest in. Conversely, entrepreneurs with a high level of grit will likely have detailed recollections of how they overcame difficulties and managed setbacks.

Furthermore, because Grit-S has been critiqued for measuring only perseverance rather than passion [12], both of which are components of grit [9, 12], another scale developed to gauge entrepreneurial passion is advised to be incorporated in conjunction with Grit-S to complement the measure of grit. The instrument devised and validated by

Cardon et al. (2012) measures passion across three entrepreneurial domains: inventing, founding, and developing [19]. As passion is concerned with intense positive feelings for pursuits that are vital and significant to a person's identity, Cardon et al. explicitly integrate intense positive feelings and identity centrality, the two dimensions of passion, into their measure [19]. The instrument uses a 5-point Likert scale ranging from "strongly disagree" to "strongly agree", yet Cardon et al. suggest that future implementation of this instrument consider adopting broader scales and anchors to avoid range restriction issues [19]. "It is exciting to figure out new ways to solve unmet market needs that can be commercialized", "Establishing a new company excites me", and "Assembling the right people to work for my business is exciting" are examples of statements that measure intense positive feelings for inventing, founding, and developing, respectively [19]. "Inventing new solutions to problems is an important part of who I am", "Being the founder of a business is an important part of who I am", and "Nurturing and growing companies is an important part of who I am" are examples of identity centrality statements for inventing, founding, and developing, respectively [19].

Similarly, VCs may incorporate assessments like the 10-item Life Orientation Test-Revised (LOT-R) devised by Scheier, Carver, and Bridges (1994) into the founder interview process to evaluate founders' level of optimism. Many psychologists consider the LOT-R technique a sufficient and reliable instrument for measuring optimism. In both research and practice, this revised scale is one of the most extensively employed measures of dispositional optimism. On a 5-point Likert scale, founders will need to respond to 10 statements such as "In uncertain times, I usually expect the best", and "I rarely count on good things happening to me" (0, "I disagree a lot" to 4, "I agree a lot") [20].

In sum, VCs may design their own assessments and fine-tune founder interview questions based on Grit-S, LOT-R, and other instruments developed and validated by researchers and scholars to gain insight into founders' not immediately observable traits and characteristics.

4 Conclusion

Evaluating founders and teams is a crucial aspect of the VC investing process. As highlighted in this paper, among other qualities, grit and moderate optimism are two essential traits of founders that might indicate or predict future venture success. Accordingly, VCs may benefit from incorporating assessments like Grit-S and LOT-R into the founder interview and evaluation process to determine whether and to what extent they possess these attributes.

Furthermore, there is a scarcity of literature on frameworks employed by VCs to assess founder qualities in practice. Several prominent VC firms, in practice, employ a variety of techniques for evaluating founders, ranging from science-based products to bespoke tools; they also collaborate with organizational psychologists and use various metrics, including strength assessments, motivation analyses, and personality assessments. Founders are evaluated through structured interviews and a variety of interactions and are observed in terms of how they act, respond to questions, and interact with one another. However, little has been found in the research field regarding the frameworks and metrics that VCs use in practice when evaluating founders' overall characteristics.

As such, there is a gap between research and practice regarding how top or experienced VCs assess founders' overall potential. Future studies might dive into the metrics employed by professional VCs in practice when evaluating founders. In addition, empirical data are needed to establish what level or extent of grit and optimism, measured by instruments such as Grit-S and LOT-R, is desirable in the entrepreneurial context.

Lastly, even the finest and most extensively used personality tests may lack reliable data on entrepreneurs who may or may not have great potential for leading venture success. Therefore, this paper does not advocate that VCs simply rely on personality or psychometric assessments when performing due diligence on founders. After all, despite enhancing the likelihood of success, the author concedes that these attributes alone are insufficient to lead a successful venture. As far as the "people" aspect is concerned, the right balance of experience, business acumen, industry skill, and leadership potential, along with a set of favourable traits, is needed to maximize the ventures' prospects of long-term survival and success.

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