A Three-Part Formula for Fueling Start-Ups

Securing the necessary resources involves much more than just getting a VC to say yes.

According to psychologist John Gottman, six factors, such as whether a couple immediately use a harsh tone when discussing a conflict, can **predict** divorce with 86 percent accuracy. However, few couples could save a failing relationship just by learning about these factors. The key is to understand the processes and steps involved in resolving the differences that will inevitably crop up during a marriage.

Similarly, to best understand how a new venture can succeed, it is important to go beyond correlations. While it is undoubtedly helpful to know that entrepreneurs who do (or who are) *X* tend to obtain *Y* results, appreciating the intermediate steps and processes that lead to these results could propel us forward. Currently, these steps and processes remain a kind of black box.

In our paper **"Turning Lead into Gold: How Do Entrepreneurs Mobilize Resources to Exploit Opportunities"**, my co-authors David Clough (from the University of British Columbia), Tommy Pan Fang, Andy Wu (both from Harvard) and I reviewed 150 leading empirical papers on how founders secure the various forms of capital they need to launch their start-up. While the purpose of our paper was to suggest a path ahead for future academic research, our work allowed us to recap what is known – and yet unknown – on the subject.

The three steps to mobilise business resources

One of our key insights is that mobilising resources is itself a process involving three successive steps.

Step 1: Search for resources

To execute on an opportunity, entrepreneurs need much more than just financial resources, such as cash, VC money or bank loans. They also need to gather human capital, usually co-founders or employees. Their success will also depend on their social capital, i.e. the social ties, networks and connections that grease the wheels of business. Beyond those, they may still need to worry about increasing their legitimacy as founders and building a compelling narrative for their ventures.

With so much to think about, many budding entrepreneurs don't know where to start. The very first step consists of identifying who has the required resources. Where to find suitable employees? Where to get funding? How to build connections, fast?

According to our review of the literature, only 20 percent of papers examined the art of searching for business resources, leaving new entrepreneurs with much to figure out on their own. That is regrettable, because the research has shown that too many entrepreneurs remain solely within the

confines of the world they know.

For instance, when looking for human and social capital, entrepreneurs tend to limit their search to their immediate social networks, such as family, friends and former co-workers. As a result, individuals who start from privilege – thanks to being born in a wealthy family or having received a top college education – tend to do better than average.

Not all is lost for the less privileged entrepreneurs, but they must compensate by becoming proactive networkers. They can't rely on serendipity to form new, helpful connections. Another avenue consists of first building a large portfolio of organisational accomplishments. **Research** also suggests that entrepreneurs with higher initial aspiration levels are less likely to be satisfied with their original set of options and therefore more likely to seek new ties with indirect contacts and strangers.

If you are a new entrepreneur, you may want to ask yourself:

- *Am I proactive in my search for resources, including new social ties?*
- *Am I limiting myself to what I know exists or do I seek help in exploring the wide world of available options and resources?*

Step 2: Persuade those with the relevant resources to come onboard

Once you have probed the full menu of potential resources for your venture, the next step consists of acquiring those you feel are the best fit. This is the most abundant stream of research in our review, accounting for some 55 percent of papers. In this loot, we found an (over)abundance of research on how entrepreneurs can secure financial support. However, accessing resources means a lot more than just making a successful pitch before a banker or VC. For instance, a crucial task may be to persuade potential employees to join your new company – a huge **challenge** for many start-ups in the ongoing "war for talent".

It may also involve forming an alliance with an established company in order to piggyback on their social capital. In fact, connections and affiliations with any high-status people or entities act as endorsements. For example, once a venture secures backing from a well-known VC, the remaining resources, such as employees, partners and additional financial support, tend to come more easily.

If you are struggling, do not underestimate the power of word-of-mouth in attracting the right resources. Your new board of directors may be able to refer great employees or partners, just like the VCs you meet may have suitable co-founders to recommend.

Research also shows that storytelling matters a lot for entrepreneurs. Building a compelling narrative can go a long way towards persuading investors that a founding team can execute on a given idea. While this is true for all start-ups, social or hybrid ventures face a special dilemma: Should their story emphasise the potential for financial or social returns? What we know is that women founders may particularly benefit from talking about their **proposed social impact**.

Here are some questions that may require your careful consideration:

- *If I decide to rely heavily on family members, am I clear on the pros and cons of this approach? They may be able to help strictly based on solidarity, but this may come with hiring expectations down the line.*
- *Have I considered getting formal qualifications and certifications? By signaling an entrepreneur's quality, they can help dispel uncertainty about the venture in the mind of potential backers.*

Step 3: Deploy the acquired resources

Even after resources are agreed upon in-principle, entrepreneurs may face issues in deploying them. For example, financial backers may have their foot on the brake if they worry about founders ceasing effort or overpaying themselves after receiving an influx of cash. A variety of governance mechanisms can mitigate risks of opportunistic behaviour and reduce friction.

Such mechanisms can be based on formal contracts and authority, but also consist of informal arrangements. About 31 percent of the papers we reviewed dealt with that resource-deployment step. (Note: The percentages add up to 106 percent due to some overlap.)

Like it or not, nascent entrepreneurs are often far more dependent on resource holders they work with than the other way around. The good news is that this power imbalance can help with the transfer of resources, as it naturally lessens the concerns that the entrepreneur might try to take advantage.

The downside is that founders can sometimes be vulnerable. For example, tech founders are often wary of accepting investments from corporate VCs that occupy a similar product space, as their intention might be to quash the up-and-coming competition. Getting a high-status VC to also come on board may help keep such threats in check.

Here is some additional food for thought:

- *Have I carefully aligned my incentives with those of the resource holders who have agreed to participate in my venture?*
- *Am I aware that founders are more likely to be* ***replaced*** *when they sell large portions of their equity to investors?*

The founders' long quest

For a venture to take off, entrepreneurs must first spot a good opportunity. Just as critically, they must then mobilise the resources required to execute on that opportunity. Our bird's-eye view of the research on entrepreneurs' resource mobilisation shows that it is a three-step process. Getting financial capital, often seen as the holy grail of the operation, is only the middle step. First, a proper founding team must coalesce. The venture is also more likely to get funding if it already has some initial ties to suppliers, customers and strategic partners. Founders must orchestrate a proper search for all of these resources, casting their net as wide as possible. After securing the required resources, they need to ensure that trust flows in both directions so that resources can be deployed smoothly. It is a long journey, which, by comparison, can make marriage seem like a walk in the park.

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