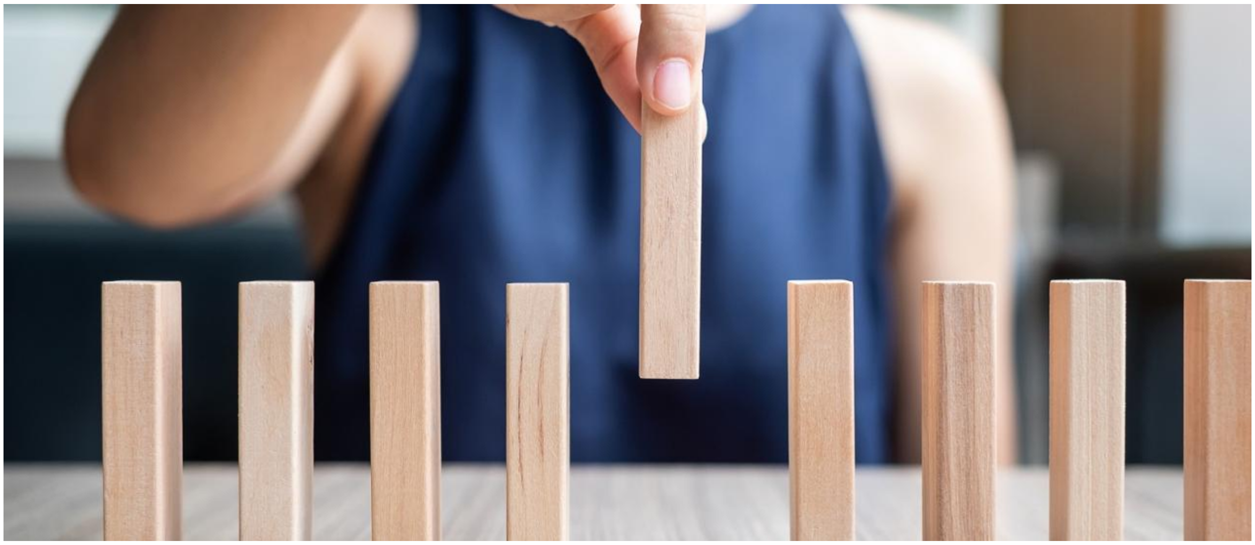
The Impact of Investor Gender on Female Founders



By Kaisa Snellman , INSEAD, and Isabelle Solal , ESSEC

Female-led start-ups backed only by female venture capitalists have a harder time raising follow-on capital.

One of the challenges female founders face is raising funds. This is particularly true when it comes to venture capital (VC), which has a reputation of being a boys' club and a tough place for women to break into. Women make up only 13 percent of investing partners at VC firms in the United States and two thirds of VC firms have no female partners at the table.

This means that female founders end up pitching to male investors –usually with little success. In 2020, **less than three percent of VC funds** went to female-led startups, while female entrepreneurs are **63 percent less likely than men** to obtain venture capital financing. Many investors rely on "pattern-matching" and invest in companies that resemble the ones they have funded in the past, which usually means companies led by men.

Some have suggested that to break into the club, female founders should reach out to female investors. Indeed, **research shows** that women venture capitalists are twice as likely to fund female-led start-ups compared to male venture capitalists.

However, our **recent research** shows that seeking funding exclusively from female investors may give rise to a new form of bias and make it harder to raise additional funding in the future. While female founders might have better success securing funding from a female investor, others might interpret this backing as a token gesture – a case of “women helping women” and not as a serious strategic investment – which might hurt their chances going forward.

Identifying the bias

We analysed data from 2,136 start-ups based in the United States that received first round funding, 71.2 percent of which went on to receive at least a second round of investment. In the study we distinguished between female-founded and male-founded firms, and whether first round investors included female VC partners, male VC partners, or both. We found that female-founded firms backed by female investors in their first funding round were two times less likely to raise further investment compared with those backed by male investors.

To further understand this bias, we conducted a lab experiment where we showed participants a start-up pitch video presentation similar to those used in traditional pitching competitions. The pitch deck and narration presented in the four cases were identical, with two exceptions. We varied the name of the founder to infer their gender, with students seeing either David or Laura Anderson. We also varied the name of the investor so that students saw either John or Katherine Clark. Each participant watched one of the four versions and were asked to rate both the business idea and the competence of the entrepreneur.

We found no differences in the ratings for the business idea or the entrepreneur, which was not surprising since the pitches and bios of the entrepreneurs were identical. The only exception was the pitch delivered by a female entrepreneur backed by a female investor. Not only was her pitch rated less favourably, but she was also perceived as less competent.

Misconceptions and false assumptions

What is driving this bias against female entrepreneurs who receive early backing from female investors? The answer seems to be a question of perception. Rightly or wrongly, individuals considering investing in individual start-ups tend to assume that a female-led start up receives funding due to the founder's gender, rather than on her own merits.

There is typically very little information to go on when assessing the potential of an early-stage start-up. They might not have any revenues, patents or even a viable product. As a result, the founder’s identity has an outsized impact on the decision-making process. Equally important for a potential investor, is who else is prepared to fund that start-up. A prior investment acts as a stamp of approval and can help give them the confidence that this could be a “good bet”.

The problem that arises when a female investor funds a female-led start-up is that other investors may assume that they only did so because of her gender, dismissing the possibility that the entrepreneur possesses the competence needed to lead a successful start-up. The fact that a woman and her backer share the same gender is used as an excuse to “explain away” a woman’s achievements. As a result, future investment becomes more difficult to obtain.

Our findings suggest that VC firms should think twice before assigning partners to support start-ups based on gender. While there may be genuinely well-intentioned reasons for pairing female VC partners with female-led start-ups, the reality is that they could actually be damaging the chances of that company receiving further funding. A similar issue could arise when it comes to minority VCs investing in other minority founders. What can seem like a positive solution in principle can, due to unconscious cultural assumptions, actually hold underrepresented minority founders back.

As sobering as our results may be, they do also outline a potential solution to help address the current gender imbalance in VC funding. We found that female entrepreneurs who received backing from both female and male investors suffered no penalty when it came to future investment. Female entrepreneurs may therefore benefit from male and female investors working together to support their start-up’s growth.

Find article at
https://knowledge.insead.edu/responsibility/impact-investor-gender-female-founders

About the author(s)

Kaisa Snellman is an Associate Professor of Organisational Behaviour at INSEAD and the Academic Director of the INSEAD Gender Initiative.

Isabelle Solal is an Assistant Professor in Management at ESSEC Business School. She obtained her MBA at INSEAD in 2008, her PhD in Organisational Behaviour at INSEAD and was a postdoctoral research fellow at the James M. and Cathleen D. Stone Centre for the Study of Wealth Inequality.

About the research

"Does Investor Gender Matter for the Success of Female Entrepreneurs? Gender Homophily and the Stigma of Incompetence in Entrepreneurial Finance," was published in *Organisation Science*.

About the series

Diversity, Equity and Inclusion

In the wake of the tragic death of George Floyd in the United States and protests in over 60 countries, global attention to DEI (diversity, equity and inclusion) has experienced a long-overdue resurgence. As the need for more inclusive forms of leadership and culture becomes apparent, we focus here on the informed perspectives of INSEAD experts focusing on race, ethnicity, gender, sexual orientation, and their intersections. These thought leaders -- both faculty and their close collaborators with rich experience in practice -- inform understanding of how to develop DEI and address identified DEI development needs.

The INSEAD Gender Initiative

INSEAD launched "iW50" in 2017 as a year-long celebration of the anniversary of the first female students to attend the school's MBA programme. Our research reflects INSEAD's ambition to achieve a gender-balanced business world.