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Laying the groundwork for an equitable startup ecosystem: Improving the accuracy of evaluation processes for greater gender equity

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- Research suggests investor behaviour – particularly discrepancies in how all startups are evaluated – can help explain why women-led startups raise significantly less capital than men-led startups of similar quality.
- Evaluating startups inconsistently reduces the accuracy of evaluations, leading investors to overlook promising women-led startups.
- The data suggest that adding three steps into evaluation frameworks can help investors and accelerators conduct more consistent, comprehensive, and data-driven evaluations across all startups, unlocking more opportunities for women-led companies.
- As architects of nascent and early-stage startup ecosystems, policymakers can include more accurate and equitable evaluation processes as a pillar of their local ecosystems.

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The role of evaluation frameworks in the gender financing gap

Entrepreneurship plays a key role in solving the world's greatest challenges and boosting economic growth. A startup's ability to grow and succeed, among other things, often depends on its ability to access funding. In an equitable world, funding decisions would be made based solely on the quality of the startup and all startups would be assessed equally. However, research shows that which startups get access to capital, in part, depends on the gender of the founding team:

- In 2021, only 14.5% of global venture capital went to women-led startups–those with at least one woman on the founding team.[1] In emerging markets, it drops to 7%.[2]
- When presented with identical pitches, differentiated only by the gender of the voice narrating the pitch, 68.33% of participants chose to fund ventures pitched by a male voice.[3]
- Investors inconsistently evaluate startups. They ask women-led startups significantly more risk-related questions and men-led startups more growth-oriented questions.[4]
- Acceleration programmes, which are designed to support early-stage startups to grow their companies, help increase the amount of equity men-led startups raise 2.6 times more than women-led startups.[5] This gap could not be explained by differences among the startups (e.g., size, industry, region) or founders (e.g., age, education, experience). In other words, the gap persists even among startups of similar quality.

These and other research studies that have been unable to find entrepreneur-facing reasons to explain why women-led startups raise significantly less capital than men-led startups have led to the hypothesis that investor behaviour – particularly discrepancies in how startups are evaluated – may play a role in explaining the gap.

Why is this important?

Ensuring equal access to funding opportunities is often at the heart of public policies that seek to strengthen the entrepreneurship ecosystem. Yet, countless entrepreneurs can be left out if the systems designed to allocate funding inaccurately identify promising startups.

1 PitchBook Data, Inc.
2 Moving toward gender balance in private equity markets. https://www.ifc.org/wps/wcm/connect/79e641c9-824f-4bd8-9f1c-00579862fed3/Moving+Toward+Gender+Balance+Final_3_22.pdf?MOD=AJPERES&CVID=mCBJFra
3 Brooks, Alison Wood, et al. "Investors prefer entrepreneurial ventures pitched by attractive men." *Proceedings of the National Academy of Sciences of the United States of America (PNAS)* 111.12 (2014): 4427-31. https://gap.hks.harvard.edu/investors-prefer-entrepreneurial-ventures-pitched-attractive-men
4 Male and Female Entrepreneurs Get Asked Different Questions by VCs — and It Affects How Much Funding They Get. Harvard Business Review. https://hbr.org/2017/06/male-and-female-entrepreneurs-get-asked-different-questions-by-vcs-and-it-affects-how-much-funding-they-get
5 Venture Capital and the Gender Financing Gap: The Role of Accelerators. https://newsandviews.vilcap.com/reports/venture-capital-and-the-gender-financing-gap-the-role-of-accelerators

Having discrepancies in the evaluation process reduces the accuracy of assessments because it may unconsciously lead the investor (or evaluator) to both underestimate and overlook promising women-led startups, and overvalue less promising men-led startups.

The key role of evaluation frameworks

Village Capital research – developed in partnership with the the IFC (International Finance Corporation), the Women Entrepreneurs Finance Initiative, the World Bank Gender Innovation Lab and academic researchers Amisha Miller (Boston University) and Saurabh Lall (University of Glasgow) – shows that how investors evaluate startups plays a key role in determining if they accurately identify promising startups in two ways:

1. When investors used an evaluation framework to score startups, the scores they gave men-led startups decreased in comparison to when they scored them without one (see Figure 1). This suggests that investors unconsciously favor men-led startups, and this preference is reduced when investors evaluate all startups consistently using an evaluation framework. However, simply using an evaluation framework was not enough to reduce the undervaluation of women-led startups.

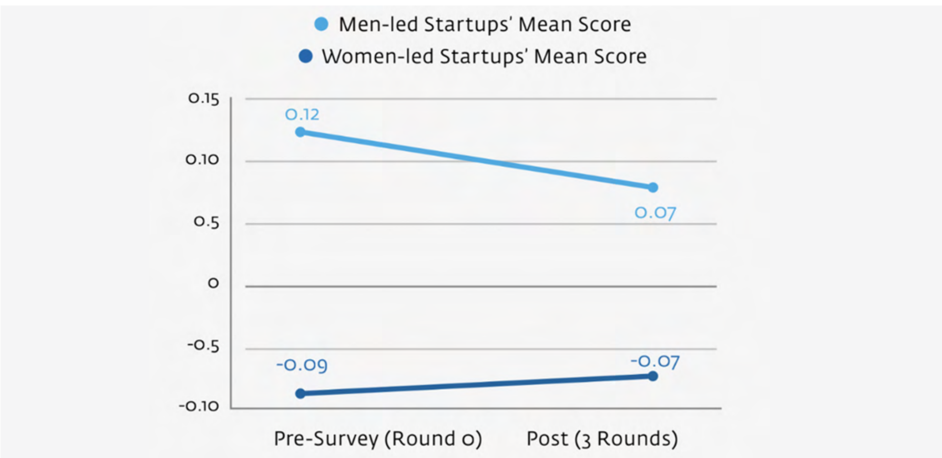
2. Improving evaluation frameworks to mitigate discrepancies can lead to more accurate assessments of all startups. Village Capital found that adding these three steps helped investors make more consistent, comprehensive, data-driven assessments:

    a. Collect information on each startup's risk and growth opportunities ensuring a comprehensive understanding of both

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

    c. Predefine what criteria will most heavily determine the assessment of a company

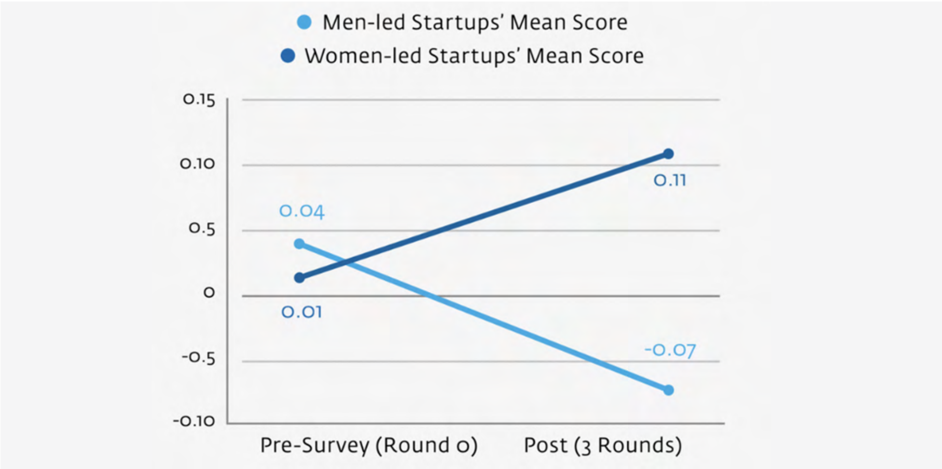
Figure 1: Mean z-score over time - control group



*Note: Learn more about how these three steps mitigate discrepancies and how they were added into the evaluation process in the Key Insights Report.

As is seen in Figure 2, investors who followed the three steps, on average, reduced the overvaluation placed on men-led startups and improved their evaluation of women-led startups. As a result, this suggests that how investors evaluate – the frameworks they use, how they collect data, and how they conduct evaluations – can have a direct impact on which startups investors decide to fund.

Figure 2: Mean z-score over time - treatment group



These results also show that increasing equity in startup funding and identifying the most promising startups are not two separate, conflicting goals.The issue is not that women-led startups do not qualify for funding. Rather, it is that the processes investors use to identify startups are not set up to accurately identify all opportunities.

What can policymakers do?

Public policy plays a key role in shaping the startup ecosystem and creating an enabling environment for startups and investors to thrive. This is especially the case in nascent startup ecosystems (and those in its early stages) where public policy and development finance institutions (DFIs) play a more involved role in setting up the institutions, structures, regulations, etc. needed for the ecosystem to function and serve in the interest of all parties.

For example, Colombia's entrepreneurship public policy includes training new angel investors and fund managers, creating institutions that enable the emergence of seed funds, designing the regulatory framework for startup financing, and developing financing opportunities for underserved communities.

As architects of the startup ecosystem with great influence on how financing dynamics are determined, policymakers can draft policy to:

1. Collaborate with relevant government agencies and academic institutions to identify the most prevalent evaluation disparities locally and design strategies to mitigate those disparities.

2. Review and adjust the evaluation frameworks and processes being used by government-backed investment funds (such as national development banks) to ensure they are able to accurately evaluate all startups. Village Capital developed a toolkit for investors and accelerators outlining how to incorporate the three steps it tested into evaluation processes.

    a. (DFIs) like the International Finance Corporation (IFC) and Development Finance Corporation (DFC) have immense investing power. By incorporating these evidence-backed steps, these investment organizations can ensure their evaluation processes more objectively identify the most promising ventures.

    b. Policymakers and DFIs acting as LPs or advisors to other investment funds could incentivize them to adopt similar strategies.

3. Train emerging and existing investment funds, fund managers, accelerators, and other ecosystem actors on best practices for more accurate and equitable evaluation.

Changing behaviour can be challenging–especially working through large organizations like DFIs. That said, these evidence-based interventions are relatively inexpensive and easy to implement, working within existing organizational structures. Village Capital has developed a toolkit specifically for investors and accelerators to aid these organizations in adopting more equitable evaluation processes.