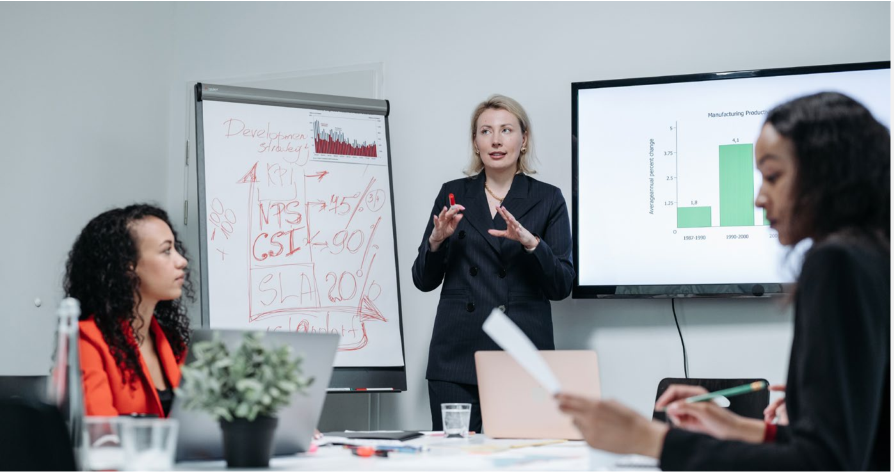

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## Smarter systems: The effect of investment organizations’ evaluation practices on gender disparities in investments

This practitioner brief draws insights from the following research project supported by the Small and Growing Business (SGB) Evidence Fund. The SGB Evidence Fund, a partnership between the Aspen Network of Development Entrepreneurs and the International Growth Centre, supports collaborations between researchers and practitioners to understand the most effective ways to support SGBs and the economic and social impact of SGB growth.

- Authors: Amisha Miller and Saurabh Lall
- Study Location: Africa, South Asia (India), Middle East, and Latin America
- Link to Related Resource: Research findings, implementation guides, and methodology are available here.

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## About the Issue

Female founders raise less capital from investors than male founders, even if their ventures are similar or identical.[1] Many policymakers, donors, and investors are aiming to redress this gender gap. For instance, Development Finance Institutions (DFIs), such as the International Finance Corporation (IFC), Development Finance Corporation (DFC), and British International Investment (BII), are committing increasing amounts to invest in female-led startups.[2]

Approaches to closing the financing gap have typically focused on eliciting changes in resource-seekers' behavior.[3] However, changing resource-seekers' behavior to overcome investors' biases creates additional work for female founders and may not affect all investors who have heterogeneous interests and priorities.[4] Ultimately, this approach does not examine the effects of investors' decision-making processes, even though changing decision-making and evaluation processes have been shown to affect gender disparities in other contexts.[5]

One obvious solution to the gendered financing gap might be setting gender quotas – overtly encouraging investors to make investment decisions based on gender. However, research in similar evaluation contexts (in hiring) suggests that this type of affirmative action could draw attention to gender and induce backlash by feeding into the belief that the selected do not have the right qualifications and credentials.[6] Instead, providing systematic evaluation frameworks could encourage investors to assess all candidates equally, thus reducing gender disparities. In this vein, the authors – Amisha Miller and Saurabh Lall – investigated whether changing systematic evaluation practices could close the gender gap in investment decisions.

1 Brooks, A. W., Huang, L., Kearney, S. W., & Murray, F. E. (2014). Investors prefer entrepreneurial ventures pitched by attractive men. *Proceedings of the National Academy of Sciences,* 111(12), 4427-4431.

2 DFC. (2021). Global Gender Finance Initiative Sets Ambitious New $15 Billion Fundraising Goal After Securing More Than Double Its Original $3 Billion Target.

3 Kanze, D., Huang, L., Conley, M. A., & Higgins, E. T. (2018). We ask men to win and women not to lose: Closing the gender gap in startup funding. *Academy of Management Journal,* 61(2), 586-614

4 Pahnke, E. C., Katila, R., & Eisenhardt, K. M. (2015). Who takes you to the dance? How partners' institutional logics influence innovation in young firms. *Administrative Science Quarterly,* 60(4), 596-633.

5 Castilla, E. J. (2015). Accounting for the gap: A firm study manipulating organizational accountability and transparency in pay decisions. *Organization Science,* 26(2), 311-333.

6 Leslie, L. M. (2019). Diversity initiative effectiveness: A typological theory of unintended consequences. *Academy of Management Review,* 44(3), 538-563.

## Study Design

The authors designed and implemented a two-stage experiment in collaboration with Village Capital across different developing regions across Africa, South Asia (India), the Middle East, and Latin America to reduce gender disparities in investment decisions. In the first evaluation stage, investors evaluated the likelihood of conducting due diligence. In the next stage, investors evaluated startups three times and conducted deeper diligence over three months, and their scores were combined to invest a pool of US $320,000 of Village Capital's investment into 16 startups (of 69). The experiment produced 30,000 investor scores on startups across categories such as market, product, and team. This resulted in a panel dataset of 1,503 investment decisions made by 65 investors on 69 startups.

Treated investors scored startups with a systematic evaluation framework with two interventions during two time periods. In the first stage, control group investors scored startups after asking any additional questions that they had in mind for startups, whereas treated investors were prompted to ask both prevention-focused questions (e.g., how many active users do you have?) and promotion-focused questions (e.g., how do you plan to acquire customers?). As investors typically ask more prevention-focused questions (risk) to female founders and promotion-focused questions (growth) to male founders,[7] the authors theorized that providing a framework to encourages investors to ask balanced questions would reduce the gender disparity.

The second intervention involved three evaluation stages over three months, in which the control group investors were provided with Village Capital's standard evaluation framework to score startups. In contrast, treated investors assessed a startup's demonstrated progress in their growth and risk management strategies during the study period. As recent research in other evaluation contexts (hiring and promotion) suggests that most managers evaluate potential more generously for male candidates than females, the authors hypothesized that inducing investors assess tangible, backward-looking performance over a short period of time would reduce the gender gap in investment decisions.[8]

7 Kanze, D., Huang, L., Conley, M. A., & Higgins, E. T. (2017). Male and female entrepreneurs get asked different questions by VCs—and it affects how much funding they get. *Harvard Business Review*, 27

8 Benson, A., Li, D., & Shue, K. (2021). Potential" and the gender promotion gap. *Working paper.*

## Results

The experimental findings confirm that using a systematic evaluation framework – prompting investors to consider both risks and growth, as well as progress – reduces or even reverses gender disparities in investment decisions.

In the first evaluation stage, control investors who evaluated as normal were much more likely to say they would conduct due diligence for male founders than females. However, treated investors evaluated firms represented by male or female founders almost equally. Specifically, investors who received a systematic evaluation framework – prompting investors to consider both risks and growth – gave startups with male founders significantly lower scores and startups with female founders significantly higher scores than control group investors.

In the second evaluation stage, investors who received a systematic evaluation framework - prompting investors to consider both risks and growth and assess progress - gave startups with female founders significantly higher scores than control group investors. Specifically, control investors were more likely to evaluate startups with male founders slightly higher than those with females, whereas treated investors evaluated firms represented by female founders higher than those with male founders. This difference was large enough to meaningfully affect who received the investment.

In both stages, startup characteristics (quality, industry, revenue, employees) were highly unlikely to drive results due to randomization and the selection process required to enter the sample. Additional analysis by investors' characteristics, such as their gender or prior experience, did not significantly affect the results.

## Practical Implications

This study provides strong causal evidence for an intervention that can be implemented right out the gate at a low cost: providing a systematic evaluation framework to investors. Investors in various regions, of different gender, and with varied experiences tend to evaluate startups with male founders better than those with females. Simply offering a systematic evaluation framework that prompted investors to ask both risk and growth-related questions closed the gender financing gap in entry into due diligence. Asking investors to assess progress rewarded startups with female founders more than those with male founders in real investment decisions. The recommendation is thus for investment firms and other entrepreneur support organizations to design a systematic evaluation framework to mitigate the parts of their evaluation processes that could result in gender disparities. If organizations provide and utilize a systemic evaluation framework, this could meaningfully affect investment outcomes.

This cross-regional study bears particularly important implications for investors and other entrepreneur support institutions focusing on early-stage startups. Evaluating early-stage startups can be complicated due to little track record or performance indicators, which makes evaluation more prone to investors' biases that could disadvantage females. Encouraging investment funds and accelerators to reevaluate their evaluation processes and provide a systematic evaluation framework to their investors will help to prevent investors and accelerators from overlooking promising female-led startups. It will ultimately reduce the gender financing gap.

**For more information on the research and actionable toolkits for investment funds and accelerators, please check the link on the first page.**

*Summary authored by SangEun Kim, Research Manager at the Aspen Network of Development Entrepreneurs.*