

What VCs Look for in a Startup Investment

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Entrepreneurship seems to be on the rise in recent years, apparently boosted by the Covid-19 pandemic. *The New York Times* reports that even though Americans were starting companies at a decreasing rate pre-pandemic, they launched 4.4 million businesses in 2020, a 24 percent annual increase compared to the year before.

What's more, innovative startups have more funding choices than ever. Many founders start with their own funds, followed by family and friends. After that, they're likely to rely on traditional or corporate venture capital to fund exponential growth. As an experienced corporate executive, entrepreneur and VC investor at Pegasus Tech Ventures, I've learned along the way what to look for in a startup investment to help ensure a positive financial return – important for investors of all kinds. Let's look at a few key factors that are important for investors to consider.

Strong management team

Perhaps most importantly, I look for a smart, creative management team to lead the startup organization. Ideally, this team consists of experienced managers and workers who cut their teeth at other successful organizations. They should have diverse perspectives, a proven factor in achieving

superior financial returns. As an example, McKinsey & Company reports companies in the top quartile of gender diversity on their executive teams were 21 percent more likely to achieve above-average profitability. It's also critical that the management team gets along well and can push through difficult decisions and move the company forward.

Innovation and viable customer market

Competition is fierce in many markets, so I do my best to find startups with innovative ideas that result in distinctive products or services. Innovation is proven as critical for growth. The European Journal of Innovation Management reports that differences in growth can be explained by the different levels of innovativeness in new ventures. Take a look at how unique the startup's offerings are and whether the company can protect its innovation through patents or other means.

It's also important as an investor to understand the startup's core customer market segment and to comprehend its growth potential. Can the startup grow by expanding into additional customer segments or geographic markets? This will help you understand whether the startup's initial momentum is likely to extend into a long-term, sustainable company. Strive to understand not only who the potential customer is, but what they need and what they are willing to spend.

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Enthusiastic customers

Even if the startup offers a unique product or service, I always try to understand how much revenue traction they have and whether their customers are loyal. This gives me an indication of how sustainable the business is, and whether it is likely to grow in the future. It's hard to overestimate the

importance of customer satisfaction and the customer experience. According to Gartner, 81% of marketers say they expect to compete mostly or entirely on customer experience.

Ideally, I speak with some of the customers myself to understand why they like the product or service, and what they think of the company's brand. Do they show a willingness to buy more or pay a higher price? Do they purchase only once, or on a regular basis?

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Solid fundraising and execution plan

I believe that any startup should think carefully about how much capital to raise and from whom. Raising more money sounds like a good idea, but it also means the startup will be under more pressure to succeed and give its investors a positive financial return. Just like in the world of financial planning, I recommend diversification. One investor gives you only one advisor to help you make decisions. It's better to rely on multiple investors – whether they are traditional VCs or corporate investors – since each of them has a unique perspective and network that the startup can leverage.

Even with a unique product or service offering and solid fundraising plan, don't forget about the importance of execution. This is how the startup's idea turns into a successful business. As previously mentioned, this is where experienced leadership comes into play. Make sure the startup has not only an experienced CEO, but also talented leaders in areas including finance, operations, marketing and HR to achieve positive results.

A formula for success

Examining startup investments is not for the faint of heart. Make sure to understand the background and enthusiasm of the founding management team, since any startup requires ambition and resilience. Be sure to do due diligence about the company's innovation and target customers. Understand if the startup raised the right amount of funding from the right type of investors, and if it has a solid execution plan to make the business idea turn into a financial success for founders and investors alike.

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