INVESTOR READINESS: DIFFERENT EVALUATIONS BY ENTREPRENEURS AND VENTURE CAPITALISTS

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ABSTRACT

Anecdotal evidence, as well as academic research, suggests that entrepreneurs evaluate business opportunities differently from venture capitalists. This paper identifies factors, from literature, on the characteristics of entrepreneurs, the cognitive processes of entrepreneurs, and the venture capital investment process that contribute to the differing assessments of investment readiness. The research methodology and instrument employed is an adaptation and extension of Douglas and Shepherd (2002). Twenty-one Australian entrepreneurs and fifty-three Australian venture capitalists responded to two questionnaires. The findings support the hypothesis that entrepreneurs assess their business opportunities as being more investor ready than do venture capitalists, even though their ratings of key investment criteria correspond. Therefore, entrepreneurs know how venture capitalists assess business opportunities but they do not know how to put the assessment criteria into practice.

INTRODUCTION

Every year, thousands of entrepreneurs approach venture capitalists in search of external funding for their business opportunities. This occurs in spite of research indicating that venture capitalists invest in less than 5% of the business opportunities that they review [4]. The venture capitalists' rejection of a high proportion of business opportunities early in their analysis (i.e. during the screening stage) is due to their concerns for the business' prospects. An effective screening process allows venture capitalists to quickly identify and allocate their limited time and resources to those business opportunities deemed 'investor ready'.

Entrepreneurs, frequently exit the venture capital investment process disillusioned by the experience and unaware of the venture capitalist's investment criteria. They cannot comprehend why the venture capitalist has not envisaged their opportunity. Entrepreneurs are of the opinion that venture capitalists do not 'share their vision' because they do not understand their opportunity and do not spend enough time in review. These opinions indicate that entrepreneurs do not understand the selection criteria and procedures undertaken by venture capitalists to evaluate their business opportunity.
Douglas and Shepherd's (2002) paper on investor readiness forms the research framework of this paper. This paper applies similar methodology but presents findings based on the responses of authentic entrepreneurs and venture capitalists as opposed to the sample of MOOT CORP[1] competition participants.

The establishment of an effective business plan is a critical mechanism by which to attract and enlist the assistance of a venture capitalist. Entrepreneurs can benefit from this research by developing business plans that accentuate their business opportunity and mitigate the potential risks. In addition, venture capitalists can inadvertently profit through the financing of an increased number of business opportunities.

[1] This is a business plan competition whereby entrepreneurs (Masters of Business Administration students) seek funding for their proposed new venture.

The motivation for this paper is the need to align the expectations of the entrepreneur with those of the venture capitalist throughout the investment process. This relates to the fact that significant differences continue to exist between the entrepreneurs' and venture capitalists' concepts of investor readiness.
This research paper consists of three parts: (1) the investigation (review) of literature on the characteristics of entrepreneurs, the cognitive processes of entrepreneurs and venture capitalists, and the venture capital investment criteria; (2) the presentation of detailed research methodology; (3) the presentation of the results and their implications for entrepreneurs and venture capitalists.

LITERATURE REVIEW

To date no venture capital literature presents an authentic field study of investor readiness. Consequently, this paper draws upon Douglas and Shepherd's (2002) research as well as other literature dealing with the characteristics of entrepreneurs, the cognitive processes of entrepreneurs and venture capitalists and the venture capital investment criteria, in order to identify the reasons for the differences in the entrepreneurs' and venture capitalists' evaluation of a business opportunity's level of investor readiness.

Characteristics of Entrepreneurs

Entrepreneurs display distinctive levels of achievement motivation / orientation, risk taking, willingness to solve problems themselves, and ability to individually set and achieve targets [25]. However, they can, at times, also adopt a frenetic pace that may appear unstructured and without direction. Entrepreneurs strive to identify opportunities everywhere within their environment and sometimes struggle to remain focused on a single opportunity. They are likely to have a high internal locus of control and a strong preference for innovation [32] [35]. This preference for innovation goes hand-in-hand with entrepreneurship [12] [29] [36].

When entrepreneurs have a strong preference for innovation, they may place higher importance on the technological aspects of a business opportunity and consider other areas, such as its marketability and management, to be of lesser importance. When entrepreneurs become fixated on the product or technology and lose sight of other business issues, the condition is termed 'investor's myopia'. It is noteworthy that Douglas and Shepherd (2002) found that entrepreneurs rated themselves as being more market ready and management ready than technology ready.

When compared with non-entrepreneurs, entrepreneurs have a greater willingness to take risks. This may be due to the inherent risks in their business opportunity influencing their perception of risk [15]. Consequently, this different perception of risk can influence the propensity of entrepreneurs to take risks and, thereby, adversely affect their decision-making processes.

Corresponding with the willingness of entrepreneurs to accept risk is their high internal locus of control (i.e. the belief that they can influence and/or control certain events). This means that entrepreneurs perceive that they have the ability to overcome certain external factors and to discount others that may hinder their achievement of the targeted outcomes in their business plan. A venture capitalist may not consider the entrepreneur to be as 'in control' of particular espoused external factors. Consequently, differing opinions on investor readiness may arise.

While the rationale as to why entrepreneurs assess a business opportunity differently from venture capitalists is unclear, their recognition and perception of risk appears to be important to gaining an understanding of the misalignment of interests and the classification of investor readiness. Entrepreneurs may respond to this misalignment by targeting investors with a similar propensity for risk and a conviction that the investment decision has a 'risk-reward' payoff.

Cognitive Processes of Entrepreneurs

When confronted with complex situations, entrepreneurs utilise unique cognitive frameworks/biases that influence their decision-making processes [21]. They also have a tendency to focus on the current situation at the expense of those factors that are relevant to the decision-making process [20].

Early experiences and influences shape the characteristics of entrepreneurs [21]. Consequently, entrepreneurs tend to formulate subjective strategies rather than make purely objective analyses of the position of the business opportunity and its environment. Subjective elements can be powerful sources of entrepreneurial intuition and vision. Therefore, an accurate subjective as well as objective assessment of a business opportunity and its industry environment is critical to entrepreneurial success. A series of carefully formulated subjective assessments could explain why entrepreneurs evaluate business opportunities differently from venture capitalists.

Research that has examined the cognitive processes employed by entrepreneurs to evaluate opportunities and situations indicates that they use irrational biases and heuristics as simplification mechanisms to deal with the multiple hurdles associated with starting a new business [8]. Their use may influence the decision-making and opportunity recognition of entrepreneurs differently from non-entrepreneurs. When faced with situations that overload their information-processing capacity and are characterised by high levels of uncertainty, novelty, emotion, and time pressure, entrepreneurs have a tendency to utilise explicit and sometimes inappropriate frameworks [1]. It is important that entrepreneurs and venture capitalists minimise tensions by collaborating on the establishment of a series of 'reality checks' (i.e. components that entrepreneurs should possess before they can be considered investor ready).

Baron (1998) identifies five cognitive biases that could cause entrepreneurs to evaluate the investor readiness of their business opportunity differently from venture capitalists. The first bias, counterfactual thinking is where the entrepreneur imagines the effects of what might have been. This bias can influence the entrepreneur's perception of the ensuing events, the decision-making process, and an individual's behaviour. The second bias, affect infusion is the influence of current affective states on decisions and judgements. Due to the commitment of entrepreneurs to their business opportunity, they are more likely to evaluate it more favourably than venture capitalists. The third bias, attributional style is the tendency of individuals to attribute various outcomes to either internal or external causes (i.e. individuals attribute positive outcomes to themselves, and negative outcomes to external factors). This bias could result in entrepreneurs focusing on their credentials in order to achieve positive outcomes whilst dismissing failures as 'bad luck'. In the fourth bias, planning fallacy, there is a strong tendency to underestimate the amount of time needed to complete a given project. In this situation, entrepreneurs hold unrealistic (overstated) views of their business opportunity's competitive strength(s). The fifth bias, self-justification and the escalation of commitment, is the tendency to justify a previous decision even if the outcome is negative. The result is a willingness of entrepreneurs to invest a great deal of time, energy, and emotion into a business opportunity but an unwillingness to accept the flaws identified by the venture capitalists.

The situations that entrepreneurs place themselves, makes them more prone to cognitive biases that influence the accuracy of their decisions [7]. Thus, if venture capitalists do not apply the same cognitive mechanisms as entrepreneurs, it is understandable that the two groups will view a particular investment opportunity differently.

Entrepreneurs may assess a business opportunity differently because they have an 'inside', rather than an 'outside' view, in which they can select and compare applicable scenarios that are representative of both the current situation and past performance(s). Accordingly, personal involvement by entrepreneurs in their business opportunity causes them to evaluate their personal targets as being more achievable than would venture capitalists. Consequently, this could result in a higher assessment of investor readiness of a business opportunity by an entrepreneur than by a venture capitalist.

Another factor that could cause entrepreneurs to assess their investor readiness differently than a venture capitalist is the finding that entrepreneurs do not consider themselves to be diverse in their propensity to take risks even though results suggest otherwise [30]. The identification and assessment of risk are important components in the assessment of investor readiness. Entrepreneurs and venture capitalists have a tendency to identify and assess risk differently. Consequently, this may cause the differences between their respective assessments of investor readiness [28].

Another explanation for the diverse assessment of investor readiness may be the fact that a venture capitalist's and an entrepreneur's perceptions of failure are different (i.e. there is a tendency for venture capitalists to attribute failure to internal reasons whilst entrepreneurs attribute failure to external reasons) [39]. These diverse perceptions could result in the misdirection of scarce entrepreneurial resources. Therefore, it is critical to manage carefully the relationship between the two groups when such a gap in perceptions occurs.

Venture Capital Investment Criteria

To an outside observer, the venture capital investment process is complex, fluid and, at times, seemingly inconsistent (i.e. no strict guidelines are adhered). The process changes over time, as venture capitalists and the markets develop [27]. This flexibility may exist because venture capital investment opportunities are rare and the 'perfect deal' seldom occurs without compromises. Another implication of this finding is that venture capitalists do not adhere to hard and fast rules when evaluating investment opportunities. Instead, they tailor their approach to the particular characteristics of the investment opportunity [13]. Consequently, it is very difficult for an entrepreneur to understand the flexible evaluation techniques and criteria used by a venture capitalist.

Research has found that there are three distinct types or 'clusters' of venture capitalists: (1) those that carefully assess the competitive and implementation risks; (2) those that seek an easy bail out; and (3) those that deliberately keep open as many options as possible [23]. When evaluating a business opportunity, the procedure adopted by venture capitalists is dependent upon the circumstances specific to that business. There is no common formula or list of common investment criteria.

Although the investment criteria employed by venture capitalists are not homogenous, research has revealed the existence of criteria groupings. Consistently and worldwide, the foremost investment criteria grouping relates to management. There are, however, discrepancies in the relative importance of other criteria relating to a business opportunity's market, product and/or service and financials [23] [40]. The quality of the entrepreneur and the management team ultimately determines the success or failure of a venture [23]. Venture capitalists consider an entrepreneur's commercial awareness, experience in a particular sector, and personal ambition to be significant attributes [38]. Hence, this paper contends that entrepreneurs can easily improve their investor readiness by appointing experienced entrepreneurs or advisers to advisory positions or to their board of directors or management team.

In addition to the entrepreneur and the management team, the business plan is also important in the identification of investor readiness. It is common practice for venture capitalists to form their initial opinion of a business opportunity solely on an analysis of the entrepreneur's submitted business plan. In fact, venture capitalists usually request a written submission of the business plan prior to speaking with a prospective entrepreneur. Consequently, an articulate business plan plays a pivotal role in a business opportunity being investor ready. It is also the basis for written and verbal interaction, and possibly contention, between the entrepreneur and the venture capitalist.

Venture capital research into investment criteria has identified 'personal chemistry' or 'gut feel' as an important subjective and intuitive influence (criterion) that determines investor readiness [17] [31]. This highly subjective approach is the result of the complex processing of a substantial amount of assorted information. Consequently, entrepreneurs may find it very challenging, if not impossible, to tailor their business opportunity to the personal chemistry or gut feel of a venture capitalist.

When assessing the business opportunity of an unknown entrepreneur, i.e. one without a referral or other source of credibility, a venture capitalist generally discounts the information received and evaluates the investor readiness of the business opportunity more critically in order to compensate for the inherent uncertainty [14]. In addition, a venture capitalist enlists consultants that seek verification for the entrepreneur's assertions. Irrespective of the criteria utilised by venture capitalists, their ultimate aim is to mitigate asymmetric information, and the effects of moral hazard[2] and adverse selection[3] [31].

Research has revealed that there are cognitive variations in how venture capitalists apply their investment criteria in order to reach an investment decision [39]. For example, venture capitalists base their decision-making on the volume and structure of the information received. More information tends to create greater (over)confidence, but it does not ensure greater decision-making accuracy. Irrespective, of this fact, venture capitalists that assess large volumes of information are willing to overlook the increased complexity of their decision-making process because they consider their decisions to be more informed and thereby, more accurate.

Experience heavily influences a venture capitalist's decision-making processes [39]. Overconfidence in the ability to predict the potential of a business opportunity may encourage a venture capitalist to take risks (e.g. limit information searches) and ultimately make a poor decision (e.g. fund a lower potential business opportunity or prematurely reject a stronger potential investment).

If bias enters into the venture capitalist's decision-making process, it will become less systematic and disciplined and it is more probable that the entrepreneur and venture capitalist will evaluate the business opportunity differently. An implication for the entrepreneur is an increased difficulty in understanding and applying the venture capitalist's evaluation criteria. Without consistency, decision-making becomes more of an art than a science.

Douglas and Shepherd (2002) hypothesise that entrepreneurs rate the importance of market readiness and management readiness lower than venture capitalists but rate technology readiness higher. However,

[2] Entrepreneurs acting in self-interest

[3] Poor investment decision

their findings reveal the opposite true but this may be due to the 'authenticity' shortcoming of their MOOT CORP Competition sample. Consequently, this research will retest the original Douglas and Shepherd (2002) hypothesis as well as three new hypotheses based on anecdotal evidence and literature review findings. The hypotheses addressed are:

Ho 1. Entrepreneurs rate their business opportunity as being more investor ready than do venture capitalists on all three scales of investor readiness: market readiness, management readiness and technology readiness. Ho 2. Entrepreneurs rate the importance of market readiness lower than venture capitalists. Ho 3. Entrepreneurs rate the importance of management readiness lower than venture capitalists. Ho 4. Entrepreneurs rate the importance of technology readiness higher than venture capitalists.

METHODOLOGY

Douglas and Shepherd (2002) study the differing views of investor readiness held by Australian entrepreneurs and venture capitalists. Their research provides three scales of investor readiness: *market readiness, management readiness, and technology readiness*, and an instrument (a 25-item, Likert scale questionnaire) to measure the different entrepreneurial and venture capitalist views on the investor readiness of a single business opportunity. It does not compare the investor readiness of a number of business opportunities.

The intention of this paper is to adapt and extend the methodology used in Douglas and Shepherd (2002), not to make a direct comparison with it. This paper alters the Douglas and Shepherd (2002) testing instrument by removing a number of questionnaire items and by revising the responses that entrepreneurs and venture capitalists can select. A reduction of the number of questionnaire items from twenty-five to fifteen lowered the time commitment required to complete the questionnaire and, predictably, increased the response rate. The refinement of Douglas and Shepherd's (2002) questionnaire response options involved the removal of all emotive words or terms that could unduly influence the selection of certain options due to misinterpretation or reluctance to select certain responses (e.g. question 1, option (c), 'crude prototype…' and question 22, option (a), 'looks like a rush job…'). Evidence from two trial runs of the revised questionnaire indicated that the respondents found the final instrument easy to comprehend.

Each scale of investor readiness in Questionnaire 1 (Q1) and Questionnaire 2 (Q2) consists of fifteen questions. Q1 and Q2 have six and five potential responses options, respectively. Q1 ranks the first five potential responses in ascending order of investor readiness. Thus, the higher the ranking order the higher the investor readiness (i.e. with '1' being least investor ready to '5' being most investor ready). The sixth potential response is a neutral option for those respondents that are unsure about the question or how they wish to respond. Q2 ranks the importance of fifteen characteristics of a business to a venture capitalist's investment decision (with '1' considered not important and '5' considered extremely important).

Questionnaire One asked ninety entrepreneurs, via mail, to self-assess anonymously their business opportunity, based on the three scales of investor readiness and the fifteen questions. The entrepreneurs contacted were firms that had approached a specific venture capital firm less than twelve months prior to the data collection period. Of the ninety contacted, twenty-one responded. The five venture capitalists that participated in the study are all of which are employees of the same venture capital firm assessed the twenty-one business opportunities based on submitted business plans. The questionnaire analysis compares the entrepreneur's individual item and scale responses with those of the venture capitalists. This paper uses the Wilcoxon-Mann-Whitney test for non-parametric data to determine if a statistically significant difference occurs between the groups. It does not determine why entrepreneurs and venture capitalists might assess their business opportunities differently.

Questionnaire Two asked the original sample of twenty-one entrepreneurs and all one hundred and thirty-five venture capitalist firms operating in Australia[4] via mail to rate the importance of each of the items in Q1 regarding investor readiness, with the addition of a 'gut feel' option, which represents the subjective characteristics of the venture capital investment process. The questions in Q2 relate to the venture capitalists' general experiences. They do not analyse specific business opportunities. The objective of Q2 is to demonstrate if entrepreneurs have a 'high level of understanding' of the investment criteria/processes used by venture capitalists to evaluate business opportunities. The paper uses the term 'high level of understanding' because a 15-item questionnaire is not comprehensive enough to test if an entrepreneur understands all aspects of the venture capital investment process. If entrepreneurs do not demonstrate a 'high level of understanding' then this is a leading factor contributing to dissension between the two groups. Similar entrepreneurial and venture capitalist responses in Q2 would indicate that the entrepreneurs possess a 'high level of understanding' of the criteria/processes that venture capitalists employ. Therefore, a major reason for the different perceptions of investor readiness is due to a knowledgeable entrepreneur applying the criteria differently to a venture capitalist. This indicates that the different characteristics and cognitive processes of entrepreneurs are major contributors to the different assessment of their business opportunity's investor readiness.

Q2 adds another dimension to the findings of Douglas and Shepherd (2002) in that it highlights the diversity between the entrepreneurs' and venture capitalists' ability to understand and apply the criteria to a specific business opportunity. Literature on the characteristics of successful and unsuccessful ventures and a review of actually employed venture capital investment criteria assisted in the creation of new items for the testing instrument. This paper uses a t-test for parametric data to analyse and identify significant differences between the two groups.

Sample

Douglas and Shepherd (2002) use team members in a MOOT CORP competition as a proxy for entrepreneurs. While all teams presented bona fide business plans, the MOOT CORP sample is not representative of an actual situation because the participants were operating within the framework of the competition. The sample is also not representative of the entrepreneurial population because it is highly unlikely that entrepreneurial companies approaching venture capital firms would have such a high proportion of recent MBA (i.e. postgraduate business) students. Furthermore, discussions with individuals who are involved in the venture capital industry and who have had experience with the MOOT CORP competition over a number of years, revealed that the business opportunities presented in the MOOT CORP competition are at an earlier stage of development compared with most businesses seeking venture capital.

[4] This was sourced from the Australian Venture Capital Guide published by the Australian Venture Capital Journal (2003)

In this paper, all of the 90 Australian entrepreneurs asked to participate in this research possess four commonalities: (1) they had contacted the same venture capital firm in the twelve months prior to the research; (2) they had supplied the firm with a complete business plan or information memorandum; (3) they had indicated an intention to remain with and represent the businesses requiring expansion capital;

(4) their request for capital excluded transactions involving the sale of the business opportunity, repayment of debt, mature management buy-outs and buy-ins where the business opportunity continues its historical business without significantly expanding, and distressed business opportunities in voluntary administration or liquidation. These restrictions are the result of the limitations of the instrument, which focuses on earlier stage business opportunities where the entrepreneur maintains an active role and uses the funds for expansion.

Twenty-one entrepreneurs (23.33%) responded to Q1 and Q2. The sample of entrepreneurial companies, who approached one venture capital firm, represented a broad cross-section of geographic locations, industries, and stages of development.

The judges in Douglas and Shepherd's (2002) MOOT CORP competition study included professionals such as lawyers, accountants and financial professionals, as well as successful entrepreneurs and venture capitalists. While some of the MOOT CORP judges match the venture capitalists profile, not all of the judges are perfect proxies because some are not experienced in the venture capital industry. Consequently, the MOOT CORP competition data does not replicate relevant and accurate venture capital industry data.

All five venture capitalists that responded to Q1 come from the same venture capital firm and, subsequently, could assure the confidentiality of the entrepreneur's business plans. They vary in age and experience but they are all responsible for reviewing business opportunities and have the authority to reject a proposal. All five venture capitalists reviewed the twenty-one respondent entrepreneurs' business plans or information memoranda before assessing their investor readiness.

In Q1, practical constraints regarding access to suitable and willing participants resulted in a small sample of five venture capitalists and twenty-one entrepreneurs that are associated with the one venture capital firm. Probability did not determine those selected in the convenience sample. The venture capital firm that supplied the five venture capitalists and the database of entrepreneurs had expressed interest in the research and had offered assistance.
For Q2, all twenty-one of the Q1 sample entrepreneurs and fifty-three (39.26%) of the 135 venture capital firms responded[5].

RESULTS

Questionnaire 1

Table 1 displays the aggregate averages of the findings from Q1. Based on the scales of market readiness, management readiness and technology readiness, entrepreneurs and venture capitalists are, at the 95% confidence level, statistically different in their evaluations of investor readiness. The results show that the sample of entrepreneurs consistently evaluates their investor readiness higher than the venture capitalists. Consequently, this indicates that they consider their business opportunity to be more attractive to an investor (i.e. investor ready) than do the venture capitalists.

[5] Twelve surveys were returned because the venture capital company had change address or left the industry.

Table 1 – Results of Questionnaire One							
	Entrepreneurs		**Venture Capitalists**		**Comparison**		
	Average	**Standard Deviation**	**Average**	**Standard Deviation**	**WMW Coefficient**	**Significant**	**Variation of Average**
Market							
1	3.14	1.79	2.52	1.29	0.0099	Yes	(0.62)
2	3.24	1.66	2.33	1.46	0.0048	Yes	(0.90)
3	3.14	1.64	2.24	1.34	0.0082	Yes	(0.90)
4	2.81	0.79	2.19	0.87	0.0009	Yes	(0.62)
5	3.57	1.50	2.38	0.86	0.0004	Yes	(1.19)
TOTAL	**3.18**	**0.82**	**2.33**	**0.90**	**0.0001**	**Yes**	**(0.85)**
Management							
6	3.67	1.13	2.10	0.83	0.0003	Yes	(1.57)
7	3.05	1.50	2.38	1.12	0.0065	Yes	(0.67)
8	4.05	0.91	2.67	0.80	0.0008	Yes	(1.38)
9	4.05	0.72	3.24	0.77	0.0003	Yes	(0.81)
10	3.90	1.27	3.14	1.06	0.0069	Yes	(0.76)
11	4.24	0.68	3.05	0.86	0.0001	Yes	(1.19)
TOTAL	**3.83**	**0.60**	**2.76**	**0.57**	**0.0004**	**Yes**	**(1.06)**
Technical							
12	3.55	1.36	2.71	0.96	0.1131	No	(0.84)
13	2.84	1.42	1.86	0.73	0.0080	Yes	(0.98)
14	3.47	0.30	2.38	1.02	0.0008	Yes	(1.09)
15	2.95	1.21	2.52	0.87	0.7736	No	(0.43)
TOTAL	**3.20**	**0.96**	**2.37**	**0.57**	**0.0001**	**Yes**	**(0.84)**

In addition to the significant differences evident in the three overall scales, all of the questionnaire items, with the exception of items 12 and 15, also indicate significant differences at the 95% confidence level. Item 12 relates to the formalised intellectual property protection associated with a business opportunity. Consequently, the insignificant difference in data may have occurred because intellectual property protection is an objective item that entrepreneurs often emphasize in their business plan. Item 15, also an objective assessment, relates to product redesign. It is noteworthy that item 13, which deals with the strength of patent protection and is a more subjective measure, indicates a significant difference between the groups. The evidence, therefore, suggests that making the investment criteria objective will assist in an alignment of the investor readiness expectations of the two groups. This result concurs with that of Douglas and Shepherd (2002).

The questionnaire results provide statistical support for Ho 1. On each of the three scales of market readiness, management readiness and technology readiness, the statistics show that the entrepreneurs have consistently rated their business opportunity as being more investor ready than venture capitalists.

Questionnaire 2

Table 2 contains the findings of Q2, the item analyses and the scales. The major difference between the analyses undertaken in Q1 and Q2 is the use of the t-test statistic, rather than the WMW test in Q2, to determine the statistical significance of the findings.

Table 2 - Results of Questionnaire Two							
	Entrepreneurs		**Venture Capitalists**		**Comparison**		
	Average	**Standard Deviation**	**Average**	**Standard Deviation**	**Coefficient**	**Significant**	**Variance of Averages**
Technical							
1	3.67	1.32	4.25	0.91	0.0824	No	0.58
2	3.52	1.14	3.51	1.23	0.9618	No	(0.01)
3	3.38	0.90	2.80	0.90	0.0351	Yes	(0.58)
TOTAL	**3.52**	**0.57**	**3.53**	**0.64**	**0.9459**	**No**	**0.01**
Market							
4	4.14	0.89	3.83	1.08	0.2149	No	(0.31)
5	3.33	1.49	3.55	1.16	0.5647	No	0.22
6	3.38	1.09	3.28	0.98	0.7241	No	(0.10)
7	4.19	0.96	4.40	0.95	0.3855	No	0.21
8	4.05	0.87	3.85	0.78	0.4281	No	(0.20)
TOTAL	**3.82**	**0.58**	**3.78**	**0.74**	**0.7921**	**No**	**(0.04)**
Management							
9	4.38	0.79	4.50	0.75	0.5905	No	0.12
10	3.29	1.24	4.67	1.20	0.0674	No	1.38
11	4.57	0.73	4.66	0.51	0.6316	No	0.09
12	4.48	0.73	4.91	0.28	0.0183	Yes	0.43
13	3.90	0.87	4.38	0.83	0.0434	Yes	0.48
14	3.67	0.84	4.45	0.77	0.0008	Yes	0.78
TOTAL	**4.02**	**0.47**	**4.26**	**0.37**	**0.0755**	**No**	**0.24**
Gut Feel							
15	3.76	1.06	3.89	0.84	0.6408	No	0.13
TOTAL	**3.76**	**1.06**	**3.89**	**0.84**	**0.6408**	**No**	**0.13**

Based on the four scales (i.e. 'market readiness', 'management readiness', 'technology readiness' and 'gut feel') that are used to measure 'investor readiness', the entrepreneurs' and venture capitalists' results are not significantly different at the 95% confidence level. The venture capitalists rate the average importance of management readiness, technology readiness and gut feel higher than do the entrepreneurs, while the entrepreneurs' rate the importance of market readiness higher in comparison with venture capitalists.

Four items (3, 12, 13, and 14) indicate statistically significantly differences at the 95% confidence level. Item 3 refers to the number of improvements made to the product from previous models. Venture capitalists rated the importance of this item lower than did the entrepreneurs. Entrepreneurs may place greater importance on the number of improvements incorporated into a product because they have been involved in each of the improvements and, therefore, place a greater emphasis on their importance to the business opportunity. The venture capitalist, on the other hand, only reads the business plan and reviews the status of the product.

Items 12, 13 and 14 all relate to the management or the existing shareholders in a business opportunity. Venture capitalists rate each of these items as having a greater importance in the evaluation of investor readiness than do the entrepreneurs. The items are:

. • Item 12 - the commitment of the management team

. • Item 13 - the willingness of existing shareholders to accept an external investor's involvement in the business
. • Item 14 - the willingness of the management team to accept an external investor's involvement in the business

In response to item 12, entrepreneurs may consider the commitment of the management team to be of lesser importance than the venture capitalists because they may have been with the business since its inception. Consequently, they may not ever consider leaving the business and, therefore, they may consider their commitment to be an obvious fact. For items 13 and 14, the experiences of the two groups could explain the disparity in the level of importance placed on the different items used to evaluate investor readiness. Compared to entrepreneurs, venture capitalists are typically much more experienced with the management of a business opportunity. Consequently, venture capitalists highly regard entrepreneurs that readily accept venture capitalists involvement in the management of their business opportunity.

Overall, the findings indicate that although entrepreneurs understand, in broad terms, the criteria used by venture capitalists, they are not aware of the expectations that venture capitalists have for each of the criteria. For example, entrepreneurs are aware that venture capitalists place a high level of importance on the management of the business opportunity but they do not understand how the venture capitalists rate the business opportunity's management team.

The results of Q2 show that, when the groups are asked to rate the importance of the three scales of 'investor readiness' and the fourth scale of 'gut feel', it is not possible to statistically separate the results of the sample of entrepreneurs and the sample of venture capitalists. Moreover, there is no empirical evidence for Ho 2, Ho 3 and Ho 4, to indicate that entrepreneurs rate the importance of market and management readiness lower and the importance of technology readiness higher than venture capitalists.

DISCUSSION

The research undertaken in this paper is different from that used by Douglas and Shepherd (2002) in that it utilizes a greater representative sample of entrepreneurs and venture capitalists and it extends their framework. It does not make direct comparisons with their findings.
The results of Q1 demonstrate that an entrepreneur seeking venture capital will regard the investor readiness of their business opportunity differently from the venture capitalist. Specifically, entrepreneurs believe that their businesses are more ready for external investment than do the venture capitalists. The findings from Q2 demonstrate that the evaluations of the four scales of investor readiness are similar for both groups (i.e. the entrepreneurs have a broad understanding of the criteria used by the venture capitalists and have, therefore, applied a similar rating of importance to each scale). However, it is noteworthy that entrepreneurs do not apply these same scales to evaluate the investor readiness of their own business opportunities in the same way as a venture capitalist.

The research findings indicate that the misalignment of entrepreneur and venture capitalist assessment of investor readiness has a series of major ramifications:
. • the venture capitalists view the selection process as an arduous undertaking;
. • few entrepreneurs receive venture capital funding;
. • the venture capitalists have only a small pool of high quality investments.

The consequence of these ramifications is the reduced effectiveness of the venture capital industry and a scale of operation that is detrimental to all participants in the system. This is a complex problem because there is no cause and effect relationship. Venture capitalists cannot target a single factor to bring about an increase in the number of entrepreneurs willing to develop investor ready business opportunities.

Implications for Entrepreneurs

The entrepreneurs' responses to Q2 indicate that they have a general understanding of the venture capitalists' evaluation criteria for investor readiness. However, the responses also indicate that, because of their lack of in-depth understanding of the venture capitalist's requirements, they do not evaluate the investor readiness of their business opportunities along similar lines. This lack of in-depth understanding may arise because of insufficient preparation prior to approaching a venture capitalist.
The following list for investor readiness is by no means all encompassing. Such a list cannot exist because different venture capitalists require different levels of preparation to be investor ready. It does offer, however, some basic components that entrepreneurs should possess before they attempt to raise venture capital:

- A current and professional business plan or investment memorandum that articulates the business opportunity to the venture capitalists and provides a level of assurance to them that the business opportunity can achieve its objectives;
- An assembled management team that has sufficient industry, market, product and strategic knowledge to afford the venture capitalist a degree of confidence that the business opportunity can achieve its objectives;
- A management team that has the ability to articulate and defend each aspect of the business opportunity to a venture capitalist.

Making a business investor ready is not a quick process; it may take from three to six months. An incremental approach to investor readiness is preferred because it consumes fewer management resources than attempting to complete the process over a short time span. Meticulous and accurate preparation of documentation and careful planning of how to best articulate the venture's business strategy to the venture capitalist can significantly minimise the distraction and is paramount to the improvement of its investor readiness and, thereby, its prospects of raising capital. Critical analysis of all aspects of the business opportunity is also important during this business planning stage because it can expose threats and circumstances that the entrepreneur must address if the business opportunity is to become investor ready. Although some entrepreneurs consider the planning stage to be a long arduous and unnecessary burden, it is a proven way by which to increase the likelihood of success and limit the probability of failure [33].

Comments made by many of the venture capitalists that responded to the survey reinforced that there are a large number of important variables involved in the evaluation of a business opportunity. No series of questions (such as those provided in this research) can fully encompass all the factors taken into consideration when reviewing a business opportunity. The variables are deal specific (i.e. the selection of criteria and analyses undertaken are dependent upon the characteristics of the business opportunity). Accordingly, there is no set formula to raise funds from a venture capitalist.

If rejected on the first approach, an entrepreneur should request, before approaching the venture capitalist again, that the venture capitalist provide an outline the changes needed. This will make the expectations of the venture capitalists more transparent and afford the entrepreneur the opportunity to present a submission that will meet the venture capitalist's requirements.

Entrepreneurs must develop an in-depth understanding of the general principles that venture capitalists use to evaluate business opportunities. They must also be flexible enough to be able to adapt their company and individual characteristics in response to the varied demands of the different venture capitalists (i.e. not be overly fixated on one specific type of venture capital investor).

Venture capital funds are not readily accessible. Entrepreneurs expecting to raise funds must be aware of this fact and be prepared to allocate accepting of the time and resources needed to obtain them. The development of investor readiness for a business opportunity is very specific and requires a large amount of knowledge and experience. Before approaching a venture capital firm for funding, it is recommended that entrepreneurs liaise with an advisor attuned with the venture capital industry and/or carry out firm-specific research, (e.g. via the Internet and practitioner journals). Advisors can be invaluable to entrepreneurs seeking to raise venture capital. To be effective, advisors must do more than just write business plans and distribute them to venture capital firms. They must have knowledge and experience that are specific to the venture capital fund raising process and they must be able to provide assistance if the business opportunity is not investor ready. By first investigating the targeted venture capitalist, entrepreneurs can tailor their business plan to the venture capitalist's desired characteristics and, thereby, reduce the venture's perceived risks and increase its chances of being 'investor ready'.

Implications for Venture Capitalists

For venture capitalists, the allocation of scarce resources to assess business plans that may be inappropriate for funding and the lengthy processes undertaken prior to the making of any investment decision represents an opportunity cost. Venture capitalists receive remuneration solely for the investments made and not for the analyses undertaken. Consequently, venture capitalists only stand to gain when they are assisting those entrepreneurs have that met their requirements for venture capital funding. This assistance includes the setting down of basic objective milestones (i.e. criteria) that a business opportunity must achieve before a venture capitalist can consider it investor ready. By clearly outlining the deal specific selection criteria, and by providing greater assistance to those business opportunities, that they believe have the potential to become investor ready, venture capitalists will be able to improve their investment analysis procedures, expedite the investment process, and make more informed investment decisions.

When provided with selection criteria and greater information, those business opportunities that have the potential to become investor ready will be more able to identify and rectify their areas of weakness and capitalise on their areas of strength.

A major impediment to venture capitalists making the necessary changes to reduce the misunderstandings surrounding investor readiness is the proprietary nature of the venture capital investment process and the confidentiality within the industry. Thus, whilst not publicly releasing comprehensive details of the venture capitalist's investment processes, one solution is to provide unsuccessful but potentially promising entrepreneurs with greater information, in particular, greater feedback. Those venture capitalists that make their key concerns known to a rejected business opportunity tend to leave the entrepreneurs more accepting of the outcome because the explanatory feedback gives them an improved understanding of the selection process.

In both questionnaires, the respondents were invited '…to make any comments against questions or on the back of the questionnaire.' A common complaint made by entrepreneurs was their disappointment with receiving only brief letters of rejection from the venture capitalists. Some entrepreneurs also

expressed the opinion that the investment process had not increased their understanding of the favoured criteria and procedure and that they had continued uncertainty about what would make their particular business opportunity more investor ready. Although venture capitalists only receive remuneration for successful investment opportunities, the responses indicate that it would be advantageous for them to take the time to state the criteria that a potential successful entrepreneur needs to address. By doing so, the likelihood of the entrepreneur becoming investor ready will improve and there is the increased likelihood of the entrepreneur returning to them for investment, thereby, improving their quality of deal flow. In addition, a venture capitalist has the opportunity to appraise the speed at which the entrepreneur achieves those required outcomes. This exercise offers venture capitalists another point of differentiation in their search for quality investments and it represents a trade-off for the resources initially employed to foster the potentially rewarding, future relationships.
Overall, this area of the research is in its infancy and, as such, provides numerous opportunities to test the recommendations presented and to develop attractive future research propositions.

CONCLUSION

This paper contributes to venture capital literature by using authentic (i.e. in the field) entrepreneurs and venture capitalists to concur with Douglas and Shepherd's (2002) finding that entrepreneurs assess the investor readiness of their business opportunities higher than do venture capitalists, even though both award the same ratings to the key investment criteria. This finding implies that entrepreneurs know how venture capitalists assess business opportunities but they do not understand how to apply the criteria in practice.

To close the gap between venture capitalists' and entrepreneurs' assessment of investor readiness, this paper suggests that a proactive response from both entrepreneurs and venture capitalists will help more entrepreneurs become investor ready and, thereby, increase the venture capitalists' pool of attractive investment opportunities. In particular, venture capitalists must provide more detailed and objective information on the investment criteria they use to assess business opportunities. This information must include the disclosure of the basic milestones that a business must achieve before a venture capitalist could consider it investor ready. For those rejected business opportunities that have the potential to become investor ready, it would be advantageous for the venture capitalist to provide them with detailed feedback; including problems to address before the entrepreneur can reapply for funding. It is also highly advisable that, prior to a reapplication for funding, an entrepreneur carries out 'firm specific' research and/or liaises with a qualified consultant in order to develop a greater understanding of the targeted venture capitalist's investment criteria.

This paper's findings confirm that venture capitalists use comprehensive and deal specific selection processes and criteria. In addition, they indicate that venture capitalists are very risk adverse and, as a result, neglect start up (early stage) 'untested' business opportunities. This risk adversity may exist because venture capitalists must be accountable to their investors. Consequently, they appear more concerned with creating shareholder value for their investors than with such altruistic goals as the building a robust, small to medium-sized enterprise sector.

Further research may involve the investigation of how to best to provide unsuccessful but promising entrepreneurs with meaningful, objective feedback. Research in this area would aim to assist the entrepreneur become investor ready and, thereby, aim to enhance the venture capitalist's quality of deal flow.

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