

# Determinants on Successful Investment of Venture Capitalist

Tianyu Gui<sup>1,\*</sup>

<sup>1</sup>School of Finance, Zhongnan University of Economics and Law, Wuhan, 430073, China

**Abstract.** Venture capital (VC) has transcended its Silicon Valley origins to become a global force shaping the innovation and economic landscape. It is imperative to recognize the critical role of VC and improve its success rate. Employing the "jockey-horse-meadow" model, this paper identifies three crucial determinants influencing VC success: the entrepreneurial team, strategic approach and business model, and the market context. Delving into specific sub-points, the paper underscores the unique significance of each determinant, substantiating their pivotal roles in shaping VC outcomes. This research not only contributes insights into the success dynamics of VCs but also serves as a valuable reference for startups seeking financing and development. Additionally, it offers guidance to investors navigating the selection process, aiding them in identifying startups with genuine potential for impactful investment. By shedding light on these fundamental factors, this paper enriches the discourse surrounding VC success, fostering a more informed and strategic approach in the dynamic world of venture capital.

## 1 Introduction

Venture Capital (VC) represents a funding avenue where investors support startups and small businesses perceived to possess significant long-term growth prospects. VCs excel at addressing a crucial challenge in market economies: bridging the gap between innovative entrepreneurs lacking financial resources and investors equipped with capital but lacking visionary ideas. The remedy, as proposed by theoretical frameworks and substantiated through prior empirical investigations into VC practices, encompasses distinct measures undertaken by VCs to overcome this funding disparity [1].

Venture capital (VC) has its roots dating back to the early 20th century. Initially concentrated in the United States, particularly in the Silicon Valley region renowned for its tech innovation and vibrant startup scene, early venture capitalists were often affluent individuals or family enterprises seeking high-risk, high-reward opportunities. In the 1950s and 1960s, as technology rapidly advanced, venture capital emerged as a pivotal force driving technological innovation and nascent industries. Venture capital firms began to gain prominence, focusing on supporting startups that faced challenges securing funds within traditional financial systems. During this period, the focus of venture capital was primarily on emerging fields like semiconductors and computer technology. The 1970s and 1980s marked further development in the venture capital industry. Large institutional investors and banks also entered the scene, contributing to the maturation and scaling of the venture capital market. The 1990s witnessed the advent of the internet, injecting new vitality into venture capital. A plethora of internet startups emerged, and venture

capital quickly became the preferred means for entrepreneurs to secure funding.

In 21st century, the venture capital ecosystem has continued to grow globally. Not only in the United States but also in other regions such as Europe and Asia, independent and flourishing venture capital ecosystems have taken shape. The critical role of venture capital in driving innovation, economic growth, and employment is increasingly recognized by governments and the business community worldwide. In summary, venture capital has evolved from its initial small-scale practices to become a key financial instrument globally, supporting innovation and driving economic development.

Despite its importance, venture capital has a very low success rate. Throughout its long history, the factors that contribute to the success of venture capital have been one of the main topics of study. There is now a wide range of research on venture capital success factors, this literature has underscored the importance of the entrepreneurial team, financial deal, legal environment, financial market context, the tax system, public spending on research and development and degree of information [2, 3]. Thus, this article focuses on three main determinants on successful VC: entrepreneurial team, strategy and business model, market context. These factors are based on "jockey-horse" framework developed by Kaplan, Sensoy and Stromberg. The entrepreneurial team is the "jockey", the strategy and business model are the "horse" while the market context is a "meadow" where horse run [1].

The following three sections will specify why entrepreneurial team, strategy and business model, and market context are key determinants of venture capital success.

\* Corresponding author: 202121030250@stu.zuel.edu.cn

## 2 Entrepreneurial team (jockey)

In the fast-paced world of venture capital (VC), the success of an investment is intricately tied to the entrepreneurial team steering the startup. The entrepreneurial team serves as the nucleus, influencing the vision, strategy, and execution of the venture. This essay delves into how the composition, skills, and dynamics of an entrepreneurial team significantly shape and impact the success of venture capital investments.

### 2.1 Board composition and complementary skills

The success of an entrepreneurial firm is closely linked to the team's dynamics, composition, and turnover, as these factors play a crucial role in introducing fresh perspectives and insights to the organization [4].

The composition of an entrepreneurial team is a critical factor that plays a pivotal role in both attracting and retaining venture capital. Investors meticulously assess the diversity of skills, experiences, and backgrounds within a team to gauge its ability to navigate challenges and capitalize on opportunities. A well-rounded team possesses the versatility needed to adapt to the ever-evolving business landscape. For instance, a blend of technical expertise, industry knowledge, and strong business acumen can form a comprehensive approach to problem-solving.

Investors also seek a delicate balance within the team, looking for a mix of risk-takers and risk-mitigators. A successful entrepreneurial team must be innovative and forward-thinking while also having the ability to manage and mitigate risks effectively. This balance instils confidence in venture capitalists, enhancing the likelihood of a positive outcome for their investment.

The synergy among team members and their complementary skills is crucial in significantly impacting venture capital success. A team where each member brings a unique set of skills, such as marketing, finance, technology, and operations, is better equipped to address multifaceted challenges. This diversity ensures that the startup adopts a comprehensive and strategic approach to its development and growth. Venture capitalists view a cohesive team with complementary skills as a risk-mitigation strategy. A well-coordinated team can efficiently allocate resources, make informed decisions, and navigate uncertainties, thereby increasing the probability of success in the fiercely competitive business environment.

### 2.2 Leadership and vision

According to the study, venture capitalists place significant importance on management-related criteria, with particular emphasis on the track record of founders and the diversity of backgrounds within the startup's core team as pivotal factors [5].

Leadership within an entrepreneurial team is instrumental in steering the venture towards success. Visionary leaders who can inspire and motivate their

team create a positive and driven organizational culture. This culture, in turn, fosters innovation and resilience, critical elements in the startup ecosystem. Venture capitalists recognize the importance of strong leadership and a compelling vision. A leader who can articulate a clear and ambitious vision not only attracts investment but also aligns the team towards a common goal. The ability to communicate this vision effectively is often considered a key indicator of a team's potential for success.

### 2.3 Dynamic collaboration

Dynamic collaboration and communication among team members are essential for a venture's success. The study indicates that relational capabilities not only result in the addition of founding team members but also contribute to growth in sales and employment [6]. Venture capitalists closely assess the team's ability to work together harmoniously, exchange ideas, and adapt to evolving circumstances. Effective communication fosters a collaborative environment where knowledge is shared, and decisions are made collectively.

Investors acknowledge that a cohesive team is better equipped to address challenges and pivot when necessary. The success of a venture capital investment is significantly influenced by the entrepreneurial team's adaptability in navigating market changes and unforeseen obstacles.

In conclusion, the success of venture capital investments is deeply intertwined with the entrepreneurial team driving the startup. The composition of the team, the complementarity of skills, effective leadership, and dynamic collaboration all play pivotal roles in influencing venture capital success. Investors are not merely investing in a product or service; they are investing in the collective capability of the entrepreneurial team to navigate challenges, innovate, and ultimately realize the full potential of the venture.

As the venture capital landscape continues to evolve, the significance of a strong and capable entrepreneurial team will remain a cornerstone of successful investments. In an environment where uncertainty is the norm, the entrepreneurial team serves as the bedrock upon which successful venture capital endeavours are built. It is the alchemy of diverse skills, visionary leadership, and collaborative spirit that propels ventures towards success, making the entrepreneurial team an indispensable factor in the dynamic world of venture capital.

## 3 Strategy and business model (horse)

The findings unveil a positive correlation between a startup founder's innovative business model and robust social networking, indicating that such startups are more likely to exhibit superior performance metrics such as sales volume, employment rates, return on equity (ROE), return on investment (ROI), among others [7]. This section will delve into the startup's strategy and business model, exploring their influence on the success of venture capital investments.

### 3.1 Clear business model

The success of venture capital investments hinges on the presence of a transparent and workable business model. Venture capitalists actively pursue startups that exhibit a clear trajectory toward profitability, thereby improving the prospects of a successful exit strategy. Primarily, a well-defined business model must encompass both Revenue Generation and Scalability.

Venture capitalists are typically more inclined to invest in ventures capable of generating substantial revenue. A clear business model should efficiently translate products or services into sources of profit, achieved through various means such as direct sales, subscription models, or advertising revenue. The choice of business model is highly positively correlated with success in securing investment as well as success, and a higher survival rate is notably associated with two business model patterns, namely Freemium and Subscription, while four patterns—Cross Selling, Hidden Revenue, Layer Player, and No Frills—are significantly correlated with a lower survival rate [8].

Also, a good business model should be scalable. Venture capitalists often seek business models with rapid scalability potential. This involves the ability of a business to achieve scale within a short timeframe. Businesses with scalability are more likely to realize significant returns on investment within the time frame that investors are focused on. Thus, they are favoured by venture capitalists for financial support.

### 3.2 Differentiation and competitive advantage

The strategy of a business should focus on creating unique value propositions and establishing a competitive advantage. This is the same crucial factor that venture capitalists consider, including the Unique Value Proposition and Barriers to Entry.

A core component of a business strategy is creating a unique value proposition. This implies that the products or services offered by the business stand out in the market, catering to the unique needs of customers. This enhances customer stickiness to reach a wider consumer base. Value specificity is one of the fundamentals of a company's ability to gain a foothold in the marketplace. Venture capitalists are more inclined to invest in ventures that can distinguish themselves in a competitive market.

While possessing special value, the startup should also consider how to establish barriers to entry to protect itself from the impacts of intense competition. This may include technological patents, unique datasets, a strong brand, and more. The presence of barriers to entry makes it challenging for other businesses to easily replicate the success model, increasing the attractiveness of the investment.

### 3.3 Market potential

The success of venture capital often relies on the market potential that a business chooses. This includes the size

and growth prospects of the market and the position of the business within that market.

Venture capitalists typically look for businesses operating in large and continually growing markets. Such markets offer more opportunities, allowing businesses to achieve substantial revenue and providing investors with higher potential returns. A business strategy should precisely define and target the specific segment of the market that the business aims to serve. Venture capitalists are interested in whether a business can accurately grasp and meet the needs of this market segment. By precisely defining the addressable market, businesses can better achieve an increase in market share.

### 3.4 Integrated impact

These three factors intertwine and collectively influence the success of venture capital. For instance, a business might possess a clear business model, but without a unique value proposition and market potential, its attractiveness diminishes. Conversely, even with enormous market potential, a business may struggle to achieve successful venture capital if its business model lacks clarity or competitive advantage.

Throughout the venture capital process, investors typically conduct in-depth analyses of a business's strategy and business model to evaluate potential returns and risks. Therefore, founders and management teams should dedicate themselves to developing an appealing business model, emphasizing a unique value proposition, and seeking growth opportunities in potentially vast markets.

In conclusion, the key to venture capital success lies in the strategy and business model of a business. These two factors complement each other, propelling businesses to stand out in a competitive market and create substantial returns for investors. Therefore, entrepreneurs and investors alike should thoroughly understand and prioritize these key factors to collectively drive innovation and business development.

## 4 Market context (meadow)

Venture capital success is profoundly influenced by the market context in which startups operate. This market context encompasses various factors, including macroeconomic conditions, legal and regulatory landscapes, and cultural influences. This discussion delves into how these three aspects contribute to or hinder the success of venture capital investments.

### 4.1 Macroeconomic conditions

Macroeconomic factors play a pivotal role in shaping the landscape for venture capital investments. The overall health of the economy, inflation rates, and interest rates can impact the availability of funds, investor confidence, and the willingness of startups to take risks. During periods of economic expansion, venture capital tends to flow more readily as investors are optimistic about growth opportunities. Conversely, economic downturns

can lead to a tightening of investment, increased risk aversion, and a more challenging environment for startups to secure funding. Through a comparative examination of the financial crisis and an economic boom, the empirical results of the comprehensive analysis assert that the United States venture capital markets exhibit significant correlations with the broader macroeconomy in specific dimensions. Changes in the macroeconomic landscape have a pronounced impact on venture risk levels, consequently resulting in risk mitigation or, conversely, risk augmentation. These outcomes are contingent upon investors' risk preferences and the defined risk-to-reward ratio [9].

The size and stability of the market also influence venture capital success. A large and stable market provides greater opportunities for startups to scale and achieve significant returns. Economic indicators such as consumer spending, GDP growth, and unemployment rates are closely monitored by venture capitalists to assess the overall market context and potential for success.

#### **4.2 Legal and regulatory landscape**

The legal and regulatory environment is a critical determinant of venture capital success. Different jurisdictions have varying laws and regulations that can either facilitate or impede the growth of startups. Various factors, including intellectual property protection, contract enforcement, and the overall ease of conducting business, play pivotal roles in determining the appeal of a market for venture capital. Research indicates that cross-country variations in legality, encompassing legal origin and accounting standards, exert a substantial influence on the governance structure of investments in the venture capital industry. Robust legal frameworks contribute to expedited deal screening and origination, an increased likelihood of syndication, reduced chances of potentially detrimental co-investments, and a smoother facilitation of investor board representation [10].

In addition, regulatory changes can have a profound impact on certain industries. For example, emerging technologies may face evolving regulatory frameworks that can either foster innovation or create barriers to entry. Venture capitalists need to stay abreast of legal developments to anticipate potential risks and opportunities associated with their investments.

Moreover, compliance with regulations is essential for startups seeking venture capital. Companies that navigate the legal landscape effectively are more likely to gain the trust of investors and operate sustainably. Regulatory clarity and a supportive legal environment contribute to a positive market context for venture capital investments.

#### **4.3 Cultural influences**

Cultural factors significantly shape the success of venture capital investments. Cultural nuances can impact consumer behaviour, market acceptance of products or

services, and the overall business environment. Understanding the cultural context is crucial for startups to tailor their strategies and offerings to local preferences. In some cultures, risk-taking and entrepreneurship are highly encouraged, fostering an environment conducive to innovation and venture capital success. Conversely, conservative cultural attitudes may pose challenges for startups introducing disruptive technologies or unconventional business models.

Cultural diversity also plays a role in the success of global venture capital investments. Investors need to navigate and understand the cultural differences in various markets to make informed decisions. In contrast to the risk-sharing motive, a heightened cultural disparity between investor countries and their invested companies is linked to smaller venture capital (VC) syndicates. This phenomenon is primarily driven by reduced representation of local investors in syndicates led by foreign VCs. However, specific syndication strategies related to cultural disparities, such as involving locally experienced foreign VCs or syndicate members from culturally similar countries, correlate with increased participation of local VCs offering valuable monitoring services. Further research indicates that these culture-linked syndication approaches significantly align with VC financing and monitoring strategies in cross-border investments, influencing their ultimate success [11]. Establishing effective communication and building relationships with local partners are vital for overcoming cultural barriers and ensuring the success of venture capital endeavours.

In conclusion, the success of venture capital investments is intricately tied to the market context, encompassing macroeconomic conditions, legal and regulatory landscapes, and cultural influences. Investors must carefully evaluate these factors to make informed decisions, mitigate risks, and capitalize on opportunities. By understanding and navigating the complexities of the market environment, venture capitalists can enhance their chances of backing successful startups and achieving robust returns on their investments.

## **5 Conclusion**

In conclusion, the three factors in the "jockey-horse-meadow" model, namely the entrepreneurial team, strategy and business model, and market context, play a very important role in the success of VCs. These three factors are indispensable, just like the success of VC is a jockey driving a horse in the meadow, which requires good driving skills of the jockey, a strong horse, and a flat and wide meadow. The composition of the entrepreneurial team, leadership, vision, and complementary competencies proved to be the key factors for a successful team; a clear business model, special value and competitive advantages, and market potential proved to be the key factors for a successful entrepreneurial project; and macroeconomic conditions, laws and regulations, and cultural influences also proved to be important contextual factors affecting the success of entrepreneurial investments. Only when good jockeys,

sturdy horses, and vast meadows are all met at the same time is a startup team most likely to get financing as well as succeed in their venture. The limitation of this article is that it does not fully include other possible influencing factors, and it is hoped that future articles will analyse the determinants of VC success in complete detail.

## References

1. P. A. Gompers, W. Gornall, S. N. Kaplan, et al., JFE, 135(1), 169-190 (2020).
2. J. Lerner and J. Tåg, ICC, 22(1), 153-182 (2013).
3. E. G. S. Félix, C. P. Pires, and M. A. Gulamhussen, J Financ Serv Res, 44, 259–279 (2013).
4. C. M. Beckman, M. D. Burton, and C. O'Reilly, JBV, 22(2), 147-173 (2007).
5. R. Eugster and M. J. Kendzia, ABR, 10(12), 132-144 (2022).
6. J. Brinckmann and M. Hoegl, SEJ, 5(1), 37-57 (2011).
7. S. C. Lee, W. H. Lim, and E. K. Suh, JDS, 12(6), 81-88 (2014).
8. J. Weking, T. P. Böttcher, S. Hermes, et al., *Does Business Model Matter for Startup Success? A Quantitative Analysis* in the Proceedings of 27th European Conference on Information Systems, ECIS, 6.
9. P. Kuosmanen, Macroeconomic impact on venture markets: Does the correlation exist? University of VAASA (2022).
10. D. Cumming, D. Schmidt, and U. Walz, JBV, 25(1), 54-72 (2010).
11. N. Dai and R. Nahata, JIBS, 47, 140-169 (2016).