

## **Venture Capitalists That Will Last When the Going Gets Tough**

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Entrepreneurs constantly face high risks. They need venture capitalists (VCs) that can handle risky events, including crises such as lawsuits. However, VCs often abandon entrepreneurs facing lawsuits. One VC told me that in his experience, 75% of investors refuse to continue to invest in startups involved in a lawsuit, even if the case has no merit. Another VC called a startup with a lawsuit a “dead man walking” because the lawsuit puts the ability of the founding team in question. To avoid losing VCs when they’re needed the most, entrepreneurs need to be able to identify which VCs will stay when the going gets tough.

In an in-depth study of VC decision-making, my colleague and I examine over 400 VC investment decisions following more than 100 startup lawsuits. According to our preliminary results, VCs with three kinds of experience will continue to invest in a startup involved in a lawsuit: (1) VC general investment experience, (2) VC experience with the specific startup investment, and (3) VC experience with their own lawsuits.

### **1. Gaining Confidence from Investment Experience:**

VCs with greater investing experience are more likely to continue to invest in startups involved in lawsuits. The VCs likely dealt with startup lawsuits in the past, they know how to help the startups successfully respond to the lawsuits, and they have confidence in their abilities to ensure that the startups will succeed regardless of the lawsuits.

### **2. Building a Trusting Relationship with Startups Involved in Lawsuits:**

VCs with more experience with the specific startups involved in the lawsuit develop in-depth relationships with the startups. Those relationships give the VCs more faith and confidence in the ability of the startups to withstand the lawsuit, making the VCs more likely to continue to invest.

### **3. “Where There is a Will There is a Lawsuit” (Addison Mizner)**

While lawsuits come with immense uncertainty and risk, VCs with greater

experience with their own lawsuits learn what to expect from lawsuits. They gain confidence in their ability to help startups deal with their lawsuits. In talking to VCs, it became clear that VCs with exposure to lawsuits are more likely to believe that lawsuits can be brought against anyone for any reason. That realization makes the VCs less likely to hold the lawsuits against the startups and abandon them when they become involved in lawsuits.

However, particularly negative lawsuit experience can be traumatizing. Negative lawsuit experience occurs when VCs are sued instead of bringing the lawsuit or when VCs must take the lawsuit all the way to trial instead of settling or dismissing the lawsuit early. That traumatic negative experience makes VCs less willing to endure a similar experience again in the startups, making them more likely to decide that continued investment isn't worth it. On the other hand, VCs with more positive lawsuit experience, such as getting out of their own lawsuits early through a dismissal or settlement, are even more likely to continue investing in startups involved in lawsuits.

### **How Entrepreneurs Can Protect Themselves by Picking the Right VCs**

Entrepreneurs can help protect themselves from future VC abandonment by initially picking the right VCs. To do so, entrepreneurs need to ask VCs probing questions about their experience investing and with difficult situations such as crises and lawsuits. Knowing that VCs have experience investing and experience with those difficult situations can increase entrepreneurs' confidence that the VCs won't scare easily in the future. Once entrepreneurs choose their VCs, developing long-term relationships with the VCs can lead to more stable and continuing investment, regardless of what issues arise. By acting proactively to pick VCs that are more likely to stay in the face of crises or lawsuits, entrepreneurs can shield themselves from future hardship and possible failure.

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