**Badge of Honor or Scarlet Letter? Unpacking Failure in Venture Teams**

**joint with** *Diego Zunino and Gary Dushnitsky*

**Abstract:**

Because venturing requires both quality and good luck, most entrepreneurs fail. Research on entrepreneurship has devoted limited attention to business failure and we know little about the investors’ perspective on the costs and benefits associated with past entrepreneurial failure, even in the case this is entirely due to bad luck. Drawing from literature on signaling, we theorize that investors interpret signals while evaluating a venture under the high degree of uncertainty that surrounds firms at the seed stage and that past failure is a noisier signal of quality than past success. Do investors punish past failure due to bad luck? And does the penalty disappear in the presence of a signal of quality? Or do investors still apply some discount to past failure due to stigma by association?

We address these questions using an online experiment with a randomized 2x2 between-subjects design. Participants are investors who evaluate an investment opportunity seeking funding on an equity crowdfunding platform. We manipulate the experience of the team regarding their failure experience (knowingly due to bad luck) and the presence of a signal of quality. In this way, we are able to measure the causal impact of failure due to bad luck.

Our results show that high costs are attached to failure due to bad luck, because it creates ambiguity about founders’ quality. However, the label of failure does not carry costs: in the presence of a signal of quality, previous failure does not lead to discounts for the entrepreneur (due to stigma by association). We contribute to the literature on entrepreneurial experience by providing a novel perspective on investors’ perception of failure and by producing causal evidence that expands on the results of earlier quantitative studies about entrepreneurial experience.