

Understanding Entrepreneur and Business Angel Investment Capabilities, Expectations, and Relationships

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Principal Topic

Informal investors have been identified as the most prevalent source of finance for new ventures. Much of the research on informal investors has been concentrated on Business Angels (BAs). BAs have been identified as high net worth middle-aged males that typically are unrelated to the entrepreneurs in which they invest. More recently, however, a much larger group of investors has been identified that fall outside this definition. Investors who are affiliated with entrepreneurs by way of family, friend, or acquaintance account for more than 85% of all early stage new venture financing. Yet, there is little research into BA investment expectations and capabilities and how these coincide with entrepreneurs. This research identifies similarities and differences in the investment expectations and capabilities between entrepreneurs, affiliated business angels (ABAs) (those that have an affiliation with the entrepreneurs in which they invest) and UBAs (unaffiliated business angels). By better understanding the expectations and capabilities of these two groups and the degree to which there is convergence or dissonance, steps can be taken to reduce entrepreneur-angel conflict and improve business (and investment) success.

Methodology/Key Propositions

The theoretical foundations underpinning the research are couched in terms of a resource based theory of the firm, the theories of reasoned action and the theory of planned behavior, and network theory. The research adopts a resource-based perspective since model constructs can be perceived as internal capabilities or resources. This perspective views firm-specific resources, such as capabilities, as the "drivers of a firm's business strategy". Capabilities reside in superior managerial and entrepreneurial skills and knowledge that make it possible to engage in advantageous business process activities. The firm, therefore, is the source of competitive advantage with its competitive advantage residing in the resources it has available. Thus, entrepreneur and investor experience and start-up skills and knowledge can be viewed as resources that potentially enhance the success of investments. The research is couched in terms of the theories of reasoned action and planned behavior which use attitude (the predisposition to respond in a generally favorable or unfavorable manner with respect to the object of the attitude), social norms (social pressure perceptions to perform or not perform a behavior), and perceived behavioral control (ease or difficulty perceptions of performing a behavior based upon experience and expected impediment) as behavior prerequisites via intentions to perform particular behaviors. These theories are relevant because they provide a basis for explaining the intentions of investors and entrepreneurs to perform investment, start-up, and growth behaviors. The research subscribes to network theory since entrepreneurship is a socio-economic activity - in particular, the relationship between the investor and the entrepreneur which has been shown to develop over time. For UBAs, any relationship prior to the investment is, at best, a mutual acquaintance. For ABAs, an existing relationship exists prior to the investment. Entrepreneur-investor relationships, therefore, should be considered when examining investment activities. The above theories provide the basis for the following hypotheses ... Since entrepreneurs typically are optimistic and investors typically conservative, H1: Entrepreneurs will expect higher returns on the investments they make in their businesses than UBAs. Since ABAs may be required to invest money more for family altruistic or necessity reasons rather than for business opportunity reasons, H2: UBA expected returns will be higher than for ABAs. Because of their optimism, entrepreneurs will have less of a fear of failure than investors. As individuals develop entrepreneurial experience, they tend to become more cautious. Research

indicates that UBAs are typically people who have had some entrepreneurial or other business experience. Thus, H3: Entrepreneurs will have less of a fear of failure than UBAs. H4: UBAs will demonstrate greater entrepreneurial experience than entrepreneurs. Because ABAs often invest for reasons other than identifying attractive business opportunities, it can be expected that they will be less experienced than UBAs. Thus, H5: ABAs will demonstrate less of a fear of failure than UBAs. H6: ABAs will demonstrate less entrepreneurial experience than UBAs. Similarly, because of their entrepreneurial experience, H7: UBAs will demonstrate greater confidence in their skills to start a new business compared to entrepreneurs. H8: ABAs will demonstrate less confidence in their skills to start a new business compared to UBAs. To evaluate these hypotheses, 12,000 Australians - randomly selected from the Australian population - were telephonically surveyed during the period 2000 to 2005 under the GEM (Australia) research program. The dependent variable is type of individual (entrepreneur or investor). Independent variables include return on investment, fear of failure, entrepreneurial experience, skills to start a business, and investor relationship with entrepreneur. Logistical regression will be used to test the differences between the groups.

Results and Implications

This research represents work-in-progress with the data currently being analysed. The research makes a contribution at two levels. At a theoretical level, it contributes toward a better understanding of the factors that underpin the investment decision for UBAs and ABAs (extending prior research) and potential sources of investment dissonance and convergence between investors and entrepreneurs. At a practical level, the research provides the basis for developing training programs for advisors, investors, and entrepreneurs that will help them appreciate individual differences and similarities. These programs should result in reduced potential investor and entrepreneur conflict through a greater appreciation of each other resulting in more successful business investments. The results also provide the basis for developing Australian entrepreneurship policy.

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