What Drives Micro-Angel Investments?

ABSTRACT. Despite of the significant role of informal venture capital in the financing of new entrepreneurial ventures, there is little research explaining the factors determining the propensity of individuals to make micro-angel investments. Building on two theoretical frameworks, a social psychological theory of planned behavior and an economic theory on the determinants of demand for risky assets in household portfolios, we develop a set of hypotheses predicting the propensity of individuals to make informal investments in new businesses owned by others. In our analysis we test whether the determinants of micro-angel investments are similar when investing in a business owned by a close family member versus more distant business. The hypotheses are tested using data from 6007 interviews of Finnish adults carried out in the Global Entrepreneurship Monitor program in 2000–2002. The findings show that the theoretical frameworks have more power in explaining investments in firms not owned by close family members. The study provides new understanding of the differences in the drivers of different types of micro-angel investments.

KEY WORDS: household portfolios, informal venture capital, theory of planned behavior

JEL CLASSIFICATION: G24, G28, M13, D14

1. Introduction

Informal venture capital including micro-angel investments has been found to be a major source of funding for early-stage entrepreneurial ventures (Mason and Harrison, 2000a,b; European Commission, 2002; Reynolds et al., 2002a; Bygrave et al., 2003). In comparison to formal venture capital allocated for start-up activities (US$59 billion), informal funding provided to new firms was five times greater (US$298 Billion) in 2001 for the 37 countries included in the Global Entrepreneurship Monitor research in 2002 (Reynolds et al., 2002a). Whereas the share of new companies receiving formal venture capital funding was only about one in 10,000, informal funding, on the other hand, was provided by 1–7% of the adult population to tens of millions of individuals involved in the start-up process according to the Global Entrepreneurship Monitor research (Reynolds et al., 2002a). To put it in economic perspective, whereas the volume of formal venture capital investment was 0.2% of GDP, the estimated share of informal investment was 1% of GDP in 2001 on average in the 37 countries participating in the Global Entrepreneurship Monitor (Reynolds et al., 2002b).1

Despite of the significant role of informal venture capital in the financing of small and new ventures, there is little theory-driven research focusing on the determinants of the propensity of individuals to make informal investments in businesses owned by others (Wright et al., 1998; Mason and Harrison, 2000a). In our research, we contribute to the understanding of drivers of informal investments by drawing on two theoretical frameworks, the social psychological theory of planned action (Ajzen, 1991), and the economic theory on household portfolios (Guiso et al., 2002) to develop a set of hypotheses pre-
redicting the propensity of individuals to make informal investments in new businesses owned by others. Further, we compare the determinants of investments in businesses owned by close family members and investments made in businesses owned by more distant entrepreneurs. In our research, we are able to leverage a unique, large, and comprehensive data set, which has not been previously employed in research on informal venture capital. The hypotheses are tested using data from 6007 interviews of Finnish adults carried out in the Global Entrepreneurship Monitor program in 2000–2002.

The rest of the paper is structured as follows. We first introduce the two bodies of literature to which this study contributes. We then lay out our hypotheses. This is followed by the method section and empirical analyses. Finally, we discuss our findings and the implications for various stakeholders.

2. Literature review

Despite of the significant role of informal venture capital in the financing of small and new ventures, there is little research on what influences micro-angel investments (Wright et al., 1998; Mason and Harrison, 2000a). The first generation of studies on informal venture capital have typically been descriptive (For a review, see e.g. Mason and Harrison, 2000a), focusing primarily on investor characteristics, investment activity, information channels, and involvement in investee companies in different countries including USA (Wetzel, 1981; Aram, 1989; Freear et al., 1994), UK (Harrison and Mason, 1992; Stevenson and Coveney, 1994), Sweden (Landström, 1993), Canada (Short and Riding, 1989; Riding et al., 1993; Farrell, 1998), Finland (Lumme et al., 1996; 1998), Japan (Tashiro, 1999), Australia (Hindle and Wenban, 1999), Norway (Reitan and Sørheim, 2000), and Singapore (Hindle and Lee, 2002). It is common for these studies that they have estimated the size of the informal venture capital market to be multiple times the size of the formal venture capital market. These studies have also frequently profiled a typical angel investor as a high-worth middle-aged male with entrepreneurial experience.

Recently, research on informal venture capital has started to shift from descriptive studies to more theory-based studies and studies employing improved empirical methods to solve problems stemming from the limited availability of data on informal venture capital (Mason and Harrison, 2000a,b). However, the evolving research has not yet focused on the determinants of the propensity of individuals to make informal investments in new businesses started by others. Given that prior research clustering informal investors in groups driven either on economic or various types of social psychological factors (Sullivan and Miller, 1996), we build our research on two important theoretical bases. First, we employ the social psychological theory of planned behavior (Ajzen, 1991), which attempts to explain the influence of (a) individuals attitudes towards a behavior (i.e. the degree to which a person has a favorable or unfavorable evaluation or appraisal of the behavior in question), (b) perceived social norms (i.e. the perceived social pressure to perform or not to perform the behavior), and (c) perceived behavioral control (i.e. the perceived ease or difficulty of performing the behavior and it is assumed to reflect past experience as well as anticipated impediments and obstacles) on intentions and subsequent behavior. Given that an informal investment should often be preceded by some form of planning and decision-making (in particular in non-family investments), this framework should be useful in explaining part of the variance in informal investment activity. Second, we employ the economic theory of household portfolios (Guiso et al., 2002b), which attempts to explain the determinants of demand for risky assets in household portfolios. Given that an investment into a new start-up attempt clearly classifies as a risky asset (even if it is not always considered as such), this framework should be useful for our purposes and help to explain part of the variance in informal investment activity.

In social psychology, the theory of planned behavior (Ajzen, 1991) has been found to provide a strong basis for explaining the intentions of individuals to perform behaviors that require some kind of premeditation. The theory and related empirical research has shown that such