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Serial Investors and Early Stage Finance

Peter Kelly
Michael Hay

This study examines the early stage investment activity of UK serial investors, individuals who have made at least three private investments. Two distinct groups emerged; one which invested on their own all the time (“solo serial investors”) and the other which invested with others almost exclusively (“syndicate serial investors”). Both groups had invested in a variety of industrial sectors, a majority of which were in sectors where no one in the investor group had previous direct experience. Concept familiarity appeared to be a necessary, albeit insufficient, prerequisite to the decision to invest. For a majority of the investments reviewed for both groups, the investor(s) backed individuals personally known to them, to another syndicate member, and/or to the deal referrer. When the linkage to performance is explored, both solo and syndicate serial investors are well advised to back entrepreneurs known to a least one member of the investor group.

I. INTRODUCTION

If one were asked to describe a “typical” private investor, research conducted in the US (Wetzel 1981; Gaston & Bell 1988), Canada (Short & Riding 1989), UK (Mason, Harrison & Chaloner 1991) and Sweden (Landström 1993) would characterise the individual as:

- a middle-aged male; with
- reasonable net income and personal net worth; and
- previous start-up experience; who
- makes one investment a year, usually close to home; and
- prefers to invest in high technology and manufacturing ventures; with
- an expectation to sell out in three to five years time.

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While it is appealing to conclude that private investors as a group across a number of countries share similar traits, the evidence collected to date supports the notion that the informal venture capital market is rather heterogeneous in character (Freear & Wetzel 1992). There is a growing awareness among researchers in the informal venture capital area of the need to disaggregate the unit of analysis further. A number of authors have developed typologies¹ to identify distinct sub-groups within the population classifying individuals based on a number of different criteria including: investment motivation, background experience, operating style and the number of investments made.

In an effort to address this research need, in this study we have restricted our attention to the most active market segment, namely informal investors which have made more than three investments in privately-owned firms. There is a growing body of evidence to suggest that a significant minority of private investors have yet to make their first investment (so called "virgin angels") or invest rather infrequently, while a smaller yet substantial group of investors are very active, often large scale, investors (Mason, Harrison & Chaloner 1991; Stevenson & Coveney 1994; Landström 1993). We refer to this latter group as "serial investors." The decision to concentrate exclusively on serial investors is motivated by several factors: i) in all likelihood, these investors account for a disproportionately large percentage of actual investment activity; ii) it is reasonable to suggest that experience effects may be operating—in this respect, we may have the most to learn from serial investors; and iii) understanding the active segment of the market may serve to stimulate additional investment activity from relatively inactive investors.

Generally speaking, private investors are remarkably entrepreneurial individuals in their own right, a majority have started a business of their own or have previous management experience in the new venture setting (Wetzel 1981; Sullivan 1992; Neiswander 1985; Short & Riding 1989; Riding 1993; Landström 1993; Mason, Harrison & Chaloner 1991; Stevenson & Coveney 1994). It seems reasonable to suggest that private investors face a challenge in making the transition from "entrepreneur" to "investor" *and* that based on the level of investment activity reported, serial investors seem to make this transition much easier than less active informal investors. In fact, all of the respondents in our study have previous direct experience in the new venture setting.

This paper is motivated by the underlying question: is there anything to be learned from the experience of this very active, entrepreneurial group of investors for ventures in their early stages of development seeking equity finance? Clearly, the answer to this question would be useful both for entrepreneurs seeking capital and for private investors alike. For entrepreneurs, this study begins to address the important question: which investor(s) should I approach? For investors, financing early stage ventures implies the assumption of a great deal of risk. Does it make sense to invest as part of a syndicate to achieve some measure of diversification?

In view of the inherently higher risks involved, should serial investors restrict their investment activity to opportunities where at least one investor has previous knowledge of the industry in which the venture competes and/or the people involved?

II. CONCEPTUAL BACKGROUND

An investor bears risk any time an investment is made. Inherently, investment returns are impacted by external developments in the firm's competitive domain; what has been referred to in the finance literature as business or market risk. In addition, there is the ever present possibility that entrepreneurs will not always act with the best interests of the investor in mind, commonly referred to as agency risk. In a theoretical world of perfect information, neither of these risks would exist—investors would be able to select investments that offer the most profitable and durable profit stream directed by an entrepreneur that is fully aware of, and acts in complete accordance with, the interest(s) of the investor. In the practical world, investors seek out ways to manage business and agency risk. For purposes of clarity, it is useful to separate out the discussion of how to manage risks inherent to the opportunity (business risk) from those embodied in the individual(s) who wish to exploit it (agency risk).

Managing Business Risk

Conventional finance theory suggests that, in part, business risk can be reduced through diversification. That is to say an investor can gain some measure of protection from business risk by investing in a number of ventures at varying stages of development, competing in different industries and/or geographic areas. Investors should prefer more diversity to less, particularly if they view the risk/reward tradeoff as unalterable (Gupta & Sapienza 1992). Under such circumstances, there is little, if any incentive for an investor to be actively involved as such efforts would neither reduce risk or increase rewards, rather their interests would be better served concentrating on the selection of investments to include in the portfolio.

Previous research has demonstrated, however, that private investors display a tendency to specialise rather than diversify in terms of the investments held in their portfolios which implies that investors do not view the risk/reward tradeoff to be necessarily fixed.² Private investors have a strong propensity to invest in earlier stages of development³ in the US (Wetzel 1981; Tymes & Krasner 1983; Freear & Wetzel 1988, 1990; Aram 1989; Postma & Sullivan 1990; Ehrlich et al. 1994) and to a lesser extent in the UK (Mason, Harrison & Chaloner 1991; Mason, Harrison & Allen 1995) and Sweden (Landström 1993). Moreover, private investors in the US (Wetzel 1981; Tymes & Krasner 1983; Aram 1989) and Canada (Riding & Short

1987; Riding 1993) demonstrate a clear preference for investing in high technology manufacturing industries. This might, in fact, be a product of geographical context as the samples were drawn from fertile areas of innovative activity. Other studies conducted in the US (Gaston & Bell 1988; Postma & Sullivan 1990), UK (Mason, Harrison & Chaloner 1991) and Sweden (Landström 1993) indicate much wider investor diversity in terms of industries backed. Informal investment activity is also highly localised⁴ in the US (Wetzel 1981; Tymes & Krasner 1983; Aram 1989; Postma & Sullivan 1990; Freear, Sohl & Wetzel 1994), Canada (Riding & Short 1987, Riding 1993), and the UK (Mason, Harrison & Chaloner 1991).

Like venture capitalists (Tyebjee & Bruno 1984), informal investors prefer to invest in markets and/or technologies which are familiar to them or in which they have had some direct experience (Sullivan 1991; Mason, Harrison & Chaloner 1991; Landström 1993; Harrison & Mason 1990; Aram 1989). In his studies, Fiet (1991; 1995a; 1995b) provided empirical support for the notion that business risk is considered more important by venture capitalists surveyed than was the case for private investors ($p < .05$). In view of their larger deal flow, venture capitalists are well positioned to assess market risk across a variety of different contexts. Based on their experience in business and industry, Fiet suggested that private investors may be comfortable in their abilities to deal effectively with business risk. He implies that a linkage may exist between investor characteristics and perceived business risk. It is important to note that Fiet's conclusion is couched in relative terms—one can not conclude that informal investors are not concerned with business risk at all.

Information economics literature often assumes that risk reducing information can be acquired but at a cost to acquiror. There is an incentive to develop specialisation insofar as information acquired for one purpose can be used, in whole or in part, for other purposes. It seems reasonable to suggest that an investor's base of prior experience can be viewed as a highly specialised source of risk reducing information. What implications does this have for individual investors? The answer it seems is dependent upon investment style.

When an investor chooses to invest solo or as a "lone wolf"⁵ (Gaston 1989), opportunity evaluation and post investment monitoring is largely undertaken by the individual investor although they may consult their network of connections informally for additional information as required. Being largely self-reliant to assess business risk, private investors may restrict their opportunity set to areas in which they have some direct experience, hence:

- P1: When an investor chooses to invest alone, they should display a propensity to invest in industries in which they have previous experience.

Investing as part of an investment syndicate would appear to offer a number of advantages to investors: i) the ability to participate in larger investments that could

not be underwritten alone; ii) benefits arising from bringing together a more diverse set of investor skills and experience to bear on a venture; iii) the opportunity to expand a network of contacts as a source of future investment leads. Depending on the nature of the experience base of its members, it also seems reasonable to suggest that an investment syndicate has a greater capacity to assess business risk over a wider variety of contexts. One can reasonably expect, however, that opportunities will be restricted to areas in which at least one member of the syndicate has direct experience, hence:

- P2: When an investor chooses to invest with others, they should display a propensity to invest in industries in which at least one syndicate member has previous experience.

Managing Agency Risk

Fiet (1991, 1995a, 1995b) reported very strong support for the notion that informal investors were much more concerned about agency risk—the extent to which entrepreneurs and investors hold differing and possibly divergent interests—as opposed to business risk ($p < .01$). This finding is not altogether surprising given the consistent emphasis informal investors place on the quality of the entrepreneur/team as a discriminating criteria during the evaluation phase (Haar, Starr & MacMillan 1988; Harrison & Mason 1992; Stevenson & Coveney 1994; Riding & Short 1987). How do investors manage agency risk?

A number of authors have suggested that informal investors attempt to manage agency risk by becoming actively involved with the venture in a number of supportive or direct roles⁶ (Harrison & Mason 1990; Landström 1992, 1993). Evidence from the US (Wetzel 1981; Tymes & Krasner 1983; Gaston 1989a; Freear, Sohl & Wetzel 1990), Canada (Venture Economics 1990), UK (Mason, Harrison & Chaloner 1991; Mason, Harrison & Allen 1995), and Sweden (Landström 1993) indicate that a vast majority, usually 75% or more, of investors can be considered “active” although a substantial minority prefer to manage their investments in a “passive” fashion, receiving only periodic financial and operating reports.⁷ Aside from active involvement, investors can choose to limit their investments to opportunities presented to them by entrepreneurs which are known to them personally (Harrison & Mason 1990; Landström 1993) or to the referrer of the deal. In either case, the individual investor or the referrer⁸ can be a source of agency risk reducing information. Assuming that informal investors prefer to back deals with perceived lower levels of agency risk, one would expect that:

- P3: When an investor chooses to invest alone, they should display a propensity to back entrepreneurs which are either known to them personally or to the referrer of the deal.

- P4: When an investor chooses to invest with others, they should display a propensity to back entrepreneurs which are known to them personally, to other member(s) of the investment syndicate or to the referrer of the deal.

Portfolio Size

Fiet (1991, 1995a, 1995b) concluded that private investors are generally more concerned with agency as opposed to business risk. In attempting to deal with agency risk, investors can choose to be actively involved with the venture in a number of capacities and/or limit their investment activity to opportunities lead by an individual known to them personally, to other investors in the syndicate and/or to referrer of the deal. Previous research has confirmed that the time commitment required of investors to actively manage their investments is often quite large. Neiswander (1985) reported that US private investors spend, on average, five hours per week with each venture in the first six months, and three and a half hours per week thereafter. A typical UK private investor spends one or two days a week assisting ventures (3i 1994; Mason, Harrison & Allen 1995) and Swedish investors surveyed by Landström (1993) spend, on average, twelve hours per month with investee firms. The issue of time commitment is particularly acute for ventures in their earliest stages of development, an interpretation consistent with Stinchcombe's notion of liabilities of newness (Stinchcombe 1965). What is the implication of active involvement in terms of portfolio size? We suggest that the answer to this question is also dependent upon investment style.

A perceived advantage of investing by way of syndicates is the ability to diversify risk over a larger number of investments. It is reasonable to suggest that it is not necessary for a given investor to be actively involved with all the ventures in which he has invested, rather a member(s) of the syndicate whose background is best suited to the task can assume an active role while other members are only passively involved. It follows that time constraints will be particularly acute for investors who forgo the benefits of co-investment and choose to invest primarily on their own, hence:

- P5: The greater the propensity of an investor to invest on their own, the smaller the number of early stage investments in their portfolio.

III. SAMPLE AND METHODOLOGY

Serial investors were identified through a combination of: i) leads provided by The Enterprise Support Group, a Guildford based company which, among other activities, manages a nationwide computerised investment opportunity database

service in the UK known as Venture Net; and ii) personal contacts. Each investor provided us with a detailed chronology of their private investment activity. In addition to written summaries prepared by respondents, semi-structured interviews (60-90 minutes duration) were arranged with each investor to gain additional insights.

For each investment made, respondents were asked to provide the following information:

- the date the investment was made;
- referral source;
- industrial sector;
- stage of development;
- size of investment;
- their personal equity stake;
- the composition of the syndicate, if any;
- their role in the venture, if any (for example, non-Executive Chairman);
- a subjective assessment of performance or exit details if available.

In addition, investors were asked to indicate whether they, or any member of the syndicate, were familiar with: i) the concept itself; ii) the industry in which the venture competed; and iii) the entrepreneur prior to the investment being made. “Familiarity” was measured dichotomously (yes/no) given the difficulties faced in trying to: i) operationalise these variables in a meaningful and consistent way for respondents; ii) accurately measure “depth” of familiarity; and iii) maintain the time commitment required of respondents to a reasonable level.

In all, eight serial investors agreed to participate in our study providing background information on forty-one private investments. The profile of a “typical” serial investor in our sample is as follows:

- a male; who
- had founded two ventures; and
- made five private investments averaging £65,000 each; to
- early stage (45%) and later stage ventures (55%); competing in
- a service (55%), manufacturing (25%), or high technology (20%) industry; and usually
- investing in syndication with others (75%).

In this paper, we focussed our attention exclusively on the early stage investments made by respondents. All but one of the investors had made at least one investment in early stage ventures which yielded detailed information on 17 early stage investments.

IV. FINDINGS

Two distinct groups of serial investors emerged; one group choosing to invest on their own *all the time*⁹ ($n = 2$) while the other almost exclusively invested as part of investment syndicates¹⁰ ($n = 5$). Compared to the results of earlier studies (Mason, Harrison & Chaloner 1991; Mason, Harrison & Allen 1995) which concluded that the majority of UK private investors are independent, a majority of the respondents in our study (70%) invest with others either exclusively or most of the time. Venture capital funds invested alongside private individuals in two syndicated early stage deals we reviewed and followed on at a later date in one other. Freear, Sohl & Wetzel (1990) were the first to provide evidence in support of the "complementarity hypothesis" concluding that private investors typically invest in smaller amounts and at earlier stages than venture capitalists. The relationship between formal and informal venture capital investors was viewed in sequential terms. On the basis of our interviews, we would expand the notion of complementarity to include deals where venture capitalists and private investors invest simultaneously with the latter assuming the role of active and informed monitor based on prior relevant industry and/or new venture experience.¹¹

To test propositions 1 and 2, we asked respondents if they, or one of the co-investors to a deal, had prior experience with the industry in which the venture competed. When an investor chose to invest alone, only one deal was completed in an industry in which the investor had some previous direct experience. For deals which involved a syndicate of investors, over half the investments we reviewed were made in an industry sector in which at least one member of the syndicate had direct experience. Clearly, solo serial investors appear to have achieved a high degree of industrial diversification in their portfolios but perhaps at the expense of forgoing the possible benefits from specialising their investments in industries in which they had prior experience. It would appear that syndicate serial investors can achieve a measure of industrial diversification simply by investing as part of a group comprised of individuals with diverse backgrounds in industry. On the basis of these findings, we conclude that proposition 1 is **not supported** and that proposition 2 received **modest support**.

That is not to say that investors invest "blindly" into opportunities totally unfamiliar to them. Respondents were asked if they or any member of the syndicate was familiar with the "concept" upon which an investment proposal was based. In a majority of cases for both solo (60%) and syndicate (82%) serial investors, at least one investor reported some degree of familiarity with the concept. In many respects, concept familiarity may be a necessary prerequisite to the decision to invest and reinforces the importance for entrepreneurs seeking funding to communicate their ideas in a clearly understandable and coherent way to potential investors.

We proposed that private investors would choose to deal with agency risk by displaying a propensity to back an entrepreneur known to them personally, to other member(s) of the syndicate and/or to the referrer of the deal. For a majority of the deals backed by solo investors (70%), the entrepreneur was known either by the investor or the referrer; the comparable figure for syndicated investments, including situations where the entrepreneur was known personally by a syndicate partner, was 55%. In general, our data lends **support** to propositions 3 and 4 which argued that private investors attempt to deal with agency risk by backing “known entities.” On the face of it, serial investors display a much stronger propensity to invest in “familiar people” as opposed to “familiar industries”; evidence which lends some support to Fiet’s (1991, 1995a, 1995b) conclusion that informal investors are much more concerned about agency as opposed to market or business risk. It is also important to note that, almost as often as not, syndicate serial investors will back entrepreneurs which are personally unknown to them or to other member(s) of the group. Anecdotal evidence suggests that there might be “comfort in numbers” insofar as individuals contemplating making an investment feel comfortable with inherent agency risk secure in the knowledge that a number of other individual investors also have capital at risk in the venture.

In view of the time required for investors to engage in various post-investment activities, particularly for ventures in their earliest stages of development, we argued that solo investors who eschew the benefits of information and “monitor” sharing through participation in syndicates should have a smaller number of early stage investments in their portfolio. We partitioned the sample into two distinct subgroups—solo serial investors who exclusively invest on their own and syndicate serial investors who exclusively or in large measure invest alongside others—as follows:

A number of interesting trends can be observed in Table 1. First, solo serial investors have made fewer private investments in an absolute sense, however, the proportion of investments made in early stage ventures is higher than is the case for syndicate serial investors. It would appear that solo serial investors prefer to deal with a small number of early stage ventures at any one point in time with the aim of developing the venture to a point that follow-on finance is required. The benefits

Table 1
Early Stage Investment Activity Summary

<i>Calculated Means</i>	<i>Solo Serial Investors (n = 2)</i>	<i>Syndicate Serial Investors (n = 5)</i>
Total Number of Private Investments Made	4.00	5.50
Proportion of Investments: Early Stage	63%	50%
Number of Investments in Portfolio	3.00	4.40
Number of Early Stage Investments in Portfolio	2.00	2.60

of risk sharing as part of a group are apparent as syndicate serial investors have both a larger number and lower proportion of early stage investments in their portfolio at the present time. We thus conclude that proposition 5 is **supported**.

V. DISCUSSION

Serial investors, whether they invest on their own or with others, display a very strong tendency to back concepts which are familiar to them and have invested in a variety of industrial sectors. Compared to the findings of a number of other studies (Sullivan, 1991; Mason, Harrison & Chaloner 1991; Landström 1993; Harrison & Mason 1990; Aram 1989) which concluded that informal investors prefer to invest in markets and/or technologies familiar to them or in which they have direct experience, the serial investors we interviewed display a great deal of diversity in their actual investment behaviour. The difference may simply be attributable to the fact that we explicitly restricted our attention to a small sub-segment of the overall population. In addition, during the course of interviews, many respondents considered their experience in building businesses to be widely applicable in any number of industries, thus in some respects, it was not surprising to find that investments were diversified by industry.

In general, agency risk is, to some extent, managed by bringing some prior personal knowledge of the entrepreneur to bear, investing alongside investors who know the entrepreneur, and/or having the deal referred to them by an individual who possesses such knowledge. Syndicate investors are more inclined to back unknown entrepreneurs as compared to solo investors and do seem to draw some measure of comfort from knowing that "I am not in this investment alone." However, it is important to note that all respondents relied on themselves to judge the capabilities of the entrepreneur. One syndicated investor commented: "No matter how good the opportunity, unless I can get along with the people, I simply won't do the deal!"

VI. THE LINK WITH PERFORMANCE

During the course of interviews, we had the respondents provide us with either: i) a subjective assessment of venture performance; or ii) details of the exit, if available. For purposes of exposition, it is useful to deal with solo and syndicated investments separately (see Table 2).

The advice to be given for serial investors who choose to invest on their own in early stage ventures is to back individuals known to them personally. Specialised industry knowledge does not emerge as a discriminating factor in our analysis. Given their entrepreneurial background, serial investors appear to

Table 2
Solo Serial Early Stage Investment Summary

<i>Industry Experience</i>	<i>Stage of Development</i>	<i>Known Entrepreneur</i>	<i>Performance Assessment or Exit Details</i>
X	Early Stage	To referrer only	Trade Sale [partial loss] (1 year)
X	Early Stage	X	Total Loss (1 year)
X	Early Stage	X	Very Disappointing (1 year)
X	Start-up	✓	Meeting Expectations (7 years)
✓	Start-up	✓	Meeting Expectations (2 years)
X	Start-up	✓	Meeting Expectations (2 years)
X	Start-up	To referrer only	Good Performance (7 years)

Table 3
Syndicated Investment Summary

<i>Industry Experience</i>	<i>Stage of Development</i>	<i>Known Entrepreneur</i>	<i>Performance Assessment or Exit Details</i>
X	Early Stage	X	Total Loss (3 years)
X	Early Stage	X	Disappointing (1 year)
✓	Early Stage	X	Satisfactory (1 year)
X	Early Stage	X	Satisfactory (1 year)
X	Start-up	✓	Good (4 years)
✓	Start-up	X	Good (1 year)
✓	Start-up	✓	Very Good (6 years)
✓	Start-up	✓	Very Good (2 years)
X	Start-up	✓	Very Good (2 years)
X	Start-up	✓	Outstanding (4 years)
✓	Start-up	✓	Trade Sale [28% IRR] (6 years)

be able to make a positive contribution to the development of early stage ventures irrespective of industry which lends some measure of credence to the believe that “venture building skills” are widely applicable in any number of industry settings.

For investors choosing to invest with others, backing known entrepreneurs appears to be a discriminating factor when the linkage with investment performance is made. In both instances where a total loss was realised and when performance was below expectations, the syndicate neither had previous knowledge of the industry or the people involved. What is particularly striking is that for every investment that has performed very well, at least one person in the syndicate knew the entrepreneur prior to the deal being consummated. Irrespective of whether a serial investor chooses to invest on their own or with others, the advice appears to be the same—back known people (see Table 3).

VII. CONCLUSIONS

In this study, we examined the actual investment behaviour of an active sub-segment of the informal market for venture capital, serial investors, and have explored, in a preliminary way, the linkage between individual investor characteristics, investment activity and performance. In view of the small sample size and the inherent and ever present problem of sampling bias, we are reluctant to draw firm conclusions, however, a number of patterns appeared based on our analysis of actual investment behaviour as follows:

- serial investors display a strong propensity to invest in early stage ventures;
- the extent of co-investment activity among this highly active group of investors is greater than previously thought in the UK;
- investments are made in a variety of industry sectors and in a majority of instances in industries where the investor and/or syndicate partner has limited direct previous experience;
- familiarity with the concept appears to be a necessary, but insufficient prerequisite to the decision to invest;
- agency risk is managed, to some extent, by backing entrepreneurs which are either known personally to the investor, another syndicate member and/or to the referrer of the deal;
- when a serial investor chooses to invest with others, they display a greater propensity to back unknown entrepreneurs, however, when the performance linkage is made, prior knowledge of the entrepreneur emerges as a discriminating factor—for both investments where a loss was realised or performance had fallen short of expectation, investors or syndicate partners did not have prior personal knowledge of the entrepreneur;
- syndicate serial investors appear to benefit from sharing the risk with other individuals—they have completed more deals, particularly in early stage ventures.

VIII. IMPLICATIONS

For investors, it would appear that some measure of diversification by industry can be achieved by participating in investment syndicates. A number of investors explicitly mentioned the importance of group composition both in terms of the blend of skills and experience each member brings to the group and likeminded expectations, particularly with respect to the timing and manner of exit. In building their portfolio, private investors need to be concerned not only with the actual number of investments made but with the pace at which investments are added to the portfolio. Respondents uniformly reported spending more time with the ven-

ture, the shorter the period of the time the investment was in their portfolio; a seemingly reasonable response to inherently high levels of agency risk in the period leading up to and immediately following the consummation of a deal.

For entrepreneurs seeking informal venture capital, our study reinforces the importance of being able to communicate in clear and unambiguous terms the nature of the investment opportunity to potential investors. Moreover, it is important for the entrepreneur to approach the right investor, preferably someone they know personally. Solo and syndicate serial investors have invested in a variety of industries, however, if an entrepreneur chooses to approach a solo investor, they should ensure that the individual has both the financial capacity and the time available to contribute to the venture development process particularly in the critically important early days. It appears that investment syndicates do have greater capacity to take on more deals and can offer a variety of different skills and expertise to the venture team.

For policy makers, particularly in the UK, which have largely concentrated their efforts on supporting means for bringing investors and entrepreneurs together in a timely and efficient manner, some thought should be given to exploring means of facilitating the formation of syndicates. Investing as part of a syndicate seems to be a much more widespread phenomenon in the UK than previously thought. Anecdotal evidence from our interviews confirmed the difficulties investors face in not only trying to unearth promising investment opportunities but in identifying suitable partners with whom to share the risk of investing in private, unquoted early stage ventures.

IX. DIRECTIONS FOR FUTURE RESEARCH

In a very real sense, our research has looked at investment activity from a “macro” perspective. There are a number of interesting “micro” issues which can be explored when detailed and complete private investment chronologies are provided by investors. How does the pattern of investment activity change when an investor realises a loss on an investment? A number of investors commented that they became somewhat more selective in the subsequent investments they made after a negative event by investing in industrial sectors in which they had direct experience and, more importantly, by backing people known to them personally or to their syndicate partners. Similarly, does the pattern of investment activity change when an investor realises a substantial gain on an investment? To what extent does a “play money” mentality set in whereby investors are prepared to back ventures competing in an unfamiliar industry lead by an entrepreneur unknown to them or to other investors in the deal? Over time, does an investor enhance his ability to identify “winners”?

A clear need also exists to examine issues related to investment syndication and co-investment activity. If the most active segment of the population disproportionately invests as a part of a group, it is imperative to understand the dynamics of syndication. How do syndicates form in the first place? Do groups of investors collectively make better decisions than an individual investor can make on their own? Previous research has highlighted the importance of having a balanced management team in place—does the same hold true for an investment syndicate? Does a diversity of perspectives among the investor group lead to a performance advantage? How is the relationship between an investor group and the entrepreneur managed? As with any emerging field of study, much work needs to be done and many issues remain largely unresolved.

NOTES

1. See Gaston (1989); Postma and Sullivan (1990); Stevenson and Coveney (1994); Landström (1992).
2. Landström (1995) identified two distinct strategies used by informal investors to aid them in making investment decisions. Specialist investors choose to limit their activity in areas related to their particular market and/or technical expertise. Compared to investors which sought portfolio diversification in terms of industry and/or stage of development, specialists examined fewer proposals and exhibited a higher propensity to invest than explicitly diversified investors. Having said this, the two groups relied on similar criteria to evaluate investment opportunities.
3. This is not altogether surprising in view of the large number of business angels with prior new venture experience. It is reasonable to suggest, however, that “venture development skills” are very general in nature and, in all likelihood, would be useful to any firm regardless of context (industry, stage of development, geographic area).
4. Investing close to home may be a logical investor response to inherent inefficiencies of the informal venture capital market. Investors are, in all likelihood, more aware of potential opportunities in their local area reliant as they are upon highly localised referral networks for creating deal flow. Moreover, research suggests that most business angels are active investors, providing ongoing “hands on” assistance in a number of capacities to investees. Distance may thus create a substantial barrier to investor/entrepreneur interaction and hamper the ability of the investor to effectively monitor his investment.
5. One in twelve investors were classified as “lone wolfs” by Gaston (1989). In general, a small percentage, usually 10% or less, of US and Swedish business angels invest alone. UK business angels are decidedly more independent, in excess of 60% of the respondents of two surveys (Mason, Harrison & Chaloner 1991; Mason, Harrison & Allen 1995) invested alone.
6. Aside from dealing with agency risks, active investor involvement in the venture development process has been identified as a key non-financial motivation or “hot button” (Wetzel 1981). In addition, through active involvement, investors have the opportunity to bring their particular skills, knowledge and experience to bear on the venture, contributions which hopefully positively affect venture performance. In essence, investors perceive that through active involvement they can favourably alter the risk/reward payoff for a given investment.
7. Freear, Sohl and Wetzel (1990) raised the possibility that some passive investors may have invested as part of a syndicate with at least one other co-investor assuming an active role in the venture on behalf of other participants in the syndicate.

8. Haar, Starr and MacMillan (1988) noted that investors were 40% more likely to invest in a venture if a deal was referred to them by a close personal colleague. Referrers have reputational capital to protect and in some respects they are a preliminary screen for investors.
9. It should be noted, however, that one investor explicitly stated that his primary role was to bring on additional investors as required. Over time, a syndicate would be formed and this respondent would be classified as a syndicate serial investor.
10. Two of the investors had each invested on their own once and had each made four additional investments either in conjunction with others ($n = 5$) or through joining an existing group of outside investors ($n = 3$).
11. This approach is widely used by 3i, the world's largest venture capital firm. In instances where a private investor has invested funds alongside 3i, the former invariably assumes an active role in the venture, usually in the capacity of non-Executive Chairman. As a matter of course, 3i reserves the right to nominate a board member if circumstances dictate, otherwise they are content maintaining a purely passive role receiving periodic reports only.

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