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Social trust and angel investors' decisions: A multilevel analysis across nations

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ABSTRACT

The decisions made by angel investors are embedded in and influenced by their institutional settings. This paper advances a multilevel model of the direct and indirect effects of social trust on individuals' angel-investment decisions. It is postulated that two dimensions of social trust, namely the level and radius, can enhance information transmission, collaboration, and sanctioning mechanisms within a society. Consequently, they facilitate angel investment and moderate the relationship between it and individual factors. A multilevel model of data from 191,907 individuals across 25 countries shows that individuals in countries with a high level of trust are more likely to make angel investments. Whereas both the level of trust and the radius of trust are found to heighten the positive relationship between an individual's perceived entrepreneurial skills and angel investment, it is interesting to note that these factors weaken the relationship between the perception of new business opportunities and angel investment. These direct and moderating effects are robust after controlling for wealth, cultural values, and other factors. This study contributes to the crossover between research on entrepreneurship and social-trust research.

1. Executive summary

This study examines how angel investment decisions are affected by social trust. Private investors who provide risk capital for new and growing businesses (angel investors) have been recognized as important financial resource providers in the entrepreneurial process. Although scholars have examined the impact of institutions on angel investment, informal institutional factors (e.g., shared values and social norms) have received less attention despite their potential impact on angel investment decisions. Thus, we extend previous research by exploring the role of social trust on the decisions of angel investors across countries.

Compared with other forms of investment, angel investment involves less formal procedures relating to project selection and investment allocation, and relies more on trust and empathy. Social trust is a key informal institutional factor that affects information transmission, cooperation, and the enforcement of sanctions within society. We argue that social trust influences angel investment because such investment activities rely on information exchange and collaboration between individual members of society, as well as effective sanctioning.

Our study focuses on two dimensions of social trust proposed by Fukuyama (2001), namely level of trust (the strength of cooperative norms) and radius of trust (the circle of people among whom cooperative norms are operative). Moreover, we test two sets of effects:

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(1) the direct effects of trust level and radius of trust on an individual's decision to make an angel investment, and (2) the multilevel moderating effects of these two national-level social-trust dimensions on two key individual-level factors that affect decision making.

Building on institutional perspective, we contribute to theory and practice in several respects. First, this study advances our understanding about the effects of informal institutional forces on specific aspects of entrepreneurship. Second, we extend social-trust research by empirically connecting both the level and the radius of trust to social economic behavior. Third, we use multilevel modeling to capture the cross-level influence of social trust on individual decision making in a multiple-country setting, thereby improving on the design of previous studies.

2. Introduction

Securing sufficient funding is crucial to the creation, development, and growth of new ventures. Angel investors, as private investors who provide risk capital for new and growing businesses (Mason and Harrison, 1995; Morrissette, 2007), are thus vital to the entrepreneurial process. In addition, an increasing number of entrepreneurship researchers suggest that the institutional environment affects entrepreneurship (Ahlstrom and Bruton, 2006; Jennings et al., 2013; Knight and Cavusgil, 2004), such as angel-investment decisions (Ding et al., 2014; Kwon and Arenius, 2010). While they are not close friends or family, angels tend to enjoy more informal relationships with entrepreneurs, based on trust and empathy, compared with the more formal relationships that exist between entrepreneurs and venture capitalists (Fairchild, 2011; Mason and Harrison, 1995). Therefore, informal institutional factors such as shared values and social norms affect an individual's angel-investment decisions (Harrison et al., 1997). In this study, we examine the influence of social trust on the decisions of angel investors in a range of countries.

Social trust is a key informal institutional factor that affects information transmission, cooperation, and the enforcement of sanctions within society (Hagen and Choe, 1998; Kwon and Arenius, 2010; Putnam, 1993). Although largely taken for granted, the set of ideas, beliefs, and actions that underpins social trust (Luhmann, 1979) varies between nations (Fukuyama, 1995). Research suggests that cooperation and mutual monitoring are critical to investors' screening and assessment of potential investment opportunities (Harrison et al., 1997). Maxwell et al. (2011) have also shown that effective interactions between entrepreneurs and angels play a key role in angel investment. Therefore, we argue that social trust influences angel investment because such investment activities rely on information exchange and collaboration between individual members of a society, as well as effective sanctioning (Bruton and Ahlstrom, 2003; Zacharakis et al., 2007). Compared with other forms of investment, angel investment involves less formal procedures of project selection and investment allocation, and relies more on trust and empathy (Duxbury et al., 1996; Sudek, 2006). We thus argue that both formal institutions and the informal institution of social trust are important determinants of angel investment. To test this hypothesis, we construct a model of the effects of national social trust on individuals' angel-investment decisions.

The model developed in this study is structured by the two dimensions of social trust proposed by Fukuyama (2001): level of trust, which refers to the strength of cooperative norms, and radius of trust, which is defined as the circle of people among whom cooperative norms are operative. The results of a recent study validate these two dimensions of trust as effective measures across nations (Delhey et al., 2011). We test two sets of effects: (1) the direct effects of trust level and radius of trust on an individual's decision to make an angel investment, and (2) the multilevel moderating effects of these two national-level social-trust dimensions on two key individual-level factors that affect decision making. The individual factors examined are the possession of start-up skills and the ability to perceive start-up opportunities, as these have been shown to influence entrepreneurial start-up and investment behavior (McMullen and Shepherd, 2006; Szerb et al., 2007; Wong and Ho, 2007). The Global Entrepreneurship Monitor (GEM) provides a distinctive set of cross-country and cross-level data for the empirical tests. The findings are obtained by hierarchical linear modeling (HLM), and confirm most of the hypotheses. In particular, individuals in countries with a high level of trust are shown to be more likely to make angel investments. In addition, both level of trust and radius of trust are found to enhance the positive relationship between an individual's perceived entrepreneurial skills and angel investment. Unexpectedly, however, both dimensions of social trust weaken the relationship between the perception of new business opportunities and angel investment. Further analysis shows that the findings are robust against several alternative explanations.

This paper contributes to entrepreneurship studies in three important ways. First, the investigation of the influence of social trust on angel investment opens up a new avenue for comparative research on entrepreneurship, as an increasing number of researchers seek to understand the effects of informal institutional forces on specific aspects of entrepreneurship (Bruton et al., 2010). A study by Meek et al. (2010) of the effects of social norms on environmental action is a case in point. We show how the informal institutional factor of social trust, not just formal institutions such as rules, regulations, and cultural dimensions (Bruton et al., 2010), may shape angel investment across nations. Benefiting from the rich literature on social trust, we detail the institutional mechanisms that underlie angel investment, and unravel institutional complexity using a comparative institutional design (Jennings et al., 2013). Second, we test two dimensions of social trust, whereas previous studies have addressed only trust level. We thus advance social-trust research by empirically connecting both the level and the radius of trust to social economic behavior, based on recent empirical findings (Delhey et al., 2011). We contend that social trust moderates angel-investment decisions, and seek to fill the gap in knowledge regarding whether and how angel investors across countries are influenced by informal institutions. Finally, we use multilevel modeling to capture the cross-level influence of social trust on individual decision making in a multiple-country setting (Hitt et al., 2007). This multilevel cross-country design improves upon the design of previous studies (e.g., Kwon and Arenius, 2010; Tracey et al., 2011; Wong and Ho, 2007) by enabling us to ascertain the validity of past findings and explore cross-level institutional influences (Hitt et al., 2007).

3. Literature review

Like entrepreneurs, angel investors make their decisions under the influence of both individual- and national-level factors (Bowen and De Clercq, 2008; Maxwell et al., 2011). As previous researchers have tended to focus on entrepreneurs, more attention should be