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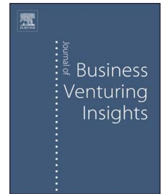

When to pray to the angels for funding: The seasonality of angel investing in new ventures

Kevin C. Cox[a,*], Jason Lortie[b], Steven A. Stewart[c]

[a] Florida Atlantic University, Management Programs Department, College of Business – Desantis Pavilion, Boca Raton, FL 33431, United States
[b] University of Mississippi, School of Business Administration, 253 Homan Hall, MS 38677, United States
[c] Georgia Southern University, Management Department, P.O. Box 8151, COBA 1109, Statesboro, Georgia 30460, United States

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ABSTRACT

Business angel (BA) investors – private individuals who make investments in new ventures – represent a significant economic impact contributing to the survival of new firms. BAs contribute billions of investment dollars to new ventures, positively influencing their growth, their ability to procure further financing, and their successful harvest. While recent research has examined BAs and their investment decision making, no research to date has examined the presence of a seasonal trend to their investment patterns even though research on other types of investments often follow seasonal trends. Utilizing a sample of 2558 independent early-stage angel investment deals over a nine-year period, we analyze the monthly total of investment deals, the average funding amount, and the monthly total volume of angel investment activity. Results suggest a seasonal trend in angel investment deals comprised of specific peaks and valleys in activity. Practical implications include a preparation time for entrepreneurs and new venture teams prior to seeking BA investment, optimal seasons for pitch competitions, and the importance of financial planning for new ventures. Theoretical implications include the potential for punctuated equilibrium in new venture teams. Finally, we contribute by identifying a novel phenomenon ripe for future research.

1. Introduction

Business angel (BA) investors are private individuals who make investments directly in unlisted companies in which they have no family connections (Mason and Harrison, 2000). Early and seed-stage investments made by BAs represent an important economic phenomenon as well as an essential resource for budding entrepreneurial firms hoping to scale their enterprise. Per the Center for Venture Research, the estimated size of the total angel investor market in the United States was $24.6 *billion* in 2015, and this investment pool resulted in the creation of 270,200 new jobs (Sohl, 2015). BAs seek to invest in high-growth startup firms and their investments have considerable positive impacts on these firms. New ventures that attract BA financing exhibit higher survival rates, increased growth, more financing, more successful exits, and more employees compared to firms that cannot attract financing (Kerr, Lerner, and Schoar, 2010, 2014). BAs also fulfill a critical gap in funding that resides between initial startup funding (e.g., personal funds, friends and family) and traditional institutional funding (e.g., venture capital) (Lam, 2010; Riding et al., 1994, 2012). This important gap is sometimes referred to as the "valley of death" which accurately conveys the common outcome for firms which cannot attract funding during this essential phase (Frank, Sink, Mynatt, Rogers, and Rappazzo, 1996; Murphy and Edwards, 2003; Osawa and Miyazaki, 2006; Wessner, 2005). Finally, BAs contribute other resources to the ventures in which they invest, such as

* Corresponding author.
E-mail addresses: Kcox24@fau.edu (K.C. Cox), Jlortie@bus.olemiss.edu (J. Lortie), sstewart@georgiasouthern.edu (S.A. Stewart).

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expertise, valuable social capital, and in some cases even emotional support (e.g. Ardichvili et al., 2002). Clearly, the role of BAs is important and in some cases essential to young ventures that require external financing.

However, the role of BAs was largely overlooked and poorly understood by most researchers and public policy makers until the phenomenon attracted explicit and consistent attention during the 1980s. Since that time, BA investment activity has received increasing research attention, most of which falls broadly within several general categories. First, the earliest research, focused on the sociodemographic characteristics of these investors and characteristics of the BA investor market (e.g., Hoffman, 1972; Wetzel, 1983), and this research continues today (e.g., Mitteness et al., 2012). A second body of BA research focuses more explicitly on BA's investment returns (Mason and Harrison, 2002; Wiltbank and Boeker, 2007; Wiltbank et al., 2009). Another area of research investigates the formation of BA investing groups and their operation (Carpentier and Suret, 2015; May, 2002; Sohl and Hill, 2007). A fourth stream of BA research focuses on how BAs operate as investors and managers (e.g., make investment decisions, manage portfolios, interact with entrepreneurs) (e.g., Maxwell et al., 2011). Finally, an area of research receiving increasing attention is the manner in which BA investment decisions are made, including stages of decision making in the deal making process (Mason and Harrison, 1996; 1996a; Maxwell et al., 2011; Jeffrey et al., 2016). We draw from this body of literature, inferences made by BAs, and comprehensive data to contribute to this existing understanding of BA investing.

To our knowledge, no previous research has explicitly investigated, and identified or verified, the existence of seasonal trends in BA investment deals. However, broader research focused more generally on many investment types provides evidence that many forms of investment exhibit seasonal trends (De Bondt and Thaler, 1987; Heston and Sadka, 2008; Keim, 1983; Loughran, 1997; Ng and Wang, 2004; Theobald and Price, 1984). There are identifiable seasonal trends across international markets (Corhay et al., 1987; Gultekin and Gultekin, 1983; Reinganum and Shapiro, 1987; Tinic et al., 1987), across investment sectors (Brauer and Chang, 1990; Colwell and Park, 1990; Hong and Yu, 2009; Lucey & Tully, 2006) and across time (Choi, 2015; Yao, 2012; Wachtel, 1942). Based upon the preceding literature and suggestions gathered directly from interactions and communication with BAs, we examine if seasonality characterizes BA investing. Put differently, we speculate that there may be *specific seasons for BA investing* which leads to the formation of our research questions: (1) is there a BA investor season (or seasons), and, (2) if so, when is it?

We seek to thoroughly investigate and establish the existence of the phenomenon thereby providing a robust foundation for future research which may focus more explicitly on the implications of this newly identified aspect of the BA investing behavior. Therefore, documenting and empirically validating this phenomenon is our fundamental purpose and primary contribution.

2. Relevant literature

As mentioned earlier, a body of research has elucidated the decision-making process by which BAs choose investment opportunities to pursue and structure deals with founders (and founding teams). Our examination in this paper focuses upon the deal between the BA(s) and the entrepreneur(s) as the unit of analysis. Within the body of literature focusing on the deal, research has indicated that the investment deal progresses through a multi-stage process, in which an opportunity is evaluated by the BA, examined during a due-diligence period, “consummated” between investor and founding parties, and then mutually enacted as the BA(s) become investment partners with the founder(s) (Landström and Mason, 2016; Maxwell, 2016). While these multi-stage models suggest a variety of different phases, all of these models suggest that BA investment deals are developed over a period of evaluation of different aspects of the business opportunity, from origination, to evaluation, to due diligence, to negotiation and consummation of the deal, to post-deal activity (Maxwell, 2016; Maxwell, Jeffrey, and Lévesque, 2011; Riding, Madill, & Haines Jr, 2007).

Research has found several contextual variables which can play a role in influencing the negotiation of the BA investment deal in the multi-stage process. The presence of various parties within the deal also play a role in BA investment decisions. Research indicates that BAs in formal investment groups make different investment decisions than individual BAs. For example, formal BA groups make larger investments, and structure different exits than individual BAs (Gregson, Mann, and Harrison, 2013; Mason and Harrison, 2015). Additionally, formal BA groups structure deals that are much more explicit, and complex than individual BAs (Carpentier and Suret, 2015; Kelly and Hay, 2003). Evidence indicates that formal BA groups are becoming more formalized, more centralized in regions, and more specialized (e.g., Tech Coast Angels and the Dinner Club) (Drover et al., in press).

Additionally, research has widely demonstrated different decision heuristics exist between more formal venture capital (VC) investors and less formal BA investors (Hsu, Haynie, Simmons, and Mckelvie, 2014; Kelly and Hay, 2003; Mason, Botelho, and Harrison, 2013; Van Osnabrugge, 2000), therefore the presence of VC investors within the deal can potentially impact deal structure and timing. For example, BAs place more emphasis on getting to know the investor in earlier stages of the deal process, and place more emphasis on economic factors of the opportunity later in the deal, compared to VC investors, who place more emphasis on economics in early stages (Hsu et al., 2014; Van Osnabrugge, 2000), and can take longer to conduct due diligence than BAs (Van Osnabrugge, 2000). Because economic factors, including business valuation and BA equity structure, are the primary reasons for deals ultimately failing, these factors are important considerations during the due diligence stage (Maxwell, 2016; Maxwell et al., 2011). Interestingly, Van Osnabrugge (2000) did not find a difference between the amount of equity stake contracted in the deal between VC investors and BAs. However, VCs can insist on different anti-dilution mechanisms and exit strategies compared to BAs (Mason et al., 2013; Peters, 2009).

In addition to the above mentioned contextual variables, the work of Jeffrey Sohl and others has shed light on the changing nature of BA investment through changing economic conditions (Mason and Harrison, 2015; Sohl, 2003a, 2011, 2012, 2003b, 2006). For example, evidence indicates that immediately following the economic recession period of 2008–2009, BAs began investing less in seed-stage funding and more in business growth funding (Mason and Harrison, 2015; Sohl, 2012). Such a change would merit an adjustment to the nature of the research performed throughout the multi-stage investment decision process by BAs.

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