**NTNU – Trondheim**
Norwegian University of
Science and Technology

# Business Angels & Non-Financial Contributions

From Value Adding Activities to Realized Valuable Output

**Ragnar Andreas Severinsen**
**Marius Monsen Ragnøy**
**Lars Dybvik**

NTNU School of Entrepreneurship
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Supervisor: Roger Sørheim, IØT

Norwegian University of Science and Technology
Department of Industrial Economics and Technology Management

# Problem Description

The purpose of this study is to increase the scholarly understanding of the non-financial contributions made by business angels to their investee companies, in terms of value adding activities and what may influence these activities. The study also explores the process of transforming potential value offered by the business angel into realized valuable output for the investee companies.

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Supervisor: Professor dr. polit. Roger Sørheim, IØT, NTNU

# Preface

This is the master thesis of the authors, who currently pursue a Master of Science degree in Industrial Economics and Technology Management at the Norwegian University of Science and Technology (NTNU). The thesis is prepared as the final report in the course TIØ4945 – Innovation and Entrepreneurship.

The basis for the thesis is a literature study performed during the fall of 2011, and a multiple-case study conducted during the spring of 2012. The cases contain sensitive information, and interviewees and cases are therefore held anonymous. Interview candidates are given fictional names and interview transcripts are not included in this thesis, in order to maintain confidentiality.

The authors wish to thank their academic supervisor, Professor Dr. polit. Roger Sørheim at the Department of Industrial Economics and Technology Management, NTNU. Dr. Sørheim´s guidance, comments and overall knowledge of the research field have been invaluable for the end result.

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Trondheim, June 1st, 2012

| Lars Dybvik | Marius Monsen Ragnøy | Ragnar Andreas Severinsen |
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# Abstract

While there exist consensus among researchers that business angels contribute with non-financial value to their investee companies, previous research on value adding activities has suffered from a lack of overview and consensus. This thesis seeks to create a general understanding of the value adding activities, how they are performed and what affects these activities. In addition we take the first step in assessing the process of realizing potential value adding, which has been indicated as a 'black box'. Paper one is a literature study, while paper two is a multiple-case study including ten business angels where each candidate presented one or more investment cases resulting in a total of 15 business cases. Paper three is a conceptual theory-building study, which combine theoretical models from other disciplines with qualitative data from the multiple-case study

Paper one conducts an extensive literature review on value adding activities performed by business angels to their investee company, in addition to explore which factors may influence these activities. We present a conceptual framework for value adding activities, and link this framework to potential factors. The findings suggest that the value adding activities may be divided between *Intra-organizational activities*, meaning the activities within the venture and *Inter-organizational activities*, meaning activities aimed at the external environment.

Paper two explain how the value adding activities are performed to the investee company. We present an in-depth explanation regarding how the activities are performed, and also present a new framework for value adding activities in accordance with the findings. The findings support that value adding activities may be divided between *Intra-organizational activities* and *Inter-organizational activities*. However, in contrast to previous research, we find that *Network* and *Legitimation* are not direct activities, as *Network* may be seen as a channel in which *Inter-organizational* activities are performed, while *Legitimation* increases the value of this channel.

Paper three assess what may influence the value adding activities. Findings suggest two major factors influencing the value adding activities; the ventures life cycle and the receptivity of the entrepreneur. We assess the *Attributes* of the investor, entrepreneur and company, and the *Relational properties* between them in the light of these two factors. In addition and stark contrast two previous research, we find that there is a difference between potential value added and realized value added, as this is a process contingent upon the entrepreneurs' ability to acquire and exploit advice from the investor. Based on the findings we present a conceptual framework, which assesses the entire process from potential activities to realized value added.

Combined, the papers presented in this thesis provide future researcher with a framework with which they may assess and analyze the non-financial contributions provided by business angels, in addition to factors influencing them. However, the main finding in paper three, which is the process of realizing potential value added, is of essence when assessing non-financial contributions. It should therefore be included in future studies on the subject, as this process needs to be fully understood in order to comprehend, and increase the efficiency of, the informal capital market.

## Abstract in Norwegian

Mens det eksisterer konsensus blant forskere om at forretningsengler (heretter business angels) bidrar med ikke-økonomisk verdi til de selskapene de investerer i, har tidligere forskning på verdiskapende aktiviteter lidd av mangel på oversikt og konsensus. Denne oppgaven søker å skape en generell forståelse av verdiskapende aktiviteter, hvordan de utføres og hva som påvirker disse aktivitetene. I tillegg tar vi de første skritt i å vurdere prosessen med å transformere potensielle ikke finansielle bidrag til realisert verdi i bedriften. Denne prosessen har tidligere blitt sett på som en 'black box'. Artikkel én er en litteraturstudie, mens artikkel to er en multiple-case-studie med ti business angels, der hver kandidat presenterte en eller flere investerings caser, resulterende i totalt 15 caser. Artikkel tre er en konseptuell teori-byggende studie, som kombinerer teoretiske modeller fra andre fagområder med kvalitative data fra case-studien.

Artikkel én gjennomfører en omfattende litteraturstudie på verdiskapende aktiviteter som utføres av business angels til selskaper de har investert i, i tillegg til å utforske hvilke faktorer som kan påvirke disse aktivitetene. Vi presenterer et konseptuelt rammeverk for verdiøkende aktiviteter, og knytter dette rammeverket til potensielle faktorer. Funnene tyder på at verdiskapende aktiviteter kan deles mellom *Intra-organisatoriske aktiviteter*, som betyr aktiviteter innenfor virksomheten, og *Inter-organisatoriske aktiviteter*, som betyr aktiviteter rettet mot det eksterne miljøet.

Artikkel to forklarer i dybden hvordan verdiskapende aktiviteter utføres til selskapet. Vi presenterer en grundig forklaring til hvordan aktivitetene utføres, og presenterer også et nytt rammeverk for verdiøkende aktiviteter i samsvar med funnene. Funnene støtter at verdiskapende aktiviteter kan deles mellom *Intra-organisatoriske aktiviteter* og *Inter-organisatoriske aktiviteter*. Allikevel, og i motsetning til tidligere forskning, finner vi at *Network* og *Legitimering* ikke er direkte aktiviteter, ettersom *Network* kan sees som en kanal der *Inter-organisatoriske aktiviteter* blir utført, mens *Legitimering* øker verdien av denne kanalen.

Artikkel tre vurderer hva som kan påvirke verdiskapende aktiviteter. Funnene tyder på at det eksisterer to hovedfaktorer som påvirker verdiskapende aktiviteter; selskapets livssyklus og mottakeligheten til entreprenøren. Vi vurderer *Attributtene* til investor, gründer og selskap, og *Relasjonelle egenskaper* mellom dem i lys av disse to faktorene. I tillegg, og sterk kontrast til tidligere forskning, finner vi at det er en forskjell mellom potensiell og realiserte verdi, da dette er en prosess påvirket av entreprenørens evne til å tilegne seg og utnytte råd fra investoren. Basert på funnene presenterer vi et konseptuelt rammeverk, som vurderer hele prosessen fra potensielle aktiviteter til realisert verdi for selskapet.

Tilsammen gir de artiklene som presenteres i denne avhandlingen forskere et rammeverk som de kan benytte til å vurdere og analysere ikke-finansielle bidrag gitt av business angels, i tillegg til faktorer som påvirker dem. Imidlertid er det viktigste funnet i artikkel tre, som tar for seg prosessen med å realisere potensiell verdi, essensielt når ikke-finansielle bidrag skal vurderes. Dette emnet bør derfor inkluderes i fremtidige studier på fagområdet, ettersom denne prosessen må forstås dersom man skal påvirke og effektivisere det uformelle kapitalmarkedet.

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# Introduction

## The Importance of Business Angels

Business angels play an important role in the economy, and in many countries constitute the largest source of external funding, after family and friends, in newly established ventures (Avdeitchikova *et al.* 2008). However, various studies show that the availability and cost of long-term investment capital is one of the most important constraints on the formation of new businesses (Oakey 1984; Monck *et al.* 1988; Binks *et al.* 1992). The venture capital industries have catalyzed the entrepreneurial process by identifying, financially supporting and nurturing growth-minded businesses with entrepreneurial talent to start-up and grow. The added value is in the U.S. shown through technological innovations, market innovations, and economic benefits like job creation, export sales and tax revenues. There is however trends in the VC-industry creating gaps in the equity markets. Firstly, the venture capital industry had a rapid growth, but came to a halt in the late 1980s, and after a boom in the early 2000s, it has decreased to the 1980 level (Kaplan 2009). Secondly, due to fixed evaluation and monitoring costs, the investment focus has shifted from early stage technology ventures to less risky, later stage management buyouts/leveraged buyouts. In addition, the spatial variations of the availability of venture capital are a direct cause for why the gap exists and even is increasing. Companies at the seed, start-up and early stages of development face great difficulties in raising equity finance from the venture capital industry. This raises the concern that potential businesses, especially within high-tech, will be constrained by the lack of sufficient financing. The problem is even bigger in regions with a less developed venture capital industry.

This underlines the importance of business angels. Angels fill what would otherwise be a void in the risk capital markets by providing development funds for technology-based inventors, seed capital for *Small, Technology-Based Firms* (STBFs) that do not meet the size and growth criteria of professional venture investors, and equity financing for established STBFs (Wetzel 1983). Van Osnabrugge and Robinson (2000) point out that business angels are essential in funding ventures which need USD 500,000 or less, because professional venture capitalists are seldom interested in making such small investments. Because business angels are instrumental in funding early-stage, fast-growth, entrepreneurial firms, which ultimately are responsible for nearly all job creation, van Osnabrugge and Robinson (2000) conclude that the actions, behavior, and investments of angel investors play a significant and underappreciated role in the well-being of the economy. They further point out that '… VCs get all the press, but the vast majority of entrepreneurial firms are actually funded by business angels, especially those firms in their earliest stages' (van Osnabrugge and Robinson 2000).

The importance of business angels is also likely to increase in the future as the venture capital industry stagnates and is in decline. The U.S. venture capital industry is at an inflection point, and there is reason to believe that the industry will decrease in size and be structured differently (Kedrosky 2009).

Mason and Harrison (1995) claim that various policy initiatives, designed to increase the regional supply of venture capital, provides a partial and costly solution to the problem. Business angels are often unable to find sufficient investment opportunities, thus representing a large underutilized source of risk capital for early stage ventures (Mason and Harrison 1995). This largely untapped pool of informal capital is caused by inefficiencies in the market operation, and thus requires a mechanism to overcome the high search costs for both investors seeking entrepreneurs and entrepreneurs seeking investors. Harrison and Mason (1995) promote the establishment of business introduction services (BIS) to provide an efficient channel for communication between business angels and entrepreneurs. However, Kelly (2007) suggests that the market is attractive *because* it is difficult to access and search for possible investments. He, among other researchers, further encourages public policy-makers to use other sorts of stimuli, for example tax incentives that some countries already have implemented, to further increase the attractiveness of being a business angel.

However, the business angel market seems to cope with some of the inefficiencies by itself, as the recent emergence of business angel syndicates (Mason 2008) may professionalize the operation regarding accessing and screening deals as well as the due diligence (May 2002). Mason (2008) argues that '… angel syndicates are of enormous significance for the development and maintenance of the entrepreneurial economy'. He further mention several reasons for this statement; (1) syndicates stimulates solo angels that have the financial capital, but does not invest due to lack of investment skills or ability to add value, (2) they fill the 'new' equity gap, (3) they have the ability to provide follow-on funding, (4) syndicates as opposed to solo angels have greater credibility with VCs, thus may have a greater ability to get further finance, and lastly, (5) the angel syndicates' ability to add non-financial value is much greater, because of the broader range of expertise as opposed to solo business angels. However, solo business angels still dominate the market, and most research concerning value added are from research on solo angels.

They conclude that there is little doubt that business angels play an important role in supporting young start-up companies financially. However, what about their non-financial value added to the companies? Previous research indicates that non-financial contribution may be of greater importance than the financial contribution (Sætre 2003). An interest in these non-financial contributions is what created the foundation for this thesis.

## Non-financial Value Added

Previous research suggests that business angels invest money in return for an equity stake in the company (Wiltbank 2005), and that motivation is mainly financial (Macht 2006). However, business angels are also interested in playing a role in the company, earning 'psychic income' (Freear *et al*. 1995), being part of a business and support the next generation of entrepreneurs (Politis and Landstrøm 2002). Their investment is often seen as an extension of their own entrepreneurship (Aernoudt 1999; van Osnabrugge 1998). Value adding activities are also a way of managing return of the business as well as reducing agency risk (Ardichvili *et al.* 2002). In this regard, agency risk is described as the possible divergence between the interest of the entrepreneur and the investor. In addition, van Osnabrugge (2000) found support through the *incomplete contract approach*, the recognition that financial contracts are inherently incomplete, that business angels best control the entrepreneur and the venture's development through being actively involved post-investment.

Previous research has agreed that business angels' ability to add value through non-financial contributions, to a large extent is embedded in their experience as former entrepreneurs. Several studies point out that most of the business angels are cashed-out entrepreneurs (e.g. Wetzel 1981, Gaston 1989), and have acquired the kind of experience it takes to start and manage young companies (Aernoudt 1999; Wright *et al.* 1998), and possibly add value.

Politis (2008) presented a good overview of previous research on value added. She identified the different value adding roles in the post-investment phase performed by business angels; *sounding board/strategic role, resource acquisition role, supervision/monitoring role* and *mentoring role*, and linked these roles to a set of value adding activities based on 14 empirical studies published between 1992 and 2005. Through the identification of different value adding roles together with the associated discussion, Politis (2008) provided a conceptual foundation for a better understanding of business angels and value added, presented in the table below.

| **Role** | **Studies** | **Some reported value added activities** |
|---|---|---|
| **Sounding board/strategic role**<br>– human capital | • Harrison and Mason (1992)<br>• Ehrlich *et al.* (1994)<br>• Harrison and Mason (1996)<br>• Stevenson and Coveney (1996)<br>• Lumme *et al.* (1998)<br>• Tashiro (1999)<br>• Ardichvili *et al.* (2002)<br>• Paul *et al.* (2003)<br>• Brettel (2003)<br>• Amatucci and Sohl (2004)<br>• Madill *et al.* (2005) | • Serving as sounding board (evaluation of product-market activities, development of marketing plans, original business strategies and products)<br>• Advice, counsel and hands-on assistance<br>• Industry knowledge<br>• Access to industry insights<br>• Shaping business concept or model |
| **Supervision and monitoring role**<br>– human capital | • Ehrlich *et al.* (1994)<br>• Lumme *et al.* (1998)<br>• Ardichvili *et al.* (2002)<br>• Sætre (2003)<br>• Amatucci and Sohl (2004) | • Strategic management and control<br>• Operational management assistance |
| **Resource acquisition role**<br>– social capital | • Ehrlich *et al.* (1994)<br>• Harrison and Mason (1996)<br>• Lumme *et al.* (1998)<br>• Ardichvili *et al.* (2002)<br>• Paul *et al.* (2003)<br>• Brettel (2003)<br>• Sætre (2003)<br>• Amatucci and Sohl (2004)<br>• Sørheim (2005) | • Recruitment<br>• Networking activities<br>• Access to high-level industry networks<br>• Finding additional sources of capital |
| **Mentoring role**<br>– social capital | • Freear *et al.* (1995)<br>• Harrison and Mason (1996)<br>• Brettel (2003)<br>• Sætre (2003) | • Serving as mentors<br>• Coaching the entrepreneur<br>• 'Lifting the spirits' |

**Table 1: Value Adding Roles**

In addition to Politis' (2008) framework, the literature also proposes other types of categories on value adding activities. Munck and Saublens (2005) identified four ways the business angel may benefit their investee companies; *help overcome funding difficulties, use of human capital to provide skills and expertise, use of social capital to provide network* and *increase investee´s opportunity to acquire further finance*. Ardichvili (2002) however only categorized the activities into *passive* and *active involvement*. Further, Madill *et al.* (2005) presented six categories of value adding activities that CEOs in different angel-invested companies reported; *advice, contacts, hands-on assistance, boards of directors & advisors, market business intelligence* and *credibility/validation*. Large and Muegge (2008) proposed eight categories, based on the VC's involvement (categories, which may be used, as we comprehend, on business angels as well); *legitimation* (credibility to the venture), *outreach* (establish direct contact to external stakeholders), *recruiting*, *mandating* (provide contract terms, performance targets, etc.), *strategizing* (business concept and strategies), *mentoring* (mentorship, guidance, coaching and motivation), *consulting* (provide planned and structured knowledge) and *operating* (hands-on activities, day-to-day managing and active planning). Lastly, Fried and Hisrich (1995) catalogued the possible VC-involvement in six categories; *Operating services, networks, image, moral support, general business knowledge and discipline*.

The empirical reports reviewed show a wide range of different categories, as well as the reported value adding activities. This shows that there is little consensus in the research field in the categorization of the different value added activities. The general lack of consensus regarding business angel research, may explain why there is several gaps in previous research. The first suggestion Politis (2008) presented in order fill some of this gap is to develop a robust operationalization of business angels' involvement in the various value adding roles. The second suggestion is to explore the effect of the hands-on involvement on the performance of the investee. We try to contribute with this thesis in the suggested areas by Politis (2008).

# Motivation for study

Despite the widespread recognition that informal investors bring added value by their active involvement in the entrepreneurial process, there is little consensus regarding the different value adding activities that business angels may undertake. Similarly, there exist several other unanswered questions. For instance, how do the business angels acquired resources lead to added value in the venture? Are some resources more important than others? Acting as a sounding board as well as being a mentor to the entrepreneur are often key roles business angels take in the venture (Coveney and Moore 1998; Hill and Power 2002; van Osnabrugge 2000). But what does this actually mean? Which problems are sounded out (Kelly 2007)? In addition, the most important question in research on business angels and value added is the effect of their hands-on involvement on the performance and daily operation of the business (Macmillian *et al.* 1988 investigated VCs on similar questions). An explanation of that these questions have remained largely unanswered in the informal capital market could be that most previous studies on informal investors have relied on questionnaire surveys with the primary focus to describe their characteristics (Mason and Harrison 2000). To some extent the different value adding activities can seem forced into categories, indirectly stating that the categories used is appropriate. Consequently the research becomes more quantitative than qualitative, leaving several questions unanswered. However, without the categorization, there 'may be a risk that continued research on this topic leads to a growing fragmentation rather than a growing consensus' (Politis 2008).

Further, the majority of previous studies have also for some reason treated the role of informal investors within a financial framework, assuming that they are opportunistic and economic-maximizing individuals (Freear *et al.* 1997; Mason and Harrison 2000). This may to some extent overlook all the other motives that informal investors may have. Most of the previous research is also highly empirical and lacks theoretical frameworks (Madill *et al.* 2005). This statement is applicable for most of the research done on business angels, but in research on post-investment, a theoretical framework approach could give significant contribution in regard to the relationship between the entrepreneur and business angel, as well as the desire to add and receive value from the investors and entrepreneurs respectively.

Previous research also forget the importance of explaining why some value adding activities take place more often than others, when they do so, as well as embedding this factors into their framework of value adding activities. Some researchers (e.g. Ardichvili *et al.* 2002) consider a few of the properties possessed by the investor when determining the value added activities. For instance whether the investor is active or passive, which some researchers have mentioned affect the value added. But what other influencing factors determine the value adding activities by the investor? Which attributes of the entrepreneur influence the investors' wish to contribute and add value? Several researchers do not mention the several other properties and attributes that determine the value added. These attributes and properties regarding the investor, the company and the entrepreneur are highly connected to each other, which all influence the value adding activities. We identify this as a gap in previous research that needs to be further investigated, and will later be addressed in this thesis. We see this issue as interrelated sets of attributes and properties that affect the value adding activities contributed by business angels.

Since the public consensus of business angel investing is something purely positive, the previous research is to some extent an investor glorification. What about the potential dark side of the business angels? Farrell (1998) found out that the failure rate for enterprises that had received private investment from informal investors was 17.4 percent, compared to 20.4 per cent that did not receive private investment. This small difference could also be understood by the fact that the enterprises receiving funding probably were a more viable business case in the first place (Madill *et al.* 2005), and may question the value of involvement provided by business angels. In addition Politis (2008) suggests that '... there may be a need to distinguish between potential value added and realized value added', owing to the fact that just because business angels have the potential to add value, does not mean that it can be effectively exploited by the investee company.

The motivation for this study is to create a general understanding of the value adding activities business angels perform to their investee companies, and create a theoretical framework in order to drive the research further. We also seek to shed light on the operationalization of these activities, in addition to why some activities are performed over others given different contexts and factors. Lastly we explore the difference between potential and realized value added, and also what may influence this process.

# A Challenging Research Field

Several areas in the research of business angels can be considered as challenging, even more challenging then research on VCs, which have more defined characteristics and are easier to access. The increase in research on business angels, and progress in terms of volume and range of topics addressed has not been matched by corresponding progress in the data sources and methodologies used in that research (Harrison and Mason 2008). The absence of adequate and agreed measurements in the research area creates a number of difficulties. Most important, the lack of standardization in data collection and the resulting fragmented nature of the empirical data from the process of business angel investing have limited the evidence base, underpinning the development of effective policies to stimulate and improve efficiency in this market.

In this section, we will discuss the different issues regarding the definitions of the business angels, the importance of a proper understanding of the term within the research field and present our understanding of the term.

## Definitional issues

Definitional issues arise from two principal areas: the lack of a common definition regarding business angels, and definitions being narrowly prescribed. The former may restrict the development of the disciplines and hinder generalization. The latter leads to a multiplicity of small, specific, highly focused studies that can hinder theory and policy development and also increase biases (Farrell *et al.* 2008).

The term 'business angel' is used to describe *private, wealthy individuals who invest their money and experience in entrepreneurial SMEs with which they have no family connection* (e.g. Deakins and Freel 2003; Mason and Harrison 2000). Their financial contributions are referred to as informal venture capital, which represent an important source of funding to SMEs as mentioned earlier. Studies made on business angels can be traced back to the early 1980s and Wetzel (1981, 1983), who initiated the 'first research generation', describing the business angel in terms of attitude, behaviors and characteristics (ABC-studies). Wetzel gave more understanding of the presumed funding gap that existed around the small high-technological entrepreneurial firms and the phenomenon of angel investment. His studies increased the interest among researchers to understand what business angels actually are, and lead to several empirical studies. These studies, made in different countries, show that the typical business angel is a middle aged male, with entrepreneurial experience who invest in companies geographically close to them in sectors they have previous experience (Freear *et al.* 1997), and often rely on business associates and friends when looking for potential investment opportunities.

The business angel's desire to operate anonymously (Wetzel 1981; Mason and Harrison 1994) and the heterogeneous nature of the informal venture capital market (e.g. Stevenson and Coveney 1996) are also of concern. This diversity among different types of business angels needs to be understood and be a part of the methodology in order to give good scientific results (Timmons and Bygrave 1986). Consequently, studies with diverging rules of interpretation regarding the characteristics of the different informal venture capitalists, gives a poor basis for comparison. However, definitional problems are also caused by cultural and institutional differences in many countries, which indicate that we need to contextualize the definition (e.g. Mason and Harrison 2000).

The terms 'business angel' and 'informal investor' are often distinguished from each other or interchangeably used. It can sometimes seem as if the development in the research on the informal venture capital market went ahead of the conclusions from the first generation of research, limiting the empirical and theoretical progress (Avdeitchikova *et al.* 2008). We have come to identify an entire group by what is really a small sub-sector of the group, leading 'us down a very narrow, self-perpetuating path' (Farrel 1998).

Earlier studies have tried to divide the heterogeneous group of business angels and informal venture capitalists into various numbers of homogeneous, small groups. For instance three investor groups (*financial, altruistic* and *self-oriented*) (Postma and Sullivan 1990) based on motivation of investment, ten categories (Gaston 1989) based on post-investment activity and personal characteristics, six distinct types of the business angels (Stevenson and Coveney 1994) based on wealth and investment activity over the last three years, nine categories (Benjamin and Margulis 1996), and lastly a four-category scheme (Sørheim and Landström 2001) defining the business angel term as an individual with high competence and investment activity. Further, informal investors are generally defined as *private individuals who make investments directly in unlisted companies in which they have no family connections* (Mason and Harrison 2000). These are broad definitions, and grey areas are identified between business angel and informal investor. For instance; how much hands-on involvement and investment activity are required to be considered as a business angel? What separates a VC and a business angel in terms of how the investment is channeled, for instance if the investor channels the investment through a family-owned company or a formalized business angel network jointly owning a company? Summarized, there are large diversities and inconsistent definitions regarding the business angel term, and which types of business angels that exist (Madill *et al.* 2005). Despite this fact, it is argued that investors not often repeat their contribution to the different investee firms, meaning that financial, social and human capital invested vary from case to case. This leaves behind a reason to change the research methodology from individual focus to focus on the investment (Avdeitchikova *et al. 2008*).

A distinction has to be made between the VC's institutions and formalized, professional, business angel networks (Avdeitchikova *et al.* 2008), which as of today are increasing in numbers (Sohl *et al.* 2007). This distinction should be based not on the investment channel, meaning whether or not the money comes from a company, a fund jointly owned by several investors or directly from the investors account, but rather based on the investors influence on whether or not to invest. In our study, an investor is a business angel if he or she makes the investment decision. This is also supported by the way investors deal with agent theory presented by van Osnabrugge (2000). Because of the agency concerns of their fund providers (i.e. the VCs' principals), VCs must demonstrate competent behavior to them from the very start of their investment process. This involves competent screening, due diligence and contract formulation before investment is placed in risky portfolio firms (i.e. the principal agent approach is followed). Conversely, since business angels invest their own money, they are not under such pressure to behave professionally and may wish to control agency problems through active involvement. In addition VCs deal with an additional level of agency relationship towards the fund providers. Once a formalized business angel has no control over his/her money this additional relationship (towards the angel group) is added to the equation, hence the individual operate as an agent for the mutual fund (principal).

In our study, and with the basis of the different definition issues outlined, the business angels term includes all of the private investor and individuals who acts as principals and decide himself/herself to invest their own money and experience in entrepreneurial SMEs (agent) with which they have no family connection, and choose to have an active role in the further development of the venture. This may seem presumptuous. However, the overall objective of this thesis is to address the non-financial value added by business angels. Consequently, defining the business angel as actively involved is therefore justified.

## Sampling issues

Sampling issues include the preponderance of convenience samples used in angel research and the unknown biases they represent (Farrell *et al.* 2008). Most research studies are based on ad hoc samples of convenience, comparability across studies and international comparison, and are limited to the comparison of the attitudes, behaviors and characteristics of business angels. Consequently, much of what is reported about angel investing comes from anecdotes and surveys of convenience samples, which are prone to biases and inaccuracies. This is often a result of surveying business angels in easily accessible networks (BANs) and introduction services (BIS). In addition, the anonymous nature of the business angels is another cause for research difficulties. Most business angels are hard to find, and given the nature of business angel investing as an invisible process, most research has focused on identifying and surveying business angels rather than on the identification, measurement and tracking of the business angel market in a wider sense.

# Methodology for Thesis

In this section we will present the overall method for this thesis and in each paper the methodology will be presented more in-depth and academic. First we will take a quick review of what has been done, and then we will present how the research started and how the research questions developed and further how it was converted to a conceptual framework. In the last part of the section we will present how the data was collected, analyzed and what limitations it has.

## A quick walk through

The study started out autumn 2011 by going through previous research on business angels and value added, in order to get an overview of the area of research; what has been confirmed and what is yet to be discovered. The literature review in paper one yields a starting point for an empirical multiple-case study conducted spring 2012, which was to confirm the propositions in paper one and gain new insights within the operationalization of value adding activities. Paper two structures empirical data with respect to value adding activities and identify undiscovered areas of research. Paper three copes with some of these areas, and combines both the acquired knowledge from previous research and the conducted interviews, with two theoretical models that have not yet been utilized in this field of research. As a result, we propose a conceptual model that seeks to give a better understanding of factors influencing the process of implementing non-financial value from business angels.

## The starting point

The first part of the thesis was conducted by summarizing and categorizing relevant previous research by exploring a total of 115 articles on the subject of post investment phase both concerning VCs and business angels, and on the subject of understanding business angels; definitions and characteristics. The outcome were one categorization of *Inter*- and *Intra-organizational activities* conducted by the business angel and a theoretical framework for Attributes and Relational properties that may affect the value adding contribution from a business angel to the venture.

The authors saw a need for confirming and further develop the framework, and therefore conducted a multiple-case study including ten active Norwegian business angels, which presented 15 business cases. Nine of the interviews were taped and transcribed in verbatim, and one of the interviews was recorded by hand, as the investor did not want to be recorded on tape. The transcription was conducted as a combination of direct and selective method, and constitute of a total of 87 pages. In addition both written and verbal data has been used to prepare for interviews and to support the findings. All interaction with informants has been written down in a contact log to keep track on a total of 94 conversations, including 39 different persons.

## Data analysis

The analysis was conducted both sequential and in parallel. For paper two, the case study data was analyzed utilizing a two-stage strategy by sorting data in different arrays in two ways. The empirical data was in many cases coherent with the data from previous research, which increase the *internal validity* of the study (Yin 2008). In parallel to analyzing the data from the case study the authors worked with analytical conceptual theory building in paper two based on theoretical theories from other disciplines, which are combined with qualitative data from a multiple-case study. This is to develop a conceptual model that describes what influences the value transfer from business angels to entrepreneurs and ventures. The emergence of the themes addressed in paper three became evident after analysis of empirical data together with gaps identified in previous research (Politis 2008; De Clercq & Manigart 2007). It was evident that theoretical models from other disciplines were to be applied in the context of this study in order to develop a conceptual model.

After the data was analyzed we presented them for context contributors, and they gave feedback in accordance with their view on business angels. They did to a large extent *construct validity* by confirming that the framework and the reported findings coincide with their understanding of business angels and value add (Yin 2008).

## Limitations

Though the authors have struggled to reduce the limitations of the study, there are still some important limitations. For paper two, the authors have developed the framework forming the foundation for the study. Consequently, the analysis of the empirical data may to some extent be biased as the authors unknowingly, and unconsciously, may be attracted to prove the framework, forcing the categories on the findings and not vice versa. To deal with this fact, the authors have focused on asking questions that not forces the interviewees into the framework. By asking the interviewees to walk us through their investment cases, we believe the responses constitute correctness. In addition, the interviewees do not reflect a representative sample of business angels. However, all the business angels in this study are actively involved in their investee companies, and the purpose of the study is to explain how the different activities are performed in a qualitative manner, not how frequent the activities occur.

For paper three a limitation is that factors describing the entity and the relationships internally, does not take into account all elements in external environment that may influence value added. For instance, the characteristics of industry may be an important determinant of the venture's external environment, which indirectly may determine the internal structure of the venture and the process of realizing the potential value added by business angels. In addition, the empirical evidence in paper three is weak, and may only be termed as 'illustrative' in preference to 'describing'. However, the purpose of the study is to describe, using theoretical models, a new conceptual model that can facilitate future research on what influences value added.

# Summary for Appended Papers

## Paper 1

This paper is a literature study that explores which value adding activities business angels take part in, and what factors may affect why business angel perform these activities. The findings indicate that the value adding activities may be divided in two categories depending on whether they are internally or externally oriented. The two categories are *Intra-organizational context*, meaning the activities within the company, and *Inter-organizational context* meaning the activities aimed at the external environment. Further, the *Intra-organizational context* is divided into three categories depending on the degree of direct involvement; *Strategic, Knowledge & Support* and *Operational Management*, while the *Inter-organizational context* are divided in *Network* and *Legitimation*.

Figure 1 illustrate the different scope of the *Intra-organizational activities*, ranging from high scope and low degree of direct involvement, to low scope and high degree of direct involvement.


**Figure 1: Intra-Organizational Activities**

While the *Intra-organizational activities* are performed internally, the *Inter-organizational activities* interact with the external environment. In addition, *Network* and *Legitimation* are highly connected to each other. The *Network* is the potential reach of the venture, while *Legitimation* assesses how much value one may harvest from the *Network*. This is illustrated in figure 2.

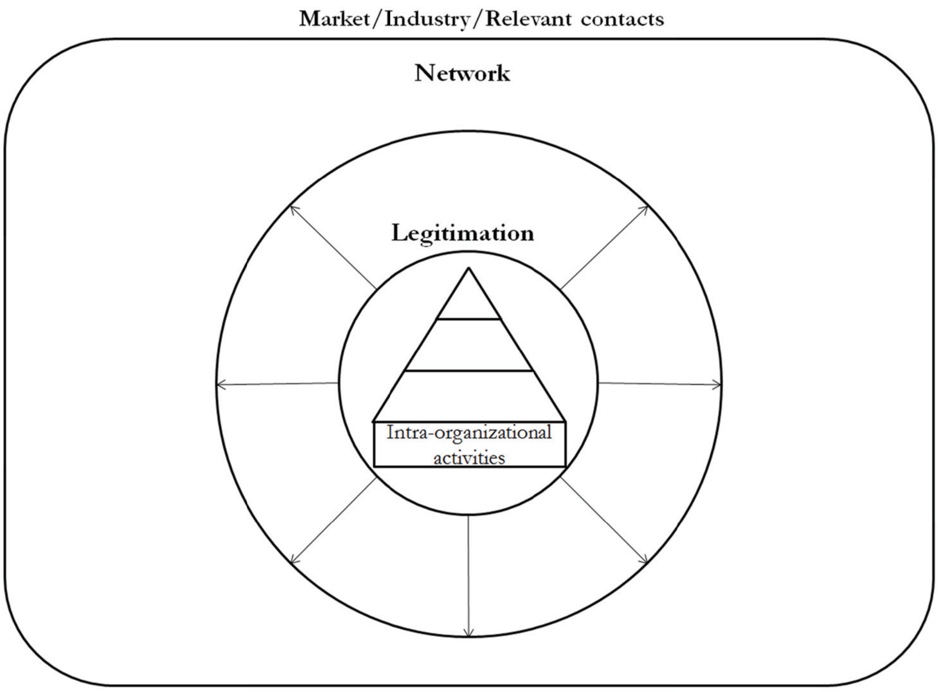


**Figure 2: Activities in a larger context**

We also find several factors that may influence the value adding activities. Both the Attributes of the investor, company and entrepreneur and the relational properties between play an important part in the non-financial contributions made by business angels, in terms of why they perform certain activities. The Attributes and Relational Properties are presented in figure 3 below.

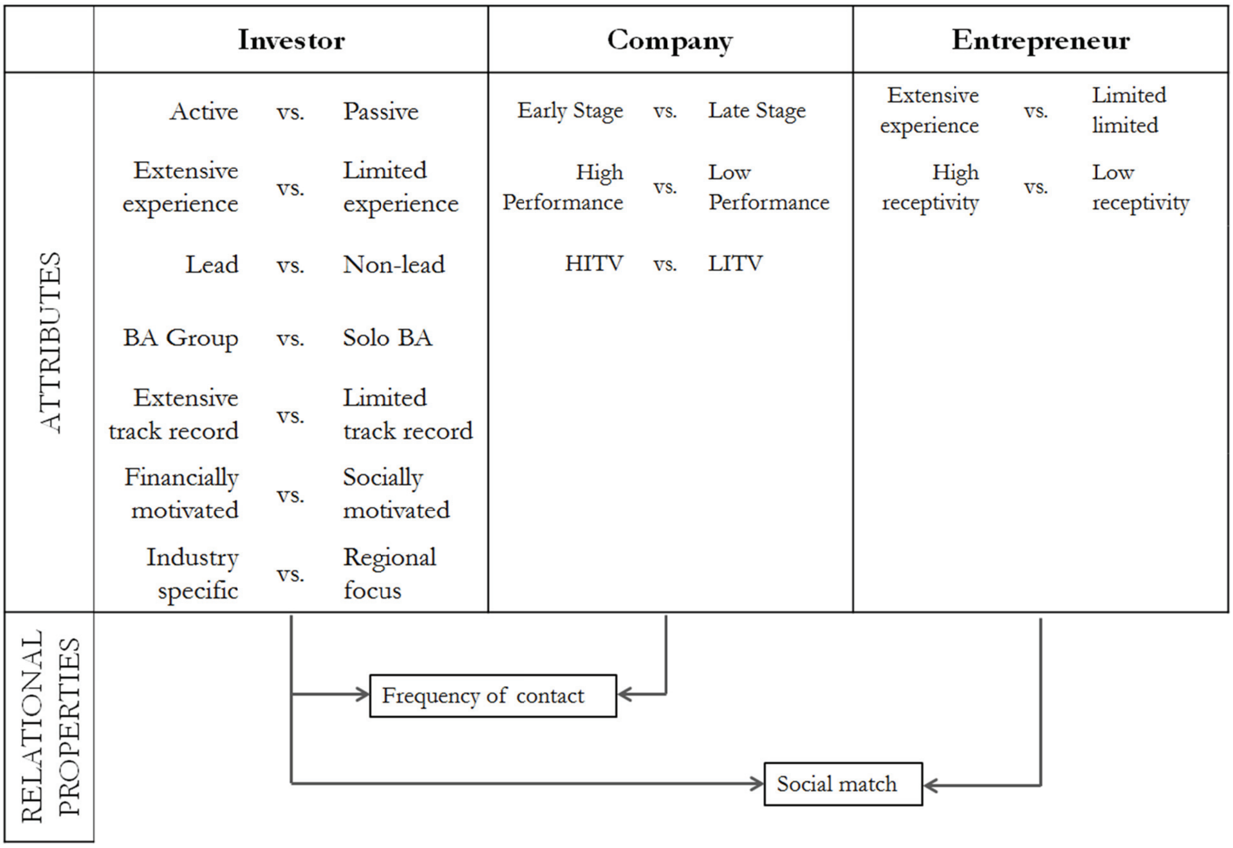


**Figure 3: Attributes & Relational Properties**

# Paper 2

This study explores how the value adding contributions made by business angels are performed to their investee companies, through a multiple-case study including ten business angels. We confirm that the activities may be divided in three categories depending on the degree of direct involvement and scope of the activities; *Strategic*, *Knowledge & Support* and *Operational Management*. The findings also suggest that all business angels take part in the *Strategic* activities, while only a few are operationally involved. We also provide an in-depth explanation on how the activities are performed (See appendix). In addition, we find, in contrast to previous research, that *Network* and *Legitimation* are not activities performed by the investor, but rather channels, which may be utilized in order to perform *Inter-organizational activities*.

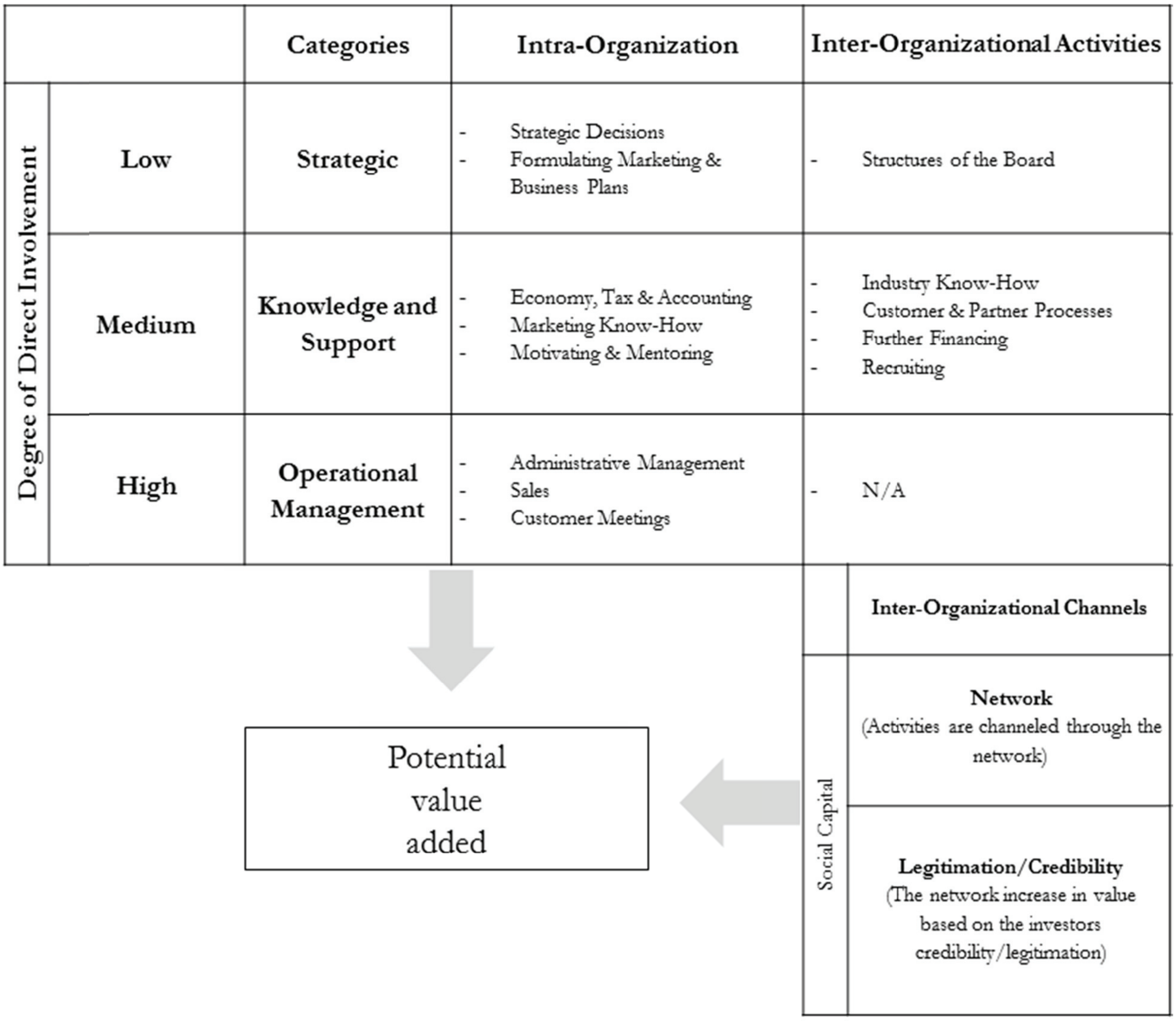


**Figure 4: Value Adding Activities & Value Adding Channels**

## Paper 3

This paper seeks to answer 'what affects the value added by business angels'. This is issue is twofold; firstly, we assess contextual factors and conditions which influence and determine which value adding activities business angel perform and further on the potential value added. Through a conceptual theory-building study, based on theoretical models from other disciplines combined with qualitative data from a multiple-case study, we find that business angel involvement greatly depends on the life cycle of the venture and the entrepreneurs' receptivity towards involvement, and explores why this may be so.

Secondly, we address what influence the process from potential to realized value added. Previous research have to a large extent taken at face value that there is a causal connection between active involvements by business angels and realized valuable outcome for the investee company. In stark contrast, our main finding is that there exists a difference between potential and realized value added, as this is a process influenced by the entrepreneurs' ability to acquire and exploit advice from the investor together with the entrepreneur's receptivity.

As a result of the above-mentioned themes, we present a conceptual model that seeks to explain the different elements between the potential and realized value added, and what may influence these elements. We also apply theories (Zahra and George 2002) regarding the entrepreneurs' absorptive capacity (ACAP) and the differing capabilities to acquire and assimilate (potential ACAP) information offered by business angels, and ability to transform and exploit (realized ACAP) this realized value to the venture.

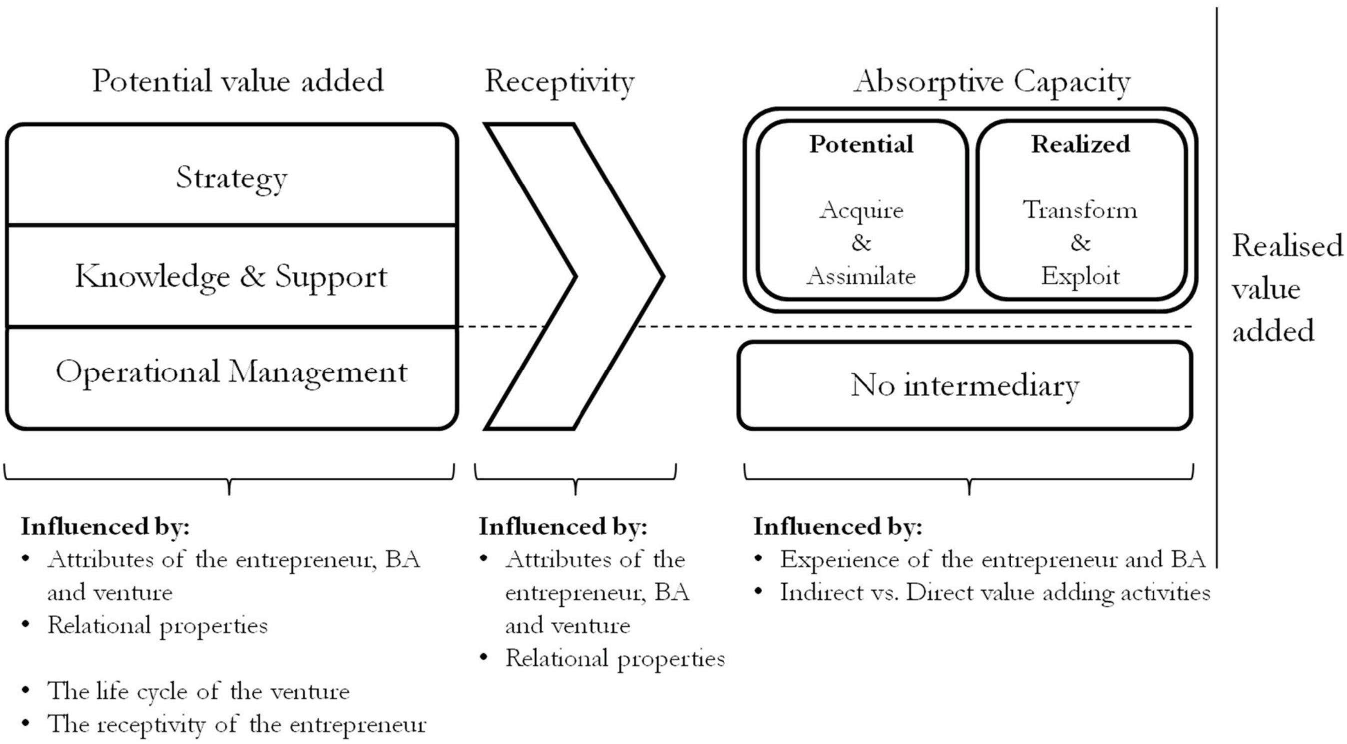


**Figure 5: Conceptual model for Realized value added**

# Policy in a Norwegian Context

The term business angel is not common in Norway. Despite their international recognition, in Norway some people still think that the term refers to a bad motorcycle club (quote Interviewee). However, they do play an important role in the economy, and in many countries constitute the largest source of external funding, after family and friends, in newly established ventures (Avdeitchikova *et al.* 2008). Despite this fact, various studies show that the availability and cost of long-term investment capital is one of the most important constraints on the formation of new businesses, and recent trends in the equity markets suggest the creation of a gap in the risk capital markets. A gap especially early stage technology ventures fall into. This is perhaps more evident in Norway than in any other well developed country. This is due to several reasons.

Governmental initiatives aimed at early stage ventures (Seed Funds, Innovation Norway) are, to a large extent, motivated by culture-political goals. In addition, tax incentives in Norway favor investments in real estate. Generally, about half of the wealth in developed countries is located in financial investments and half in non-financial assets. However, in Norway, the proportion of non-financial assets (primarily real estate) is by far the largest (about 74 percent). The tax system in Norway has made putting money in the bank a folly, while investments in real estate are lucrative. In comparison to the rest of the countries within OECD, Norway has on average per person the second lowest amount of capital placed within financial assets (not counting real estate) (Vinje 2011). Low taxation on real estate and high taxes on working capital is in this respect considered as disincentives for the type of investments business angels make.

There are no fiscal incentives through tax policies that specifically encourage increased investment in early stage companies, where business angels are likely to operate. A number of other countries in Europe (Belgium, France, Ireland, Italy, Germany, Luxembourg, Portugal and Great Britain) and the United States operate with tax credits for investments in small start-up companies (Grimsby 2010). The argument is generally that there is a need for such incentives, as the early stage equity markets is characterized by information asymmetry and high risk, and that there is a need for risk reduction in this investment segment.

Vinje (2010) promotes a specific proposal for how the tax system in Norway may be changed in a productive direction. The main purpose is that it should be less advantageous to invest in real estate and more beneficial to invest in other assets. The main proposals are that tax on labor is reduced and that the wealth tax should be abolished. This is to be funded by an interest deduction for personal property and consumer loans.

A Norwegian political party, Venstre, directly suggest the introduction of tax incentives towards early stage investments. Venstre promotes increased access to private seed and startup capital for all entrepreneurs through the establishment of "KapitalFunn", and a "KapitalFunn" register based on the following outline: 20% tax credit for up to 3 private investors per venture, limited to a maximum capital contribution of NOK 500 000 per person. The condition is that the capital contribution will remain in the company for a minimum of 2-3 years. All "KapitalFunn" investments should be registered in a publicly accessible register. This will help to highlight the recognition of both entrepreneurs and private investors, and to create a more open market, which again increases the likelihood of attracting more capital at the scale-up of promising initiatives at a later date (Venstre 2011). Similarly, France (which also operate with a wealth tax) propose a 50% reduction in tax base on the wealth tax for investments up to £50 000 (Stratégique Centre d´ analyse 2011).

In general we support proposals that increase the incentives to invest in early stage ventures, as direct incentives should be put in place in order to encourage and reduce the risk of these types of investments. However, we think the 500.000 NOK limit is not sufficient, and experience from France show that direct tax credit only implies marginal increase in early stage funding, while the cost of such an incentive is 8 times larger (Stratégique Centre d´ analyse 2011). Norwegian policy makers should gain experience from France and work out incentives that make a difference for start-up companies.

And what about the business angels' anonymous nature? Will they willingly let their investment be registered publicly? In addition, it seems as if we are working under the presumption that market transparency will result in more deals and investments. Kelly (2007) suggested that the invisible character of the informal venture capital market is both its defining trait, and an important stimulus for the investment itself. In addition, mechanisms need to be explored to facilitate the sharing of experience and risk-taking among active business angels (Kelly 2007). Consequently, policy makers will need to create conditions where business angel capital can be optimized, both in terms of tax incentives, and sharing of experience and risk-taking, without creating a transparent market.

Business angel networks (BANs) may serve in such respect. This thesis suppose that active involvement by business angels is just as important as the financial investment, and that the process of transforming potential value to realized valuable output is a difficult process. Such networks may increase the competence of the investors, both in terms of investing and knowledge transfer to the entrepreneurs. They may help to visualize business angels as an investment group to potential entrepreneurs. In Norway, the Ministry of Trade and Industry (Nærings- og handelsdepartementet) will, in cooperation with relevant ministries, give Innovation Norway the responsibility to establish business angel networks (Regjeringen 2011-2012). However, given the nature of the informal venture capital market and that the market is attractive because it is difficult to access (Kelly 2007), we argue that policy makers should rather look at other stimuli in order to increase business angel investing activity. Instead of taking an active part in the foundation of BANs, policy makers should encourage private investors to establishment such networks on their own.

We therefore suggest that policy makers should investigate the possibility of giving tax credit on the wealth tax on investments in new ventures, and as the creation of BANs is thought to be important when it comes to risk sharing and knowledge transfer, we propose that the tax credits should be higher for BANs than for solo business angels. This will both provide incentives for private investor to invest in early stage and high-risk start-ups, and also encourage private investors to establish more formalized networks. In addition, to separate the informal investors from the VCs, we also suggest that in order to get tax credits on the investment, the money should come from the investors' own 'pocket', as these incentives are aimed at business angels, not professional funds. These incentives will to a low degree influence the established tax system (as opposed to the incentives proposed by Vinje 2011). It will however provide the informal capital market with important stimuli.

# Conclusion and Implications

It is widely recognized that business angels contribute with both financial and non-financial value to the entrepreneurial ventures they decide to invest in. However, the non-financial contribution through active involvement may also in some cases be more valuable than financial capital. This thesis has conceptualized the value adding activities, explained how they are performed, assessed factors that may influence them and also shed light on the process from potential value added into realized valuable output for the investee company. This has been done in order to create a general understanding of business angel involvement, and present a conceptual model for how value adding may increase the venture's performance, as previous research to a large extent has suffered from a lack of consensus and overview.

Paper one gives a thorough review of previous literature on value adding activities and the contextual factors that may influence them. Based on 16 studies between 1988 and 2005 we sorted the different types of value adding activities business angels typically perform to their investee companies, and presented a conceptual framework with three different categories; *Strategy, Knowledge & Support* and *Operational management*. To support this categorization we introduced the concept of the degree of direct involvement performed by the business angel, which we argue should be considered in future research on distinguishing between different value adding roles. Further, the lack of scholarly understanding regarding different conditions influencing value added (Politis 2008) was to be proved as we reviewed literature regarding this matter. With inspiration from the more developed field of VCs, we conceptualized these different contextual factors by presenting these as the *Attributes* describing the investor, company and entrepreneur, and the *Relational properties* between them. We further argue that the resulting framework adds up what is known regarding this theme, as the factors all influence the value added activities, and maybe more interestingly influence each other.

With a sense of what previous research in this area had accomplished so far, empirical data was gathered in order to perform a multiple-case study in paper two, consisting of ten business angels and a total of 15 business cases, which aimed at explaining how the value adding activities are performed in more detail. In addition, paper two, being based on empirical data, improved and confirmed the framework presented in paper one.

Both the literature review in paper one, and indications from interviewees in paper two, put us on the path of assessing, in depth, two of the factors affecting the value adding activities that were perceived underdeveloped and highly depended on the other factors; the ventures life cycle and the entrepreneurs receptivity. In paper three we assess these two contextual factors to enhance the scholarly understanding of what may influence value added. Lastly, and perhaps most important, paper three also takes the first steps in opening the 'black box' (De Clercq and Manigart 2007) of assessing how potential value added becomes realized valuable output for the ventures.

Following this line of reasoning, we argue, together with Politis (2008) that future researcher have to separate between potential value added and realized value added when assessing non-financial contributions made by business angels, as this is a process contingent upon the entrepreneurs receptivity towards exploiting and the ability to exploit. Accordingly, we take this a step further, stating that most previous research on contextual factors influencing value added, only have considered what may influence *potential* value added. However, it is the *realized* value added that is true value added. In this respect, and inspired by Zahra and George

(2002), we introduce a ratio between potential value added and realized value added called the 'efficiency factor'. If this factors is high, the entrepreneur have been receptive towards the potential value from the business angel, and have the ability to acquire, assimilate, transform and exploit this information into realized value added.

The conceptual model presented in paper three further emphasize the need to distinguish between indirect (instructing) and direct (self-performing) involvement from the business angel, since we argue that the process of realizing the potential value of these involvements differs greatly. Accordingly, direct involvement is not contingent upon the receiving entrepreneurs' absorptive capacity, as opposed to indirect involvement.

Thus, future researchers should to a greater extent consider the entrepreneurs ability to exploit, as opposed to what the business angel may or may not contribute with. Future studies regarding this theme should be done in a qualitative manner with, for instance, entrepreneur-investor dyads, with in-depth study assessing the exploitation of investor advice if the entrepreneur where receptive. What was the intention on behalf of the business angel, and how was the outcome of this information?

Lastly, in line with Macht (2011), the entrepreneur's receptivity seems to play a major role both regarding what potential value the business angel offers, and what of this value that are to be realized in the venture. This should also be emphasized in future research.

## Summarizing main findings

- We present a categorization and in-depth explanation for how the value adding activities are performed, based on both previous research and empirical data from a multiple-case study
- We explain and collect factors influencing value added based previous research, theoretical models and a multiple-case study
- In stark contrast to previous research, we separate between potential and realized value, as the process of realizing potential value is contingent upon the entrepreneurs' absorptive capacity
- We present a conceptual model that explains the different elements influencing the process from potential to realized value added
- We also introduce the 'efficiency factor', which assess if the entrepreneur is receptive towards advice and have the ACAP needed to acquire, assimilate, transform and exploit potential value into realized valuable output

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# Appendix

## 1. Examples of reported Intra-organizational activities

| Level 1 - Strategy | |
|---|---|
| Strategic decisions | One investor reported that:<br>- He argued to drive market introduction to biogas, instead of the first observed and most obvious market.<br>- He participated in the decision to go into a partnership with one of the major players, and made this partnership get established.<br>- He gave corporate advice on potential partners and exit-candidates, but also saw what the investee company needed in order to perform satisfactory. As a result they recruited a CFO and took an even more direct involvement in the sales process. |
| Structure of the board | One investor reported that:<br>- He stresses the importance of an appropriate structure of the board, and contribute to make the board structure as good as possible for the right decision making process.<br>- Structure boards based on their knowledge, resources and their ability to contribute.<br>- He believes he was included in the board to support the view of the entrepreneur and as a counterweight to the financially driven investors. |
| Formulating marketing & business plans | One investor reported that he often formulate business plan for his investee companies, and by doing this i claims to establish a clear target image and a 'language' for what to achieve. |

| Level 2 - Knowledge & Support | |
|---|---|
| Industry know-how | Several investors reported that they invest in industry specific start-ups in order to exploit their industry specific knowledge.<br>One investor reported that:<br>- It's valuable if investors have a basic understanding of the industries they invest in. He often observes board members who do not understand the industry well enough, and as a result they cannot contribute with value.<br>- He has specialized on a specific industry and often turns down requests from entrepreneurs from other industries. He also reports that he have a lot of contact in this industry which gives the ability to open doors. |
| Marketing know-how | One investor reported that:<br>- Contributing with marketing know-how was one of the most important activities he undertakes and that most people don't understand what it takes to commercialize technology with regard to marketing. "There are no products that sell themselves today". |

| | |
|---|---|
| | - "...Over time it is the brand that sell. Not the product." Therefore he believes it's important to understand what the customer will pay for. |
| Customer & partner processes | One investor reported that their contribution to a partner process resulted in agreements with three prospective customers who wanted to buy the product and in that way documented the market enough to attract VC-funding. |
| Motivating & mentoring | One investor reported that "keeping the entrepreneurs happy is worth a lot" and in one case he bought a cabin to the entrepreneurs in order to give them something back for their sacrifice. |
| Economy, tax & accounting | One investor reported that she manages all the "manual work" required to run a business, so the entrepreneurs can focus on technology development. The work includes accounts, audits and dealing with laws that apply. |
| Further finance | One investor reported that:<br>- He is working hard to reduce financial risk for later stage investors. As an example he got in place 'letters of intent' with customers and partners.<br>- He has an extensive network of investors, and that some have entered the investment cases he was involved in. |
| Recruiting | One investor reported that:<br>- He has networks making it possible to do targeted recruiting, background checks and the competence to evaluate job applications.<br>- He strengthened a team with industrial expertise, network and credibility by recruiting a guy that had co-founded a company in the same industry. |

| **Level 3 - Operational Management / Early phase management** |
|---|

| | |
|---|---|
| Administrative management | One investor reported that:<br>- She has been so operational that she was hired as a general manager in one of the investee firms.<br>- He often goes 50-60% capacity into one case and taking a role as manager in the company. |
| Sales & Customer meetings | One investor reported that she take an active part in sales and marketing in 90% of the investments. |

# Paper 1: Value Adding Activities - A Literature Review

**Authors:**

Lars Dybvik
Marius Monsen Ragnøy
Ragnar Andreas Severinsen

Norwegian University of Science and Technology
Department of Industrial Economics and Technology Management

# Abstract

This study explores which value adding activities business angels take part in, and what factors affects why business angels perform these activities. We present a conceptual framework for value adding activities based on 16 studies on value adding activities between 1988 and 2005. The value adding activities may be divided in two categories depending on whether they are internally or externally oriented. The two categories are *Intra-Organizational context*, meaning the activities within the company, and *Inter-Organizational context*, meaning how the activities interact with the external environment. Further, the *Intra-organizational context* is divided into three categories depending on the degree of direct involvement; *Strategic, Knowledge & Support* and *Operational Management,* while the *Inter-organizational context* are divided in *Network* and *Legitimation*. We also provide a conceptual framework regarding what affects value added, hence *Attributes* of the investor, company and entrepreneur, and the *Relational properties* between them. Lastly, we link the *Attributes* to the respective value adding activities. The findings in this study will mainly provide future researcher with a tool with which they can assess, analyze and understand the value added by business angels, and why some business angels perform certain activities given different contexts and conditions.

## Introduction

The 'business angel' term include all private investors and individuals who act as principals and decide himself/herself to invest their own money and experience in entrepreneurial SMEs with which they have no family connection, and choose to have an active role in the further development of the venture. However, business angels do not only contribute with financial capital to their investee companies, and as the literature suggests they often wish to take a role in the newly invested company, earning 'psychic income' (Freear *et al.* 1995) and support the next generation of entrepreneurs (Politis and Landstrøm 2002). Further on, it is indicated that business angels add value through human and social capital; network, legitimation, strategy, advice etc. Value adding activities are also a way of managing the potential return of the business as well as reducing agency risk (Ardichvili *et al.* 2002).

Even though the research area has gained some interest, previous research on value adding activities has suffered from a lack of overview and consensus among researchers. Thus, this is an area of great complexity as several different sets of value adding activities have been reported, and little emphasis has been placed on what affects the different activities that are performed. Such information is of great value for both the demand (entrepreneurs) and supply side (business angels) of venture capital.

We will in this paper systematically present specific sets of value adding activities based on previous research, since it is important to get an overview of the non-financial contributions business angels bring to their investee companies. Further, the paper will present factors that has been indicated to influence *when* and *why* business angels contribute with these value adding activities - factors that is defined as *attributes* of the investor, the company and the entrepreneur, and *relational properties* between them. The factors we present here will more closely examine what determines the sort of activity and the amount of involvement from the investor. This engages us in questioning; according to previous research, *how* does a business angel add non-financial value to their investee company and which factors determine *when* and *why* they do so? And how are these factors linked to the different value adding activities? The purpose of this paper is to explore this area of research and shed light on these addressed problems.

Firstly, the different value adding activities are presented in categories, based on 16 studies on value adding activities between 1988 and 2005. Secondly, the different *attributes* and *relational properties* suggested by previous research that influence value added is introduced in a systematic order. Lastly, we suggest how the value adding categories are linked to the different *attributes* and *relational properties,* and also where future research should be undertaken and what the focus of this research should be.

# Methodology

This paper summarizes and categorizes relevant previous findings from research on business angels and value added. The data have been gathered while exploring a total of 115 articles on the subject of post-investment phase both concerning VCs and business angels, and on the subject of understanding business angels; definitions and characteristics.

## Search for literature

With regard to searching for literature, Google Scholar and BIBSYS (library resource offered by NTNU) have been mostly used, with keywords: business angels, value added, informal investors, informal venture capital, post-investment. The search started with a broad approach to get a overview of the field and research and to gain a perspective on what to study further. Then searches became narrower and relevant citations were looked up and taken into account. All articles have been published in well-known journals like; Journal of Business Venturing, Venture Capital, Entrepreneurship Research Exchange, Entrepreneurship and Regional Development, International Small Business Journal and International Journal of Entrepreneurial Behavior & Research. We have focused on systematizing the scientific contributions both regarding the different value adding activities and the factors that could influence them. Two different inclusion criterions have been used when gathering information about these two subjects, presented in reversed order.

For the last part we gathered relevant studies regarding the factors influencing value added. This is, as we comprehend, factors that concern both VCs and business angels. Little has been mentioned about influencing factors in the study of value added by business angels. Studies of VC's regarding this subject is however more comprehensive. With caution, VC studies have been an inspiring part in elaborating the different influencing factors. Contradictory for the first part, the value adding activities have been gathered from studies made on business angels. Their contributions and more active nature as opposed to VCs, results in different value adding activities and cannot be collected from studies of VCs (Ehrlich *et al.* 1994).

## Structuring the data

Previous research made on business angels and value added report several different post-investment activities, and 16 empirical studies between 1988 and 2005 list specific sets of value adding activities. Some studies propose different value adding categories, were some studies have been more preferred than others due to citations. These studies were compared, and were listed in a large spreadsheet, and placed into nine categories; Funding, Involvement, Knowledge, Management, Support, Strategic, Network, Recruiting and Legitimation. Due to certain overlaps in several categories, these were first reduced to seven, then to six and lastly to five categories; *Strategic, Knowledge & Support, Operational Management, Network* and *Legitimation.* Another reason for the downsizing was the increasing clarity of the definitions between them. Existing theories have been used to support the viability of each category.

With regard to *attributes* and *relational properties*, data was structured by listing reported factors that influence value added to ventures. Previous research has reported a number of factors that we have structured into properties and characteristics affecting; the Investor, Entrepreneur, Company and the relation between them. After reading a large number of articles on the subject and without observing new and relevant factors, the data were considered satisfactory for the theoretical framework.

# Conceptual Development

## Value adding activities

Previous research has reported several value adding activities, as well as categories that they may be placed in. For instance, Munck and Saublens (2005) identified four categories in which business angels can benefit their investee companies; *help overcome funding difficulties, use of human capital to provide skills and expertise, use of social capital to provide network* and *increase investee´s opportunity to acquire further finance*. Ardichvili (2002) however only categorized the activities into *passive* and *active involvement*. Further, Madill *et al.* (2005) presented six categories of value adding activities that CEOs in different angel-invested companies reported; *advice, contacts, hands-on assistance, boards of directors & advisors, market business intelligence* and *credibility/validation*. Lastly, Politis (2008) identified four categories; *sounding board/strategic role, resource acquisition role, supervision/monitoring role* and *mentoring role*, and linked these roles to a set of value adding activities based on 14 empirical studies published between 1992 and 2005. This paper however, presents a new set of categories for two reasons. Firstly, seen in light of the factors influencing value added, none of the categories presented earlier were found suitable. Secondly, the divisions of different types of hands-on involvement were not sufficient.

Therefore, in order to establish consistency we introduce a framework with five categories of activities presented in table 1. The framework is based on sorting value-adding activities reported from 16 studies between 1988 and 2005 by grouping similar activities, based the amount of direct involvement and whether they are externally or internally oriented. The activities are categorized in *Intra-organizational context*, meaning the activities within the company, and the *Inter-organizational context*, meaning how the activities interact with the external environment:

**Intra-organizational context**

- **Strategic activities** add value by focusing on setting the course for the venture by providing strategic advice to the entrepreneurs. Typical activities are helping with business model, business concept and be part of Boards of Directors.
- **Knowledge & Support** activities include indirect activities such as providing assistance, mentoring, giving advice and contributing with knowledge to the venture and the entrepreneur team.
- **Operational Management** activities include activities that are direct and definite work tasks. Typical activities may be the soliciting customers, developing products or services or other daily work tasks.

**Inter-organizational context**

- **Network** is seen as a resource pool in which other activities may be gathered and/or performed. The business angel's network is a 'structural dimension' of social capital, meaning the contacts outside the investee company. For instance potential customers, suppliers or by setting up a professional support group.

- **Legitimation** adds credibility to the venture through the trustworthiness of the investor. This further increases the probability of acquiring later stage funding, the likelihood of attracting critical personnel and the general value of the *Network*.

Each of the proposed categories will further be defined more thoroughly, and be linked to theoretical perspectives and previous empirical research. Although the five categories presented represent a distinct division of the different value adding activities, they should be seen as complementary and internally linked to each other, where one category may influence and enhance the effect of another category. For instance some activities may be seen as *strategic*, but may be further explained as a result of *strategic activities*, leading to direct involvement, thus *Operational Management*. For instance, the making of a strategic goal (*Strategic*) may lead to the recruiting of a manager in order to make the venture perform satisfactory (*Operational Management*). The different activities are presented on the next page in table 2.

| | Categories | Activities | Authors |
|---|---|---|---|
| INTRA-ORGANIZATIONAL | Strategic | - Formulating marketing plans<br>- Testing or evaluating marketing plans<br>- Serving as sounding board to entrepreneur team<br>- Help with the business concept or model<br>- Strategy<br>- Strategic advice<br>- Serving as sounding board (evaluation of product-market activities, development of marketing plans, original business strategies and products) | MacMillian (1988)<br>Ehrlich et al. (1994)<br>Ardihcvili (2002)<br>Brettel (2003)<br>Harrison & Mason (1992)<br>Harrison & Mason (1996) |
| | Knowledge and Support | - Monitoring financial performance<br>- Monitor operating performance<br>- Advice and counsel (in marketing, finance and accounting, and general management)<br>- Management know-how<br>- Financial know-how<br>- Marketing know-how<br>- Industry know-how<br>- Industry knowledge<br>- Motivating personnel<br>- Coaching<br>- Personal development<br>- 'Lifting the spirits', 'sharing the burden' and 'providing a broader view' | Ehrlich et al. (1994)<br>Harrison and Mason (1992)<br>Harrison & Mason (1996)<br>MacMillian (1988)<br>Brettel (2003)<br>Sætre (2003) |
| | Operational Management | - Managing crises and problems<br>- Selecting vendors for equipment<br>- Developing production or service techniques<br>- Developing actual product or service<br>- Soliciting customers or distributors<br>- Negotiating employment terms with candidate<br>- Interviewing and selecting management team<br>- Solicit customers/distribution<br>- Management<br>- Searching for candidates of management team*<br>- Replace management personnel*<br>- Recruitment of management* | MacMillian (1988)<br>Ehrlich et al. (1994)<br>Ardichvili (2002)<br>Harrison & Mason (1992) |
| INTER-ORGANIZATIONAL | Network | - Provision of contacts<br>- Develop professional support group<br>- Social network connections<br>- Network and contacts<br>- Networking activities | Munch & Saublens (2005)<br>Ehrlich et al. (1994)<br>Ardihcvili (2002)<br>Brettel (2003)<br>Harrison & Mason (1996) |
| | Legitimation | - Reduce the "liability of newness" and thus increasing the apparent track record for the entrepreneurial team<br>- Help overcome funding difficulties<br>- Facilitation of further funding<br>- Obtaining alternative sources of debt financing<br>- Obtaining alternative sources of equity financing<br>-Interface with investor<br>-Other sources of funds<br>-Capital | Sorheim (2005)<br>Munch & Saublens (2005)<br>MacMillian (1988)<br>Ehrlich et al. (1994)<br>Ardihcvili (2002)<br>Brettel (2003) |

**Table 1: Value Adding Activities**

## Detailing the categories

The categories of activities are separated between *inter-organizational context*, meaning the activities within the company, and the *inter-organizational context*, meaning the interaction with the external environment. This has been based on the Resource-Based View (RBV) as a conceptual background (Hamel and Prahalad 1994). While the market-based view identifies attractive markets, the RBV sees whether or not the firm has the resources and competencies to compete in the market. In this respect we analyze the resources added by a business angel to expand the bundle of resources internally in the firm (*Intra-organizational*), and the external activities, which affect how the firm is viewed in its environment, and the use of external resources (*Inter-organizational).*

In our categorization, we also connect the different categories to relevant theory, increasing our understanding of the categories and as well as strengthening the foundation of the categories.

## Intra-organizational activities

The intra-organizational activities have been categorized depending on the type of involvement and whether or not the activities performed are *direct* or *indirect*. *Indirect* involvement is instructing, mentoring or coaching how to do a certain activity, while direct involvement is actually participating in the activity. The categories range from high-level and indirect involvement (*Strategy*) to low-level and direct involvement (*Operational Management*). This has been done due to the fact that *strategy* include a broader perspective and scope than daily management, but also include a lower degree direct involvement as business angels contributing only with strategy is less involved in the daily operation than business angels contributing with *Operational Management* and *Knowledge & Support* (see table 2). Similarities can be drawn to basic management theories, defining management as top-level, mid-level or first-level.

### Strategic

When discussing *strategy* we mean setting the overall goal, endpoint and objective for the venture, and how the firm should operate to achieve these goals. In general, active business angels tend to be involved strategically rather than on a day-to-day basis (Politis and Landström 2002).

Most angel-funded companies have at least one business angel in their Board of Directors, which seems to be the most common form of involvement (Mason and Harrison 1996; Landström 1993), and may also be the Chairman of the Board (Macht and Robinson 2009). Board members and Chairmen often discuss strategy with the management team and contribute to decision-making, controlling and overseeing the entire company, which reinforce the business angel's strategic involvement in the investee companies (Politis and Landström 2002). They help develop goals, strategic plans, company policies, and make decisions regarding the direction of the business. These angels should in general have a broadened understanding of how competition, world economies, politics, and social trends affect organizational effectiveness.

However, strategy is hard to concretize and is by its nature different in most start-ups as it is a process of decision-making. This is also because firms are constantly engaged in conflicting processes that balance flexibility and efficiency; these are 'exploration' versus 'exploitation' (March 1991). The trade-off between the two influences the strategic choices and March (1991) proposes the importance of balancing the two. By combining them a firm will be able to build sustained competitive advantage. This may also be seen in comparison with 'causation' and 'effectuation' (Sarasvathy 2001). Causation and effectuation are two different sets of decision-making principles (Sarasvathy 2001). Causation describes a decision-making heuristic rooted in prediction. On the other hand, effectuation focus on using a set of evolving means to achieve new and different goals.

Causation (as with exploitation) involves a high degree of planning, and is an important mindset for high-tech start-ups. By attracting an experienced business angel with hands-on experience and relevant capital in the given industry, the venture may increase its chances of success.

In contrast, 'effectuation' and 'exploration' is an important mindset for lean startups (how much can we afford to lose, not how to maximize profits). 'Effectuators' are observed to employ effectuation in situations of uncertainty, when a company develops rapidly in the early start-up phase of growth and enters new markets. Effectuators follow the process to gain early customer and committed partners who then create new means and new goals as resources and viewpoints are added to the mix ('exploratory mindset'). By applying these two theories on the value added to break down the strategic decisions into either a decision of exploration/effectuation or exploitation/causation, one can more easily assess the actual value added by business angels.

**Knowledge & Support - indirect involvement**

The categories *Operational Management* and *Knowledge & Support* are both based on value added which leverage from the business angel's human capital and focus on the business angel's contribution on the operationalization of the firm. The separating factor is whether it is *direct* or *indirect* involvement, as defined above. As elaborated earlier, strategy is involvement on an even higher level (see table 2).

*Knowledge & Support* contains indirect involvement activities. The portion of involvement by passive business angels is mostly indirect, but active business angels do also make indirect value adding, but a smaller portion of the total value added. Business angles contribute with their personal experience in their role as advisor, coach or mentor in general business issues, enhancing the entrepreneur's ability to handle issues emerging in the entrepreneurial landscape and to complement the technological knowledge the founders possess (Madill *et al.* 2005). The role can be emphasized as executing organizational plans in conformance with the company's policies and the objectives from the *Strategy* and most importantly inspire and provide guidance to the entrepreneur towards better performance. To clearly separate this role from that of *strategy* we underline that business angels contributing with *Knowledge & Support* devote more time to organizational and directional functions.

Several indirect activities have been identified in previous research, such as advice on corporate strategy, managerial and general business advice and provide information on government programs. Indirect involvement is highly informative, sharing experience to the entrepreneur, which further can be used in the operation of the company. To function as a mentor the business angel needs to have developed a reputation as a trustworthy and competent business person (Politis 2008), and build trusting relationship that may increase the likelihood that the entrepreneur values the mentorship role and actually use the advice given by business angels. The trusting relationship is influenced by the social match between the investor and the business angel, which may result in routinized learning '... through repeated interaction and shared beliefs over time' (Deakins and Freel 1998; Deakins *et al.* 2000). In connection to this, the frequency of indirect compared to direct involvement would often be higher if the entrepreneur wants to run the business without someone interfering.

The indirect contribution from business angels may increase and supplement the 'resource-base' of the firm. In this case, the indirect contributions from the investor may higher the level of the resource base, and consequently increase the competitive advantage. Barney (1991) identifies these characteristics for a resource to be strategically important; 'valuable, rare, inimitable and non-substitutable'. As these characteristics may be used to identify how valuable a certain resource is to a firm, it may also be used to assess how valuable the non-financial contribution through *Knowledge & Support* by a business angel.

Lastly, it may also be used to define how valuable certain resources are on a general basis. For instance, *knowledge* is seen as potentially the most strategically important resource. In terms of strategy, both tacit and explicit knowledge can be very important. When it comes to business angels it is argued that knowledge in form of relevant capital is the most valuable resource to obtain (Sætre 2003). Knowledge is embedded in people and is extremely difficult for competitors to replicate.

**Operational Management - direct involvement**

The direct involvement is most common by active investors that have invested in entrepreneurial ventures and actively participate in the operation of the venture. Previous research argues that the vast majority of direct involvement concerned unique events, such as meetings with customers. Some business angels are involved operationally by temporarily being 'employees' in the company, filling personnel gaps in the management team. This occurs when the company lacks a balanced management team in early stages of the venture (van Osnabrugge and Robinson 2000). Madill *et al.* (2005) made a qualitative survey of 33 CEOs in different start-ups, which identified direct involvement activities as negotiating with different players connected to the company and provision of business services. Direct involvement requires a willingness to be receptive to the involvement on the part of the investee (Murray 1996), and is largely dependent on the *experience* and knowledge possessed by the investor and entrepreneur.

Business angels in this respect usually have the responsibility of assigning employees' tasks, guiding and supervising employees on daily activities, ensuring quality and quantity production, making recommendations, suggestions and have an active role in the daily operation. Business angels investing in early stage ventures will more often take this role, blurring the lines between the entrepreneur and the angel, as some business angels have been seen as a co-founder by the original entrepreneurial team (Sætre 2003).

## Inter-organizational activities

*Inter-organizational activities* are linked to the external environment of the company, where the business angel provides external contacts in his/hers *Network,* and increases the value of this network through *Legitimation* and the outwards image of the company.

**Network**

Business angel's value added seems to be highly embedded in their personal network, in addition to be an important part of the recognition of entrepreneurial opportunities. Throughout their professional career the business angels acquires several business contacts that can benefit the investee company. Their network of contacts brings valuable knowledge about potential customers and suppliers, enhanced information and increased trust and cooperation from others, allowing the company to gain additional resources and develop the organizational infrastructure (Politis and Gabrielson 2006). Macht and Robinson (2009) made an overview of the different business contacts the business angels provided; *accountants, lawyers, customers, potential recruitment's* and *further financiers*.

The *Network* category includes all activities that contribute network value from such benefit-rich networks when the contacts are 'non-redundant' with regard to those contacts the start-up company holds. Further on, respondents report that the most significant contribution investors made to their investee company where the use of their personal network (Brettel 2003). When entrepreneurs are to choose an investor they have to evaluate their benefit from different resources, besides the financial capital investment, and thus, the theory of structural holes may be a useful tool.

**Legitimation**

Business angels investing in a company can be seen as a legitimation of the company, reducing the 'liability of newness' (Sørheim 2005). Accordingly, legitimacy and trust increases the potential value the *Network* can offer. This is largely dependent on the track record of the business angel, and may especially ease the process of further finance (Sørheim 2005; Madill *et al.* 2005). Business angels' financial contribution is in this case an addition to their own investment.

Through their own *Network* and *Legitimation* of their investee company, they help the investee company in the process of acquiring further finance, such as VC funding and debt finance, making it easier to overcome funding problems (Madill *et al.* 2005). Business angels investing strictly in their region may also have a better foundation when negotiating debt financing, because of their good reputation from regional investments in the past (Sørheim 2005). In addition, it appears that business angel helps the company prepare for additional funding, by 'providing on-the-ground monitoring that serve to reduce the impacts of information asymmetry that would otherwise inhibit venture capital investment' (van Osnabrugge and Robinson 2000). Business angels desire for additional funding are incentivized by their goal of profitable exit, which is often depending on the company's financial ability to grow and further be a commercial success.

In addition to ease the process of further finance, legitimating the company can make it more attractive towards potential counterparts; employees, partners, customers and suppliers, by reducing the transaction costs evident for the counterpart. The transaction cost theory is, among other fields, used to evaluate whether a firm should grow or outsource tasks, by examining 'internal and external' transaction costs (Commons 1931). In this case the legitimating power of the business angel reduces the 'behavioral uncertainty' (Rindleisch and Heide 1997). In all transactions between firms there are costs related to engaging in a new business relationship.

When a counterpart is unknown, the transactions costs related to engaging in a new relationship are higher, compared to dealing with an existing relationship. Because the costs of engaging in new relationships are higher, the counterpart may consider dealing with existing supplier even if the monetary costs are higher, due to the influence of transaction costs. A start-up company usually lacks history and legitimation, and thus higher the risk for potential counterparts. The business angel, with his legitimating power, may reduce the risk and newness related to the company, and thus reduces the evident transactions costs for potential counterparts.

## Contextual presentation of activities

To summarize and illustrate the different value adding activities we present them in their respective contexts. The *Intra-organizational activities* (the activities within the company) are presented below, in figure 6. The figure illustrates the different scope of the categories. It also shows that level of direct involvement increase in the lower range of the pyramid (*Operational management*).


**Figure 6: Intra-Organizational Activities**

While the *Intra-organizational activities* are performed internally, the *Inter-organizational activities* interact with the external *Network*. The different categories are presented in figure 7, showing the *Intra-organizational activities* contributed by business angels in the triangle, with the surrounding *Inter-organizational activities* that communicate with the external environment.

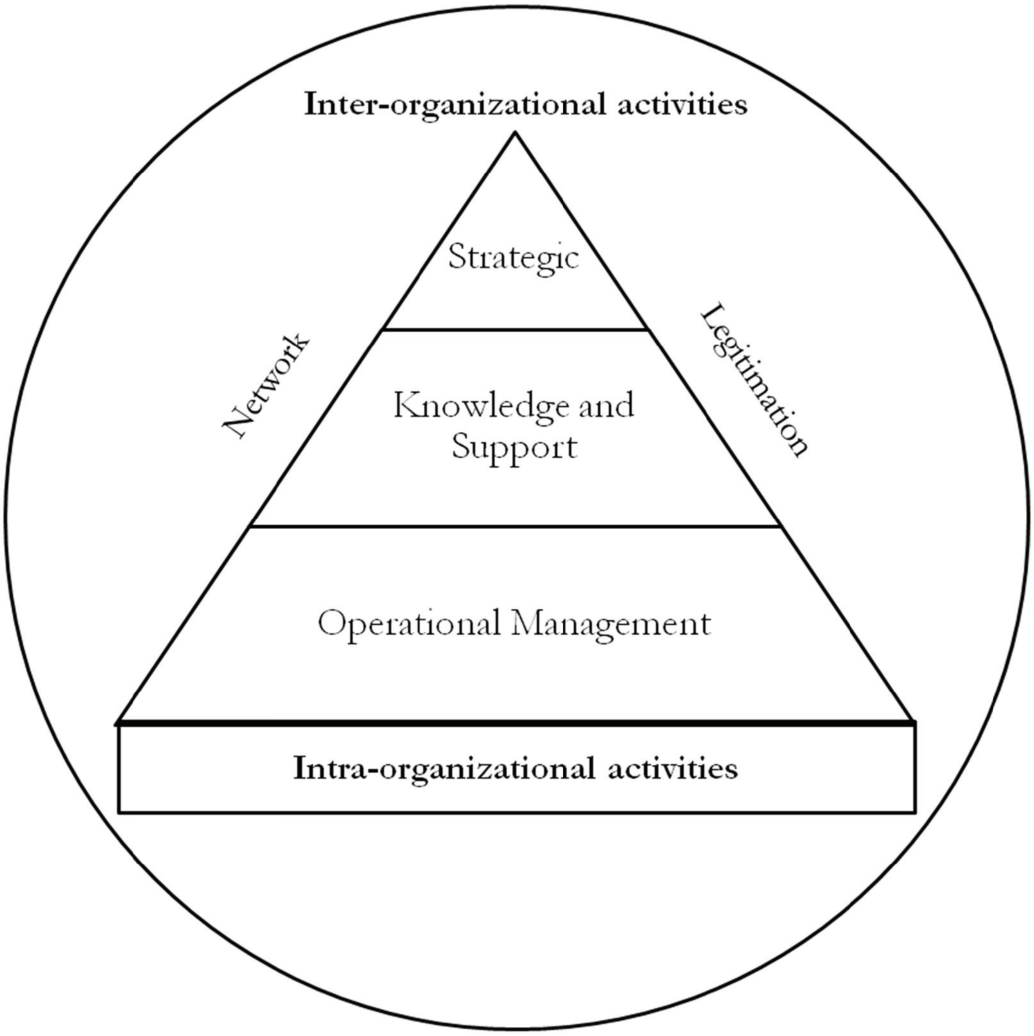


**Figure 7: Inter-Organizational Activities**

However, *Network* and *Legitimation* are highly connected to each other. The *Network* may be seen as a 'pool of potential resources', while *Legitimation* assess how much value a business angel may harvest from the *Network*. This illustrated in figure 8. An optimal *Network* is one where the borders are the same as the borders of *Legitimation*. By maximizing the efficiency of these two activities one may optimize the activities within the firm.

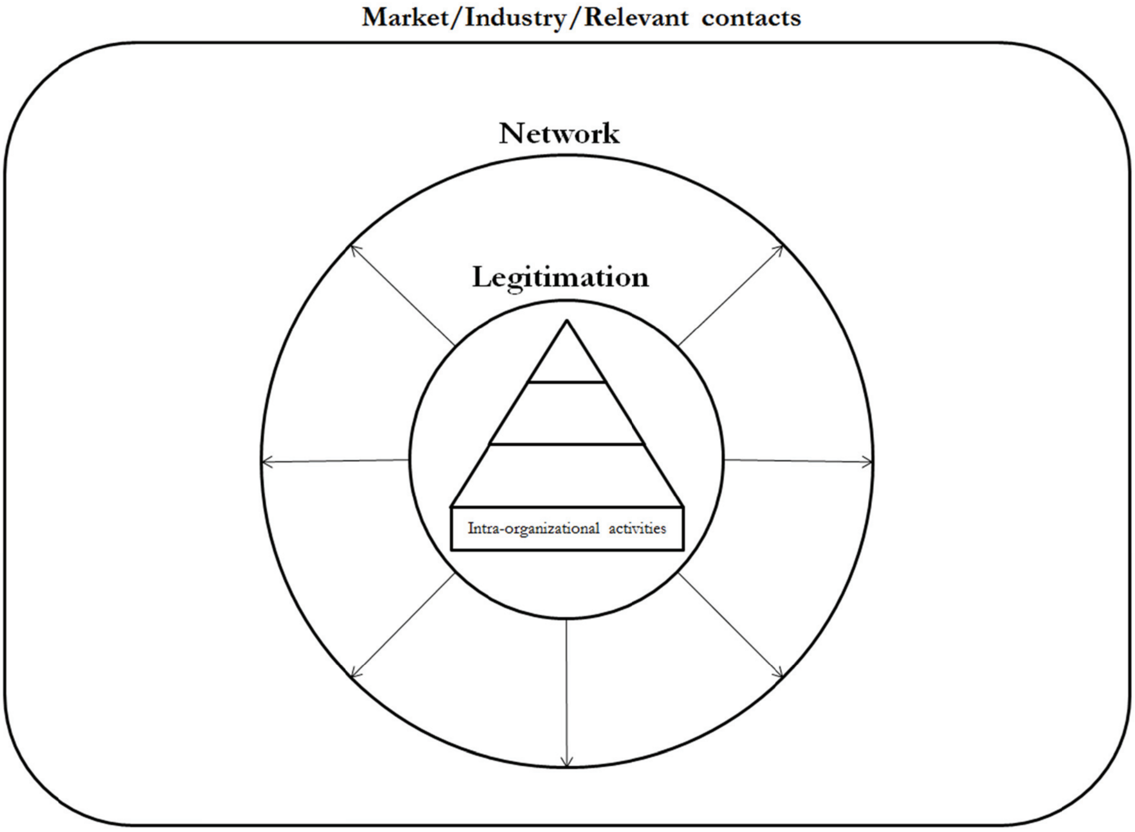


**Figure 8: Activities in a Larger Context**

The overall goal of figure 8 is not to visualize how the activities may be intertwined, but rather to see where they bring the most value and why. There are however also other factors influencing the value adding activities other than their context. For instance, the experience of the investor will highly influence the value of the industry know-how, network etc., and consequently how much value the investor may bring to the investee company. However, the properties of the entrepreneur and company will also influence the potential value an investor may contribute with. In the next section we will present factors and properties influencing the non-financial contribution.

## Factors influencing value added

Factors that influence value added from the business angels to either the company and/or the entrepreneur are a complex field of study, which is demonstrated by the lack of research on this specific topic. Some researchers have focused on some specific factors, e.g Sørheim (2005) that elaborated different *attributes* of business angels and their diverging effect on legitimating the company. Although some factors are well known, none have tried to gather these factors in the field of business angels and value added, especially not in connection with different value adding activities. However, some have tried to look at several factors together in the field of VCs and value adding (Sapienza *et al.* 1992; Sapienza 1996; Jens Ortgiese 2007).

The gathering of factors is crucial because of the interconnected nature of them. The importance of this overall subject is highlighted by Politis (2008), stating that; '...how the value added contribution of business angels may be influenced by different conditions in the internal or external environment of the venture is an issue that is of great relevance to consider.' Politis

(2008) further argue why this is in fact so. Firstly, it '...may enhance the scholarly understanding of the process in which their [...] value added contributions can become effectively implemented and incorporated in the ventures in which they invest'. Secondly, she emphasizes the importance of a foundation that enables research on business angels and value added, to be validated and compared across different contexts. Thirdly, she highlights that value adding roles as they are presented in research today are fundamentally static and do not consider that value adding may vary from various conditions. It is a dynamic relationship between the investor, entrepreneur and company that varies with context and condition. The context and condition are important in this field of research, and next section will try to quantify the context and condition into different factors.

The paper divides different factors that influence the value adding activities in the subsections; *Attributes* and *Relational properties*. As elaborated earlier, the purpose is to explain *why* and *when* business angels might add value. Most data are collected from other research papers on business angels and value added. However, due to lack of literature regarding influencing factors and business angels, some factors are cited from research on VCs.

The *Attributes* are specific properties and characteristics affecting the value added concerning respectively the investor, company and entrepreneur. The *Relational properties* between them relate to characteristics of the relationships between the players, and how this affect the value added. *Relational properties* are not defined until after the investment and are separated from the specific *Attributes*.

## Attributes - investor

***Degree of involvement:*** Ardichvili *et al.* (2002) proposed active vs. passive investor as an important property of investors affecting the actual value added. For instance, a passive business angel will to a large extent just attend board meetings, and as such solely perform the sounding board/strategic role, which again affect which human resources the business angels add to the business. However, passive business angels are likely to become actively involved, on a daily basis, during periods when the company is experiencing difficulties (Mason and Harrison 1996). This suggests that the performance of the company is another *attribute* of the company determining both the involvement and value added by the business angel. Active business angels also tend to be involved to a greater extent in strategic decisions than on a day-to-day basis (Politis and Landstöm 2002), and often use their knowledge, skills and experience to monitor, manage and control the investment in a more hands-on way than passive investors (Mason 2002)

A parallel may also be drawn to value added by VCs. MacMillan (1988) made an interesting comparison on the value added from VCs, depending on their level of involvement ('Laissez Faire', 'Moderate' and 'Close Tracker'*)* compared to the entrepreneur. They also compared the level of performance as a result of the level of involvement. He suggested that the lowest degree of involvement (Laissez Faire*)* occurred in those activities concerning the ongoing operation, while being a Close Tracker investor often took part of a sounding board. Fried and Hisrich (1995), with some of the same categorization as Macmillan (1988), concluded that high involvement VCs were more involved than low effort VCs in soliciting customers and distributors, developing professional support groups and obtaining alternative sources of financing. They also found high involvement VCs to be more involved in developing actual products or services and in formulating marketing plans and monitoring operating performance.

Interestingly enough, the entrepreneurs seem to report less involvement from the investor than the investor himself (Macmillan 1988).

The boundaries between active and passive business angels are blurred (Macht and Robinson 2009), where some scholars (e.g. Sapienza *et al.* 1996) describes passive business angel as provision of financial investment only, whereas active business angels is described as supplying non-financial value added to the company. However, in this study, we consider both passive and active investors to contribute with non-financial support, where active and passive investors are two extreme points of the degree, level and frequency of the involvement.

***Extensive vs. Limited experience - investor:*** There is little doubt that the potential value added is largely dependent on the experience which the business angel possess, and that experience highly influence the possibility for the investor to actually add value to the venture. As elaborated earlier, business angels are often cashed-out entrepreneurs, with industry specific knowledge and/or general business acumen acquired through their former business activity. Business angels are a heterogeneous group of investors, some more experienced than others. Less professional investors can work against the investee company, leaving negative value added (Madill *et al.* 2005).

However, a distinction should be made between experience and the knowledge thereby acquired (Reuber and Fischer 1994). The business angels' experientially acquired knowledge is the basis for the potential value adding, not the experience alone. A business angel may have experienced a lot through their professional life, but if it has not been transformed into knowledge through experiential learning (Kolb 1984), the ability to share valuable advice to the entrepreneur may have been weakened. Thus, this distinction should be kept in mind when analyzing how prior experience influences the business angel's value adding.

Because of the potentially broad experience a business angel might have, it is reasonable to divide the experience in some distinct categories. Jens Ortgiese (2007) identified four different experiences of VCs that could influence the value added, a division that may be applicable for business angels;

- *Investment experience:* The experience gained from working with different investees is an important influencing factor, because of the increased level of understanding how and when to add value. Sapienza *et al.* (1996) did, interestingly enough, not get empirically support for the assumption that VCs with extensive investment experience add more value. However, it is on the part of business angels, who are less financially motivated, reason to believe that they are not comprehended as 'financial MBA-types', thus not decreasing the entrepreneur's receptivity towards involvement.
- *Entrepreneurial experience:* The business angels experience in entrepreneurial activity is often quite good, as said earlier. It is reason to assume that this experience makes the investor more equipped in handling entrepreneurial and strategic issues, thereby adding value. Mason and Harrison (1996) suggests that the business angels involvement can be seen in light of their entrepreneurial drive and experience gained from working with new or growing ventures.
- *General Management experience:* Several studies have pointed out that most business angels have management experience from previous ventures and organizations (Aernoudt 1999), which seems to provide an important basis for adding value (Freear *et al.* 1994;

Politis and Landström 2002; Mason and Harrison 1996). Most previous research have reported assistance in general management as an important value adding activity (Lumme *et al.* 1998; Tashiro 1999; Brettel 2003)

- *Relevant Industry experience:* This is maybe the most valuable experience (Sætre 2003) related to adding value. Through industry experience the business angels are better situated in adding value because of their presumably larger knowledge base. Further, extensive industry experience would increase the investor's ability to offer relevant contacts as well as have the ability to place the investee's product or service in the right market context. Sapienza *et al.* (1996) found that VCs with operating experience in the investee's focal industry added significantly more value than those with less industry-specific experience. Their study also indicated that the interaction between the VC and entrepreneur were more frequently when the VC had great experience in the investee's industry.

***Lead vs. Non-lead - Investor*:** Business angels often syndicate deals, which mean that they invest on the same terms. In these cases one of the angels will often be the lead investor, which often negotiates the terms with the investee company on behalf of the rest of the investors. The lead investor will often visit their company more frequently than a non-lead investor (Zacharakis 2011), and will also often make the biggest investment. In addition, lead investors often take a more active role in securing further finance (Sørheim 2005). Connected to this is the amount invested and how financially tied the investor is to the company. It is reasonable to assume a greater need to both control and add value when a significant amount is invested. Similar notion were suggested in VC-research (Gomez-Mejia *et al.* 1990).

***Business angel group vs. Solo business angel:*** Whether or not the business angel is part of an informal angel group, a syndicate deal or operating alone may also be an influencing factor. Solo business angels dominates the informal venture capital market, however there is evidence suggesting that business angels to a greater extent are syndicating deals (Sohl *et al.* 2003; Mason 2008).

The value adding contribution on the part of business angel groups are largely unexplored. However, it is reason to believe that the ability to add value for an angel group is much greater compared to the single business angels, due to the broader range of business expertise and experience (Mason 2008). The likelihood of acquiring further finance from VCs for the angel syndicates companies is assumed to be higher because of their professionalism and quality (Mason 2008), compared to individual angel which have less credibility (Harrison and Mason 2000).

As a comparison towards the more professional business angel groups in regard of size, the large VC-firms provided the least, and the medium-sized firms the most assistance to portfolio companies (Fried and Hisrich 1995).

***The degree of track record - investor:*** This factor is somewhat connected to the experience and number of investments the business angel have done, but mostly the reputation the business angel have both in the entrepreneurial community, but also in the venture capital community. An investor's reputation or track record will strongly affect how he/she can contribute to the process as facilitator for further finance (Sørheim 2005).

It is also reasonable to assume that reputation have a positive effect on the reciprocity entrepreneurs have towards involvement, further motivating the business angel to become more involved. A well-known business angel's ability to add value is also most likely good, and would probably be highly appreciated when adding value.

***Motivating factor for the investor (financial vs. social):*** Evidence show that business angels' investment are primarily motivated by financial returns (Macht and Robinson 2009; Ehrlich *et al.* 1994) made on the serial entrepreneurial CEOs, stating that none of the business angels were primarily motivated by participating in the entrepreneurial process. When this is the case, the business angels do not become actively involved to a great extent. However, business angels that are solely motivated by financial return may become incentivized to become more involved in the company if that involvement can support their main goal of a substantial return (Landström 1992).

***Industry specific vs. regional focus - investor:*** Previous research suggests that most business angels generally are not very concerned about industry sector, but they need to understand the generic business (van Osnabrugge and Robinson 2000). Their concern is more related to the geographic aspect, and invests in companies close to them (Mason and Harrison 2000). However, some business angels specialize in specific industries (Landström 1993). Some entrepreneurs even consider industry specific business angels to be most valuable, and assume they will add significant value to the company in which they have invested in that specific industry (Sætre 2003). This is supported by Sapienza *et al.* (1996), who found that VCs with experience in the ventures focal experience added significantly more value than those with less industry-specific experience. Nevertheless, strategic involvement in young companies requires general business acumen rather than industry specific experience (Mason and Harrison 1996).

## Attributes - company

***Early stage vs. Late stage investment:*** The value added depends greatly on whether the business angel invested in a late or early stage (Gorman and Sahlman 1989). The type of involvement needed in the ventures vary during the ventures' life cycle stage, which affect the value added by business angels (Flynn and Forman 2001). For example in the early stages, ventures often need to negotiate various legal and governmental issues, and to a greater extent establish relationships with suppliers and distributors, than in the later stages. In addition, the managerial skills of the entrepreneur (who in most cases is not a professional manager) may not be enough to cope with the growing demands of the business (Meyer and Dean 1990), consequently it would be a need for advice regarding general management experience from the business angel.

Little research has been made on business angels concerning this factor, although some VC-research has been made. It was reported in these studies that the earlier investment stage, the VCs had more interest in ventures built upon proprietary products and high growth markets, and added more value because of the high business risk and uncertainty (Sapienza *et al.* 1996). Early stage investors had also greater emphasis on recruiting managers, while late-stage investors seem to be more concerned with the market acceptance gained by the venture. However, late-stage investors seem to use more time evaluating potential investment, but after their investment, time spent with the investee company did not differ much with early stage investments (Fried and

Hisrich 1995). MacMillan (1988) supports this, claiming little variance by stage (*seed, startup, growth* and *late*) for any of the 20 value adding activities reported in his study.

***High vs. Low level of Innovation - the company:*** Presumably, the higher degree of innovation in the venture, the greater is the demand of value adding activities that could be provided by the business angel. However, business management advice is not highly valued by the entrepreneur that pursues more technical innovations (Barney *et al.* 1996).

Timmons and Bygrave (1986) evaluated the difference between *High-* (HITV) and *Low-Innovative Technological Ventures* (LITV). His results point out that VCs, which may be compared to the business angels' mindset, invest on much earlier stage in HITV than in LITV. Thus this property is highly connected to the property above, which further influence the value added from the business angel, with a more intense and early involvement.

***High vs. Low Performance - the company:*** The degree to whether the company is performing relative to the investors presumption may influence the business angels wish to add value and to contribute in the venture. However, because business angels invest at such an early stage, the venture's path is not yet determined. Thus, it is not easy for the investor to determine whether or not the company is under- or over performing. Notwithstanding, if the business angel perceive something that can determine the performance, it is not unlikely that they will adjust their value adding and monitoring. The question, together with *if* they adjust, is *how* they adjust?

Research regarding this question on VCs is twofold; on the one hand, the VC desires to add value to portfolio companies that performs poorly to reduce business risk and protect their investment (Gomez-Mejia *et al.* 1990). On the other hand, they wish to devote significantly more time and value to companies that perform well, in order to realize substantial returns on their investment (Sahlman 1990; Sapienza *et al.* 1996). Obviously enough, who does not want to be a part of a winning team? Considering business angels, it would probably have the same twofoldness but with more social motives. Thus, there were reported some interpersonal contributions such as 'lifting the spirit' and 'sharing the burden' (Mason and Harrison 1996), presumably in tough periods.

The performance of the company would also most likely influence the entrepreneur's receptivity towards and need for involvement from the business angel (Sapienza *et al.* 1996), however Barney *et al.* (1996) did not find evidence for this assumption.

## Attributes - entrepreneur

***Experience - entrepreneur:*** The experience of the entrepreneur would also influence the non-financial value adding from the business angel, together with the entrepreneur's ability to benefit from information received from the business angel (Cohen and Levinthal 1990). The experience term should, as the experience of the investor, be divided. Different experience may influence value adding differently. For this reason, Jens Ortgiese (2007) divided the entrepreneurs experience in four distinct categories:

- *General Management experience:* The entrepreneurs' ability to manage the venture would influence the business angels need to assist in a managing role and give managing advice. The general management experience in regard to the entrepreneur is often limited.

Consequently, the value added in cases where this experience is extensive, would decrease relative to other cases.

- *Relevant Industry experience:* It is reasonable to assume that entrepreneurs with extensive industry experience to a greater extent can leverage from the information provided by the business angel. However, extensive industry experience may also lead to low receptivity towards involvement, viewing it as an affront of their expertise (Jens Ortgiese 2007).
- *Entrepreneurial experience:* Most entrepreneurs are technically oriented, and lack both management and entrepreneurial experience. Closing this gap could be a significant contribution from the business angel to the entrepreneur and company. As stated earlier, entrepreneurs that have high level of competence in both business and technology do not need or wish to have a lot of active support from business angels (Kelly and Hay 2001).
- *Overall Team Tenure experience:* Entrepreneurs often commit themselves to work together in ventures if the previous experience with working together were successful (Cooper and Bruno 1977; Roure and Maidique 1986), where they develop mutual trust among them (Hambrick and Fukutomi 1991). The degree to which the entrepreneurs, or the new venture team, have high team tenure experience they tend to already have established operating patterns that may influence the receptivity towards operational advice from the investor negatively (Barney *et al.* 1996), further decreasing motivation to give advice on behalf of the business angel. If the business angel perceive that the entrepreneurs have good team experience from previous or current ventures, he or she may feel pestering or not 'one of them', thus be more reluctant to involve because of their social uncomfortableness.

***High vs. low receptivity towards involvement - entrepreneur:*** Entrepreneurs differ to a large extent in their desire to involve business angels in decisions and their desire to learn and share experience with the investor. The investor can only add value if the entrepreneur is responsive and keen to learn (Sapienza *et al.* 1996; Barney *et al.* 1996). This is often connected to the track record and experience of both the entrepreneur and the investor (Barney *et al.* 1996). An entrepreneur with limited track record and experience would probably be more receptive to receive advice and involvement from the business angels, than an entrepreneur with extensive track record and experience. This is also related to the experience of the investor, and his/hers ability to add valuable knowledge to the entrepreneur.

The diverging perspectives of the investor and entrepreneur regarding the operationalization of the venture will also influence this factor. This diverging perspective may be productive as of two different perspectives leading to an improved perspective, but may also be counterproductive if the two perspectives is incompatible and further decrease the receptivity towards involvement (Sapienza 1992).

Receptivity may be seen as the 'need for assistance', a term used in several studies (e.g. Sapienza *et al.* 1996). It is reasonable to assume that if the venture perceives a need for assistance, the entrepreneur will be more receptive. However, Sapienza *et al.* (1996) did not find evidence for this assumption.

## Relational properties

***Frequency of contact:*** The first *relational property* is the frequency of interaction between the business angel and entrepreneur. The more interaction between them, the higher likelihood for adding value in terms of sharing information, and the possibility of the business angel to be a part of the operation.

Many angels operate locally (Mason and Harrison 2000), however in some cases an angel will invest in a startup that is not situated locally. This affects the degree and frequency of involvement offered by the angel, solely due to the distance between them. Landström (1992) suggested that frequency of contact between angels and their investee companies is inversely related to the geographical distance that separates them. In addition, the number of investees simultaneously on the part of business angel may also influence their opportunity to be frequently in contact with one specific investee.

***The social match between the business angel and entrepreneur:*** We often consider business angel investments as business transactions, ignoring the matching and relationship rituals that cause them to happen. Why do certain business angels and entrepreneurs connect, while others fail to do so (Kelly 2007)? The motivation of sharing their knowledge and experience with different entrepreneurs is a highly personal decision, and to some extent triggered by their social connection with the entrepreneur. The *social match* is intended to cover the 'relational dimension' of social capital, accordingly the social capital related to trustworthiness, trust and motivation in social relations, as well as the structural dimension, meaning the overall pattern of connections and the tie strength (Nahapiet and Ghosal 1998).

Successful investors are often trying to build social, trusting relationships with their entrepreneurs (Sapienza 1989), with a possibility to be more motivated in assisting the entrepreneur for reasons different from economic ones (Zaheer *et al.* 1998). This may also enhance the transfer of complex tacit knowledge (Nonaka 1994), and the entrepreneur's ability to detect 'hidden' value adding skills (De Clercq and Manigart 2007).

The social match is depended on e.g. the demographic similarity, the personal chemistry and if the social bond existed before the investment was made. It is important to consider that value adding is a process, not something static (Politis 2008), however a conceptual framework for what affects these activities is important in order to assess and analyze the subject. The *attributes* and *relational properties* determining the values added are tabulated on the next page (Figure 9).

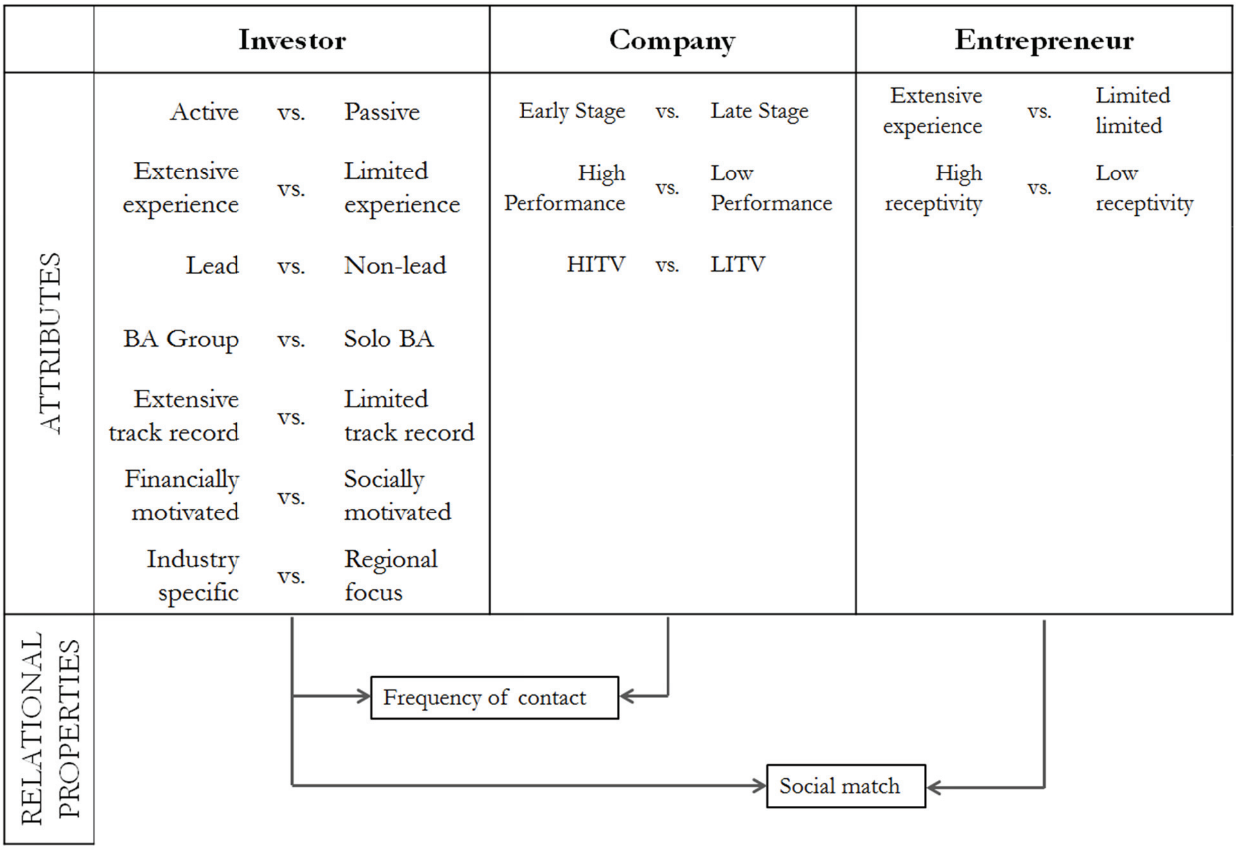


**Figure 9: Attributes & Relational Properties**

# Discussion

As mentioned earlier, the categories of activities is separated between *Intra-organizational*, meaning the activities within the company and the *Inter-organizational activities*, which is the interaction with the external environment, where the business angel provides external contacts in his/hers *network*, and increases the value of this network through legitimation (see figure 8). However, these two categories are not definite. The *Inter-organizational activities* affect the activities within the firm, and vice versa. For instance, recruiting affect several categories. It is often a consequence of the *Network* possessed by the investor (*Inter-organizational*), which again has value due to *Legitimation*. On the *Intra-organizational level,* the decision to actually recruit new personnel may be a result of a *Strategic* activity. Finally, the business angels' involvement in the hiring process is an *Operational Management* activity. Further, the *Knowledge & Support* activities business angels provide would also indirectly be a *Strategic* activity, strengthening the entrepreneurs' ability to act *Strategic,* thereby adding *Strategic* value. It is therefore important to underline that there are 'grey areas' between the value adding activities, and that the framework for value adding activities in this study represent a simplification. However, a simplification is needed in order to be able to analyze the different activities.

When it comes to the *attributes* and *relational properties* influencing the value added, figure 9 illustrates that previous research is investor-driven, with few *attributes* addressed to the entrepreneur. This leads to a limited basis for understanding the influencing role entrepreneurs have on when business angels add value. A lot of the previous research is characterized by qualitative data, where some argue that the issues addressed never directly have been measured before, thus a broader perspective is needed (Gomez-Mejia *et al.* 1990). It is nonetheless indicated that the factors presented in this study play a vital role when assessing what affects the value added.

## Conclusion & Summary

It is widely recognized that business angels contribute with both financial and non-financial value to the entrepreneurial ventures they decide to invest in. The non-financial value in form of human capital may also in some cases be more valuable than financial capital. Some entrepreneurs even view funding as a commodity (Sætre 2003), while the relevant capital an investor can bring to the table may be seen as a foundation for competitive advantage, and thus more valuable. This study tries to conceptualize the different types of valuable resources business angels typically bring to their investee companies, and also which factors determining the value added. The latter was conceptualized by addressing the *Attributes* describing the investor, company and entrepreneur, and the *Relational properties* between these, which all influence the value added activities, as well as influencing each other. The remaining question is however how and which of these factors influence these five value adding categories; *Strategy, Knowledge & Support, Operational Management, Network* and *Legitimation.*

*Strategy* contains the value adding activities that business angels contribute with regarding strategic decisions, which often takes place in the Board of Directors. Both *active* and *passive* investors attend Board meetings, but the relative portion of involvement is higher for the *passive* than the *active* investor regarding the attendance of Board meetings. The attendance will also be affected by whether there is a *lead* or *non-lead* investor, where lead investors to a greater extent would participate in Board meetings, looking after and securing their investment, on behalf of the *business angel group* if it is a syndicate investment. The possible value added in these Board meetings is further influenced by the *track record* of the investor, solely due to the possibility to actually add value to the strategic decisions. It may also be argued that the more *active* a business angel is, the more direct his/hers involvement will be. The investor will in this sense move down in the company pyramid (figure 1) the more active role he chooses to take. This is however influenced by the *receptivity* towards the entrepreneur.

Both *Knowledge & Support* and *Operational Management* are highly affected by the *receptivity* towards involvement from the entrepreneurs' perspective. As elaborated earlier, *receptivity* is influenced by several other *attributes* and *relational properties;* e.g. *track record of the investor, experience* of both entrepreneurs and investors, *industry specific or regional focused investor* and the *social match between* the investor and entrepreneur. Further, the *active* investor will probably to a greater extent take part in *Operational Management* activities than the *passive* investor. This is often well received by the entrepreneurial team if the investor is active, while on the contrary, active involvement by a passive business angel is not. This could for instance be a business angel that visit his/hers investee company rarely, but when he/she does he addresses issues related to the daily operation. The *frequency of contact* also affect the value adding categories, owing to the fact that the degree of value added probably is dependent on the ability to be present. Both *Knowledge & Support* and *Operational Management* is also dependent on the *track record* and *experience* of investor, whether or not knowledge, skills and experience possessed by the investor is characterized as business or technical acumen. Through the life cycle of the company, several influencing factors may vary, together with the need for different value adding. For instance, the *early stages* would require more technical expertise, while the *later stages* would require more business acumen, positioning the company in a competitive environment. Whether the investor is *financially* or *socially motivated* would also affect *Knowledge & Support*, since the *socially* motivated investors probably to a greater extent seeks to increase the knowledge of the entrepreneurs.

*Network* is the resource pool that enables external value adding, and the provision of relevant contacts for the investee company. This category is highly influenced by the attributes of the investor. Especially the *track record* and *experience* of the investor gives an indication of their potential contacts gained through either entrepreneurial activity or other forums where relevant contacts may be acquired. The nature of contacts is affected by whether the investor is *industry specific* or *regional focused,* further influencing the value added from the investor to the investee company.

The last category is *Legitimation.* The ability for the investor to add legitimation of company, decrease the 'liability of newness', increase the value of the *network* of both the entrepreneur and the investor and ease the process of further finance is highly influenced by the *track record o*f the investor and the reputation that may cause. Further, *legitimation* could also be affected by whether it is a *industry specific* or *regional focused* investor. The *track record* of the investor has different value in the *industry* compared to the *regional* area, meaning an investor with *regional focus* and *extensive track record* in the region would most likely add greater value of legitimation towards regional stakeholders than *industry specific investors* without the *extensive track record* within that region.

The categories are listed below together with the influencing *attributes* and *relational properties* in table 2 on the next page.

| Category | Influencing attributes & relational properties |
|---|---|
| **Strategic** | • Active vs. Passive Investor<br>• Lead or non-lead investor<br>• Track record of the investor<br>• Experience – investor<br>• Receptivity – entrepreneur<br>• Early stage vs. late stage – company |
| **Knowledge & Support** | • Receptivity – entrepreneur<br>• Active vs. passive investor<br>• Geographical distance<br>• Track record - investor<br>• Experience - investor<br>• Experience - entrepreneur<br>• Early stage vs. late stage – company<br>• Financially or socially motivated - investor<br>• Frequency of contact |
| **Operational Management** | • Receptivity – entrepreneur<br>• Active vs. passive entrepreneur<br>• Experience - investor<br>• Experience - entrepreneur<br>• Frequency of contact<br>• Early stage vs. late stage - company |
| **Network** | • Track record of investor<br>• Industry specific vs. regional focus - investor |
| **Legitimation** | • Track record of investor<br>• Industry specific vs. regional focus - investor |

**Table 2: Activities, Attributes & Relational properties**

## Implications & Future Research

This paper presents a conceptual framework for value adding activities and the factors influencing the value added based on previous research. Consequently, it has some shortcomings as it lacks empirical evidence. It should also be mentioned that some factors are supported by research on VC's only, which should motivate for further research in regard of business angels. The degrees to which the different factors influence the value added are highly uncertain. However, these proposed *attributes* and *relational properties* provide a basis for future research and should be considered when evaluating and analyzing the value added by business angels in entrepreneurial ventures.

In addition, perhaps the most important question in business angel research still remains unanswered. What is the effect of business angels' hands-on involvement on the performance of the business (Politis 2008)? And what is the operationalization of the different activities? We therefore suggest that future research should enrich and analyze the frameworks in this study with empirical data. As studies on business angels have primarily been conducted using postal questionnaires and have been largely descriptive with very limited theoretical background (Politis 2008), the most logical way to approach future research will be through a qualitative study. Additionally, future researchers should consider making use of more theory-building case studies (Eisenhardt 1989; Yin 2008), in order to gain a clearer understanding on the operationalization of business angel involvement, and how and why they perform certain activities in different settings.

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# Paper 2: How Do Business Angels Add Value?

**Authors:**

Lars Dybvik
Marius Monsen Ragnøy
Ragnar Andreas Severinsen

Norwegian University of Science and Technology
Department of Industrial Economics and Technology Management

## Abstract

This study explores which value adding activities business angels take part in and how these are performed to the investee companies. Through a multiple-case including ten business angels, where each candidate presented one or more investment cases resulting in a total of 15 business cases, we confirm that value adding activities may be divided in three categories depending on the degree of direct involvement; *Strategic, Knowledge & Support* and *Operational Management*. While all the business angels take part in the *Strategic* activities, only a few perform activities within *Operational Management*. We also provide an in-depth explanation to how these activities are performed. In addition, we find, in contrast to previous research, that *Network* and *Legitimation* are not activities performed by the investor, but rather channels in which other activities may be performed.

## Introduction

Business angels are private investors and individuals who decide for himself/herself to invest their own money and experience in entrepreneurial SMEs with which they have no family connection, and choose to have an active role in the further development of the venture. It is widely recognized that business angels provide their investee companies with non-financial value in addition to funding, and that they are actively involved in the ventures they invest in, both due to social motivation, but also to control the investment (Ardichvili *et al.* 2002; van Osnabrugge 2000). Previous research on business angels and value added have focused on identifying what value adding activities they undertake and what types of value adding roles they take (e.g. Harrison and Mason 1992, 1996; Ehrlich *et al.* 1994).

Even though these contributions, which are not only focused on the characteristics of the business angels (ABC-studies), have brought the research field forward, there are still gaps to be filled. For instance, the post-investment phase is one of the most under-researched areas in the study of business angels. This calls for intensified studies and further theory development (Politis 2008). An important avenue for future research is to a develop robust operationalization of business angels´ involvement in the different value adding roles (Politis 2008), and the purpose of this study is to shed light on the operationalization of the different value adding activities and how these are actually performed in order to add value to the investee companies. This will drive the research field in a direction where future researchers may be able to assess the effect of business angels' hands-on involvement. Assessing the effect of business angels' hands-on involvement will be difficult as long as the question; *how the value adding activities performed and what are the outcome* remains unknown. A question that is important to answer in order to understand, streamline and incentivize the informal venture capital market. This study argues that by providing future researcher with a framework for value adding activities and an in-depth explanation for how these activities are performed, the possibility to assess the effect of the hands-on involvement by business angels will increase.

To answer how the value adding activities are performed we firstly go through relevant literature and present a conceptual framework for value adding activities. We then give an in-depth explanation for how these activities are performed, and the potential outcome of the different activities. By combining the findings in this study with previous research we propose a revised framework for value adding activities. Lastly, we summarize the findings and suggest where future research should be undertaken and what the focus of this research should be.

## Literature review

Previous research has reported several value adding activities, as well as categories that they may be placed in. For instance, Munck and Saublens (2005) identified four categories in which business angels can benefit their investee companies; *help overcome funding difficulties, use of human capital to provide skills and expertise, use of social capital to provide network* and *increase investee´s opportunity to acquire further finance*. Ardichvili (2002) however only categorized the activities into *passive* and *active involvement*. Further, Madill *et al.* (2005) presented six categories of value adding activities that CEOs in different angel-invested companies reported; *advice, contacts, hands-on assistance, boards of directors & advisors, market business intelligence* and *credibility/validation*. Lastly, Politis (2008) identified four categories; *sounding board/strategic role, resource acquisition role, supervision/monitoring role* and *mentoring role*, and linked these roles to a set of value adding activities based on 14 empirical studies published between 1992 and 2005.

By combining the previous literature we present a listing of activities in which business angels take part. We have then categorized the activities in either *Intra-organizational context*, meaning the activities within the company, and the *Inter-organizational context*, meaning the activities that interact with the external environment. The result is a conceptual framework for value adding activities (see table 3 on the next page).

The *Intra-organizational* activities have further been categorized depending on the type of involvement and whether or not the activities performed are *direct* or *indirect*. *Indirect* involvement is instructing, mentoring or coaching how to do a certain activity, while direct involvement is actually participating in the activity. The categories range from high-level and indirect involvement (*Strategy*) to low-level and direct involvement (*Operational Management*). Similarities can be drawn to basic management theories, defining management as top-level, mid-level or first-level. This is due to the fact that *Strategy* includes a broader perspective and scope than daily management, but also include a lower degree direct involvement as business angels contributing only with strategy is less involved in the daily operation than business angels contributing with *Operational Management* and *Knowledge & Support*.

Inter-organizational activities are linked to the external environment of the company, where the business angel provides external contacts in his/hers *Network,* and increases the value of this network through *Legitimation* and the outwards image of the company. Although the five categories presented represent a distinct division of the different value adding activities, they should be seen as complementary and internally linked to each other, where one category may lead to, influence and enhance the effect of another category.

| | Categories | Activities | Authors |
|---|---|---|---|
| INTRA-ORGANIZATIONAL | Strategic | - Formulating marketing plans<br>- Testing or evaluating marketing plans<br>- Serving as sounding board to entrepreneur team<br>- Help with the business concept or model<br>- Strategy<br>- Strategic advice<br>- Serving as sounding board (evaluation of product-market activities, development of marketing plans, original business strategies and products) | MacMillian (1988)<br>Ehrlich et al. (1994)<br>Ardihcvili (2002)<br>Brettel (2003)<br>Harrison & Mason (1992)<br>Harrison & Mason (1996) |
| | Knowledge and Support | - Monitoring financial performance<br>- Monitor operating performance<br>- Advice and counsel (in marketing, finance and accounting, and general management)<br>- Management know-how<br>- Financial know-how<br>- Marketing know-how<br>- Industry know-how<br>- Industry knowledge<br>- Motivating personnel<br>- Coaching<br>- Personal development<br>- 'Lifting the spirits', 'sharing the burden' and 'providing a broader view' | Ehrlich et al. (1994)<br>Harrison and Mason (1992)<br>Harrison & Mason (1996)<br>MacMillian (1988)<br>Brettel (2003)<br>Sætre (2003) |
| | Operational Management | - Managing crises and problems<br>- Selecting vendors for equipment<br>- Developing production or service techniques<br>- Developing actual product or service<br>- Soliciting customers or distributors<br>- Negotiating employment terms with candidate<br>- Interviewing and selecting management team<br>- Solicit customers/distribution<br>- Management<br>- Searching for candidates of management team*<br>- Replace management personnel*<br>- Recruitment of management* | MacMillian (1988)<br>Ehrlich et al. (1994)<br>Ardichvili (2002)<br>Harrison & Mason (1992) |
| INTER-ORGANIZATIONAL | Network | - Provision of contacts<br>- Develop professional support group<br>- Social network connections<br>- Network and contacts<br>- Networking activities | Munch & Saublens (2005)<br>Ehrlich et al. (1994)<br>Ardihcvili (2002)<br>Brettel (2003)<br>Harrison & Mason (1996) |
| | Legitimation | - Reduce the "liability of newness" and thus increasing the apparent track record for the entrepreneurial team<br>- Help overcome funding difficulties<br>- Facilitation of further funding<br>- Obtaining alternative sources of debt financing<br>- Obtaining alternative sources of equity financing<br>-Interface with investor<br>-Other sources of funds<br>-Capital | Sørheim (2005)<br>Munch & Saublens (2005)<br>MacMillian (1988)<br>Ehrlich et al. (1994)<br>Ardihcvili (2002)<br>Brettel (2003) |

**Table 3: Value Adding Activities**

# Methodology

## Research design

The research design for this study is a multiple-case including ten business angels, and each candidate presented one or more investment cases each resulting in a total of 15 business cases. In addition, two attempt candidates and one context giver have contributed to the preparation and interpretation of the data. One of the attempt candidates has been included in the analysis. In contrast to single-case studies, multiple-case studies allows for replication logic, which reduces the problem of *external validity* and thus apply for greater *generalizability* (Yin 2008).

## Design

Informants have been used to get in touch with relevant interviewees. The informants have been investors in business angel networks, the environment around Norwegian University of Science and Technology and other private contacts. We asked for names and/or contact information to "active" and "lead" Business Angels and collected some 30-40 potential candidates. Some of the candidates were gathered by the "snowballing" technique. All candidates were collected in a table with contact information, geographical location and background based on Google searches and conversations with informants. Further on, this information was used to screen relevant investors, which was to be contacted. The main focus was to find active investors that were able to highlight value-adding activities and to provide a specter of activities. Giving a random sample has not been a goal for this study. Following Eisenhardt's (1989) suggestion that the ideal sample size for a case study is between four and ten cases, we decided to aim for 15 cases due to the risk for dropouts. This resulted in 15 cases.

To get an in depth-overview we have chosen a qualitative study with the goal to increase the understanding on how business angels add value. Investment cases often contain disclosed data that should not be released to e.g. competitors. Without the chance of hidden data that may be valuable for this study, the interviewees were given the promise of confidentiality.

The theory on business angels and value added outlined in this paper will be used a theoretical framework and a starting point for the research. We have selected cases where investors have taken a more or less active role in the post-investment period. To minimize potential errors and biases in the study we used two test-interviews to improve our technique and to establish a case study protocol. The case study protocol is a major way of increasing the *reliability* of the case study research (Yin 2008). Our protocol included a standardized procedure for doing interviews and a template for handling transcription and the work on collected data. After test-interviews and feedback round was completed we changed the protocol according to the experience.

## Data collection

The main source of data is 12 interviews accomplished between February 16th and March 20th 2012. Two of the interviews were related preparation and for giving the study context. Ten of the interviewees were Norwegian private investors located in Norway, Sweden and the US, where three were conducted through Skype and seven face to face. Nine of the interviews were taped and transcribed while one were only recorded by hand as the investor did not want to be recorded on tape. The transcription was conducted as a combination of direct and selective method, and constitute of a total of 87 pages. In addition both written and verbal data has been used to prepare for interviews and to support the findings. All interaction with informants has been written down in a contact log to keep track on a total of 94 conversations, including 39 different persons.

## Overview of data sources

### Investors

| Interviewee | Overview |
|---|---|
| **Ned** | Ned has invested actively in several new ventures, and he views this as his professional business. He dedicates all his time to this through screening and follow-up on his investments, and he never invest if he cannot contribute with non-financial value to the startup. Despite this fact he rarely share offices with the founders, he is situated at own offices, which he shares with other investors. Ned also invest, for the most part, industry specific and his experience range from IPO processes, M&A, fund raising, due diligence, crisis management, general operation and strategic planning. |
| **Grant** | Grant has experience as a business development consultant in a management-consulting firm. Together with a few other investors he has started a small investment company, where they actively invest in startups with both financial and non-financial value. They often take the part as CEO in the investee company and provide the full range of activities in order to accelerate the maturation of the company to attract venture capital and/or exit/trade sale. They call this *early stage management*. |
| **Marc** | Marc is an investor, serial entrepreneur and former financial analyst. He has, for over two decades, founded or participated in the establishment of several new ventures. He focus on building the company over a period of five years, invest only in certain sectors and seek synergies between existing investments. Marc has more than 15 years of experience in building international businesses. |
| **Blake** | Blake is an investor, serial entrepreneur and keynote speaker. He wants to be actively involved in the investee companies. However, he ensures that he is not too involved in the operational management since his intention is not to replace the entrepreneurs. He has experience within product, market and business models. His contribution depends on the entrepreneurs' competence and skills, as he wishes to complement the entrepreneurs' expertise. |
| **Phil** | Phil has invested in new ventures, both as a private investor (business angel) and through a venture capital fund, the last 10-15 years. Prior to this he founded a technological oriented company and sold his stake some 10 years ago. Consequently, he has experience both as an entrepreneur and competence in building businesses, and also as an investor. He typically enters the board of directors, assists in strategic planning, recruiting and facilitate further finance. |
| **Arron** | Arron is a former entrepreneur and invest in new ventures through a collaborative investment company (3 employees). They combine a financial investment with an active, hands-on, day-to-day management approach, primarily focused on sales and marketing, in order to help the investee companies achieve a breakthrough in terms of sales and international deal making. He has experience in building new ventures, and also focus on industry specific investments. |
| **Paul** | Paul is a cashed out entrepreneur that invest his own wealth in businesses, both startup companies and in stocks. He was an active business angel ten years ago, but has reduced the number of investments the last five years due to a lack of return on investment and because he no longer believes that early stage investments benefit the company. Paul has experienced that investments reduces the companies' ability to get competitive. |
| **Neil** | Neil has background from running a contracting company, and he has invested actively in eight new ventures from the local university environment after an exit in the early twenties. He typically enters the role as an CFO by taking responsibility for paying bills |

| | |
|---|---|
| | and salaries, preparing financial statements and doing annual accounts. If the company runs out of cash, he provides loan. If the entrepreneurs are tired, he forces them to go on vacations. In that way he controls the venture, and is also a caring 'parent' for the entrepreneurs. |
| **Nick** | Nick has experience and a fortune made from real estate. Over the last five years he has invested in local start-up companies to contribute to the local society. Nick stated that venture capitalists are greedy, and that his experience with generating profit is an important competence, and at least as important as making clever term sheets with entrepreneurs. The investments are placed in tech startups both close to the company location and to his hometown. After several not so successful investment, Nick has decided to get more involved with the ventures he invest in. |

**Table 4: Investor Overview**

## Attempt candidates and context contributors

| **Interviewee** | **Overview** |
|---|---|
| **Mac** | Mac was the first attempt candidate we interviewed in the early stages of the data collection. He served, for the most part, to test and further develop the case study protocol. However, he did bring interesting data to the table, and is therefore included in the paper. Mac has experience from case study research at the local university and a diverse management background from both public and private sectors. He also has his own consulting company, which helps entrepreneurs in the startup phase. |
| **Jack** | Jack is an attempt candidate we interviewed in the early stages of the data collection. He served to further develop the case study protocol. Jack has hands-on experience as an executive manager, as an investor and entrepreneur. He has been involved in the formation, fundraising, and business development of several new ventures. He is highly involved in the local university. |
| **Bryan** | Bryan has contributed with context and a "real life-check" of our results through the analysis phase. Bryan have more than 35 years of experience as a serial entrepreneur, CEO, CTO and business developer. The last years he has been partner in a innovation community with responsibility for funding through private investors. |

**Table 5: Attempt Candidates**

## Analysis setup

The analysis started out by structuring the research data in a large table, organized by interviewee. Findings and results were parted into nine columns; *interviewee, reported activities, properties affecting the activities, quotes, comments, how this affect the value added, why this affect the value added, role* and *follow up*. The most important findings were collected in each cell. Our second strategy was to organize the findings first by *attributes* of the investor, second by *the reported activities* and lastly by *the investor role*. Columns were *investor, case description* and *discussion/possible rival explanations/theory*. This table was completed with eight attributes, 15 activities and six roles. The empirical data was in many cases coherent with the data from previous research presented in table 1, which increase the *internal validity* of the study (Yin 2008).

After the data was analyzed we presented them for Bryan and he gave feedback in accordance with his view on business angels. He did to a large extent *construct validity* by confirming that the framework and the reported findings coincide with his understanding of business angels and value added (Yin 2008).

## Limitations

Firstly, the authors have developed the framework forming the foundation for this study. Consequently, the analysis of the empirical data may to some extent biased as the authors unknowingly, and unconsciously, are attracted to prove the framework, forcing the categories on the findings and not vice versa. To deal with this fact, the authors have focused on asking questions that not "forces the interviewees into the framework". By asking the interviewees to walk us through their investment cases, we believe the responses constitute correctness.

In addition, the interviewees do not reflect a representative sample of business angels. However, all the business angels in this study are actively involved in their investee companies, and the purpose of the study is to explain how the different activities are performed in a qualitative manner, not how frequent the activities occur.

# Results

## Overview of reported activities

| Investor | Background | Activities |
|---|---|---|
| Mac | Investor and Researcher | - Strategy<br>- Mentoring<br>- Dialog with customers |
| Ned | Investor | - Network<br>- Credibility<br>- Recruiting of board members<br>- Establishing investment teams with complementary skills<br>- Financial activities<br>- External processes |
| Grant | Investor and Business development consultant | - Strategy<br>- Customer processes<br>- Operational roles as CEO<br>- Legitimation<br>- Network<br>- Further financing |
| Marc | Investor, Serial Entrepreneur and financial Analyst | - Board participation<br>- Financing<br>- Customer focus<br>- Networking<br>- Motivating entrepreneurs |
| Blake | Investor, Serial Entrepreneur | - Product development<br>- Market development<br>- Business model formation<br>- Board participation<br>- Networking<br>- Pricing strategy<br>- Mentoring |
| Phil | Investor and Entrepreneur | - Board participation<br>- Strategy workshops<br>- Recruiting |
| Arron | Investor and Entrepreneur | - Market development<br>- Dialog with customers<br>- Strategy formation<br>- Operational activities |
| Paul | Investor and Entrepreneur | - Board participation<br>- Implementation of measurement systems<br>- Controlling financial performance<br>- Motivating entrepreneurs |
| Neil | Investor and Contractor | - Legitimation<br>- Auditing<br>- Financial activities<br>- Customer processes<br>- Mentoring |
| Nick | Investor within Real Estate and venture | - Board participation<br>- Financing<br>- Customer processes |

**Table 6: Reported Value Adding Activities**

## Activity categories

The framework presented in table 1 provides an overview of activities investors may participate in. The framework is based on a literature study on business angels and value added. The purpose of this study is to gain overview of the activities business angels take part in, how these are performed and also present a framework in which all activities may be placed. Many of the reported activities in previous research are the same even though the different business angels call it by different names (supported by Large and Muegge 2008), who found that when an input was reported in multiple studies, the terminology varied). Variants on *'management recruitment'* include *'helping to find and select key management team members'* (Timmons and Bygrave 1986), *'recommending staff to hire'* (Perry 1988*), 'management recruiting'* (Gorman and Sahlman 1989), *'management recruiter'* (Sapienza 1992), *'assistance with recruitment'* (Murray, 1996), *'recruitment of key personnel'* (Gabrielsson and Huse 2002) and *'recruiting an outside CEO'* (Sætre 2003). This is also exemplifies the fact that many earlier studies has suffered from a lack of consensus.

By combining table 6, which are the activities reported by the business angels in this study, and table 3 we propose a new and revised framework for value adding activities performed by business angels, which aims at covering all activities business angels offered to their investee company. This is presented in table 7. Based on these categories we will present empirical data from the case study to get an in-depth understanding of each activity. The intra-organizational activities are divided into three levels, *Strategy, Knowledge & Support* and *Operational Management*. In activities where several investors share the same viewpoint we have occasionally selected the one investor who provides us with the clearest image of the involvement.

| | Categories | Activities |
|---|---|---|
| INTRA-ORGANIZATIONAL | **Strategic** | - Strategic Decisions<br>- Structures of the Board<br>- Formulating Marketing & Business Plans |
| | **Knowledge and Support** | - Economy, Tax & Accounting<br>- Industry Know-How<br>- Marketing Know-How<br>- Customer & Partner Processes<br>- Motivating & Mentoring<br>- Further Financing<br>- Recruiting |
| | **Operational Management** | - Administrative Management<br>- Sales<br>- Customer Meetings |

**Table 7: Intra-Organizational Activities**

## Intra-organizational value added: Three levels

### Level 1 - Strategy

Strategic activities add value by setting the course for the venture by providing strategic advice to the entrepreneurs. Typical activities are helping with business model, business concept and be a part of the Board of Directors.

All the investors that are included in this paper have reported that they take a part in the *Strategy formation,* but to a varying extent. Through this type of involvement the investors do not focus much on the operational aspects of the investee company. Ned is a typical active investor on the *strategic* level, and about the role he takes in the company Ned says:

> First of all I contribute by board participation, and in that way as an active board member. I'm rarely situated with the company and entrepreneurs because that's too close. I sit in separate offices together with other private investors, and makes visits to the start-ups. It is and it will always be like that, because normally I may be running ten boards in parallel. I distribute my time along the different companies.

**Strategic decisions**

Strategic decisions are the process of providing *strategic* advice, guidance and planning on a "corporate level". It is long-term planning and a very low degree of direct involvement, however the decisions made on a high level may often result in performing other activities on a lower level. This may vary depending on the investor and entrepreneurs' expertise.

Grant tells about an investment where he had significant influence in the strategic decision and how to get the technology to the market:

> The most interesting market for this technology was probably within oil and gas, but the requirements are so strict when it comes to pressure and volumes and such. So the investor team saw biogas as a simpler technology market. We decided that we should drive market introduction to biogas.

This is a clear example on how the investor participated and contributed significantly in the overall strategic decision process. Phil also gave several examples of what he did in respect to this activity. He matches many of the characteristics as Ned, and does not co-locate with the investee company. He distributes his time on the investments mainly through board participation. Phil told about how he gave strategic advice through board participation for a venture in the seismic industry:

> I joined the Board and worked a lot for a period of time to get to know the manager. We were supposed to grow, gather capital and get the technology into the market. We discovered quite early that if this were to be a successful business we needed to go into partnership with one of the major players. There are three major players in the seismic industry and we also looked at these as appropriate exit candidates.

Phil was a major opinion holder in this decision making process. Further on he said:

> We had to bring in a CFO to get control of the money. And we were also very keen to get into some good sales resources so that we could sell the venture to one of the seismic companies. We

> were very much involved in those decisions. So we decided to recruit a new chairman. We who were to invest in this, we contributed significantly to getting them on track.

To clarify, Phil gave corporate advice on potential partners and exit-candidates, but also saw what the investee company needed in order to perform satisfactory. As a result he was also engaged in the recruiting of a CFO and took an even more direct involvement in the sales process.

Paul has a different aspect and procedure when it comes to strategic decisions. He mainly contributes to the venture through the board. He gave an example where he was involved in a company as an active investor on a strategic level. Since he has previous experience within financial software, and a interest for financial management systems, he worked to implement good financial systems for increasing the information available to the decision makers and the attractiveness for exit-candidates. In this case he mainly contributed in strategic decisions, but saw how he could increase the value of the strategic advices by implementing financial systems. This is yet another example where this activity result in involvement on a lower level *(economy, tax & accounting).*

Participating in strategic decisions is a low degree of direct involvement, and as it is the process of providing overall strategic guidance it does not occur on a daily basis. However, the outcome of the activity may be very valuable. This is exemplified by the involvement and advice given by Grant and Phil to their investee companies where they used their knowledge to provide advice on how to enter the industries, which partners to attract and the overall plan for the startups in form of exit-candidates. This is typical for this activity. Business angels only performing this activity has no or little knowledge of the daily operations in the venture, they focus on the "big picture". However, most of the investors in this study also perform other activities as well, often as a result of the strategic decisions.

**Potential outcome:** Setting of goals, overall guidance in the competitive environment and the "big picture"

**Degree of direct involvement:** Low

**Structure of the board**

Structure of the Board means that the business angel is involved in how the Board is put together, not simply participating at it. Paul is highly engaged in the way the board of directors are put together and how the businesses are managed. He elaborates:

> A challenge may occur if for instance the chief of development has a role in the Board of Directors as a result of his ownership share. Then he would through the board control what goals the chief executive officer (CEO) should lead after, at the same time as he is an subordinate to the CEO. That is an unfortunate situation for the top management. Employed owners should only sit in the management team.

Ned explains how he structures the board, something he sees as one of the most crucial things to get involved in when investing in startup:

> Taking your business to the next level involve building a strong board of directors, and attracting competent people and build the right expertise around the company. It can be both directors but it could also be to bring investors. In several companies I have invested as lead angel investor,

> which means that I have put together a group of investors [...] In these cases I have often sewn together investor teams and a board of directors which I know have an interest in the area, or sometimes due to financial reasons. It has been everything from legal help, and then I have brought lawyers into the board and also as investors, but it can also be an engineer with technical competence.

Mac did not put the board together, but believe he was invited as a minor investor in a technology venture by the entrepreneur to benefit the composition of the Board. The other investors were way more financially driven, and Mac served as a counterweight. Both regarding standpoint in strategic decisions and when it comes to supporting the entrepreneur as a mentor. Mac was active in strategic choices conducted by the Board. He mentioned one case where the choice was whether to sell the venture in an earlier phase than the venture eventually made an exit, or not. Mac argued not to sell.

This activity does not directly affect the entrepreneur and the operationalization of the venture. It does however have an indirect effect on both, as the Board controls the venture and also have its say in important decisions. It is therefore of great value to the entrepreneur to have a business angel who perform this activity with the entrepreneurs best interests in mind. Having a board with complementary skills also benefit the venture, as the pool of potential resources increase.

**Potential outcome:** Complementary board composition, expertise and skills within crucial areas, increased network and legitimation

**Degree of direct involvement:** Low

**Formulating marketing & business plans**

Formulating marketing and business plans include some of the same elements as *strategic decisions,* it is however a more hands-on activity. The planning performed is also more detailed.

Marc explains why formulating business plans is something he does often in his investee companies and why it is important, a view supported by several of the investors:

> I have made many business plans. I know exactly how customers, and investors think, and you have to know how to communicate. There is often a challenge to create a "language" so that all the stakeholders in the process understand what the goal is. I help to establish a clear target image and a language of what we want to achieve [...] and it also important to lift it up and [...] see that this is something that is viable as a larger business.

Formulating business and marketing plans is a rather direct involvement by the business angel. However, it does not occur on a regular basis and is not an operational involvement. Despite this, the outcome and value of formulating good plans may potentially be high. The plan provides a third party an image of the startup and its goals, which is important. Especially since third parties often evaluate different aspects of the startup and the entrepreneurial team.

**Potential outcome:** Overall planning and setting of goals, a clear communication towards third parties (for instance potential investors)

**Degree of direct involvement:** Low to medium

## Level 2 - Knowledge & Support

Knowledge & Support activities include indirect activities such as providing assistance, mentoring, giving advice and contributing with knowledge to the venture and the entrepreneur team.

### Industry know-how

It is often wise to do an industry analysis before you start your business. This type of knowledge is also something an entrepreneur can gain from business angels, as they often possess experience from certain industries. Many business angels (including Ned and Arron in this study) report that they invest in industry specific startups. Industry know-how includes industry participants, distribution patterns and competition and buying patterns, in many ways an understanding of Porter´s five forces. Ned explains his point of view concerning this:

> I think it's very valuable if the investors have a basic understanding of the industries they invest in. I often see Board members who do not understand the business, industry and markets well enough, and as a result they cannot add value to the start-up. I believe that a board should not only control, but also contribute, and if you do not possess any kind competence within the market it becomes difficult. It is not to say that one must be an expert, but you should have a general understanding.

Arron support his argumentation:

> I think industry know-how is very important, even though I get a lot of requests from other industries. I have specialized particularly in one sector, so I know almost everything about what's out there in the market. I don't know anything about fish, but I have some contacts that may open some doors and I also know how to build a company. So I can still contribute with something even if its out of my industrial expertise, but I can certainly contribute more in the industry I know. I have a strong network in the industry, I know all the business models and I can call the big players. I can trade, and know who to talk to. Then everything goes a lot faster and easier.

Not every business angels invest industry specific. Some are more socially motivated and invest geographically. However, several of the industry specific investors in this study mentioned that they invest in some specific sectors, because they have industry know-how. They also stated explicitly that they believed that having at least a general understanding of the industry is extremely important if who want to contribute with non-financial capital. They also stated that this type of knowledge is very valuable.

**Potential outcome:** Industry know-how, valuable contacts
**Degree of direct involvement:** Medium

### Marketing know-how

Marketing know-how includes marketing ideas, sales strategies, advertising and customer relations tips for growing businesses. Arron report this as one of the most important activities he undertakes:

> It never ceases to amaze me how few entrepreneurs that have an understanding of the commercialization process of a technology. Most people think that if the product is good enough

> it will sell itself. However, the world will never act like that. It is completely independent of the product you have. There are no products that sell themselves today.

Nick share his opinions:

> We believe that waking up in the morning, being serious and actually understanding that there is a customer who will pay for it in a way is relatively the same in all businesses. The technology can be very different, but that does not help if no one buys it. Over time, we see that it's branding that makes money, not the products. There is a reason why people buy Audis and not Skodas, and it is not the car. There are other things that influence, and over time that's what's important.

Marketing know-how is very important for technologically minded entrepreneurs, who may often be solely focused on the product. Making sales is the key in building a viable business, especially when the startup is early stage. As the investors say, marketing and commercialization is something completely different than R&D, and many often lack this expertise.

**Potential outcome:** Marketing know-how, customer focus, buying behavior, value propositions

**Degree of direct involvement:** Medium

**Customer & partner processes**

Customer & Partner processes involve supporting the entrepreneurial team in attracting potential customers and key partners. This includes analysis, deal making and negotiations. Grant explain how they assisted their investee company when they were looking for pilot customers and other partners:

> After the investment we entered into a dialogue with some heavier Norwegian partners. The companies would not commit, but we challenged them specifically and said that we need to establish letters of intent, first and foremost in relation to the first, second and third pilot. When will it be delivered, what should it costs and what will you contribute with. We got in place agreements with three prospective customers who wanted to buy our products provided that it met some given criteria. At that point we had actually documented the market since we had three contracts with customers who would use our technology before the product was finished. We had enough credibility to make the deals.

To perform this activity the business angels' *legitimation* and industrial experience is important as attracting early customers and partners involve gaining trust and building relationships. However, most business angels have more business experience than the entrepreneurs and they can consequently add value through this activity by supporting the investee company in negotiations and deal making.

**Potential outcome:** Know-how and support in connection with gaining customers and attracting partners, deal making, support in negotiations

**Degree of direct involvement:** Medium

**Motivating & mentoring**

Business angel may provide the entrepreneurs with "mental support" and motivation as they see the bigger picture, have walked the road before and know that the rewards will come. In this respect the business angels (and Board of Directors) should ensure that the entrepreneurs are motivated and provide the entrepreneurs with a clear image of the potential future reward.

Marc explains how he overcame these obstacles and motivated and kept the entrepreneurs happy:

> When I started the company with two good guys I interviewed their wives first. I guaranteed that there would not be 10 years of only bad times. I told them I would sell enough shares after two years so that they could buy a cabin each. So in that way the families would get something more in return for the commitment they made instead of just having two good jobs. And I did so. I sold shares valued at several million NOKs to a large player so that the families got something in return for the sacrifice and they could buy a cabin each. It sounds very banal. However, keeping the entrepreneurial team happy is worth a lot.

This is a widely reported activity. Mac argued that in addition to bring capital, his sole purpose in the venture was to support the entrepreneur and serve as a "father figure".

This activity is in many ways abstract and hard to assess. The business angels ensure that the entrepreneur is motivated, and also serves as a mentor whom guides the entrepreneur in "new business jungle" which may be difficult to maneuver.

**Potential outcome:** Guidance, lifting the spirits, mental support

**Degree of direct involvement:** Medium

**Economy, tax & accounting**

Economy, tax and accounting involve the basic economic and legal aspects of running a business. Experience within these activities are something entrepreneurs often lack, and also do not want to waste time doing. It is also a good way of controlling the business, and several of the investor cover these aspects when investing in startups. Arron underline this:

> We have often seen that it has been a poor level of knowledge on basic economics. As an entrepreneur, you very often lack this expertise.

As elaborated earlier Paul is a driving force for implementing beneficial financial systems for the purpose of strategic decision-making. In order to implement these systems he contribute with knowledge to the entrepreneur team. Paul states:

> Startup companies have a lot of errors in their annual accounts, errors that may cause a bad basis for business strategy.

Neil invest in local startups, and uses his skills in accounting to manage all the "manual" and legal aspects of running a business, so that the entrepreneurs may focus on R&D.

> The last ten years we have invested in new businesses from the local university. We go in with capital and I take a position at the board. In addition, I take the operational role as accountant, and also manage all the "manual work" required to run a business so that the entrepreneurs can concentrate on the development of the technology, as they should do. They should not think of the auditor, law and the laws that apply. That is my expertise. In the periods when they are broke I pay their wages. So I'm always directly involved in the business. I always make sure that they

> have money for what they need, and it goes without saying that these kinds of companies do not use money for anything, and they are also not allowed to do so. I check every invoice.

In this respect Neil is very actively and operationally involved. However, he does not sit with the entrepreneurs and make sure that he keeps her distance. These activities are also something the entrepreneurial team would often have to outsource. In addition, the most important value he contributes with is legal advice concerning taxes.

By performing this activity the entrepreneurs may focus on the development of the business. They also get some financial systems, which they must abide. This creates a more structured and goal oriented environment in the business. In addition, the business angel has the opportunity to control the investment. These are also activities some startups may outsource, due to a lack of knowledge. Hence they also save money.

**Potential outcome:** The entrepreneur may focus on R&D, save money, structured work environment

**Degree of direct involvement:** Medium

**Further financing**

Facilitation of further finance has been reported as being one of the most common activities performed by the business angels in this study. Grant, who is an early stage investor, explains how he operate in order to gain further finance:

> After strengthening the team and putting in place 'letters of intent' with customers and partners, we planned to reduce financial risk. We contacted Innovation Norway with an Industrial research & development contract (IRD). They gave us a grant of 5.5 million NOK, which assumed that we had with us an investor who could cover up their own efforts. We then started the process of attracting investors, and by now we have done our "homework". The market is ready, the technology is ready, and you have customer agreements and a solid team. You know the market, they have sufficient expertise, and we brought with us 5 million NOK in risk reduction. Then we signed with a venture company, and they said that they would not have invested if it weren't for us. We provided them with sufficient risk reduction.

Ned also seeks to help the investee company attract further finance, but invests later than Grant:

> I come in before the VC-funds and in many cases I introduce the startup to venture capital. I also take an active role in the financial processes of raising additional capital, as I have a network and expertise in structuring transactions. I have an established network of investors and a relationship, which is also financial. This network consists of both private investors and venture funds that then have entered some of the projects I've been involved in.

Ned further mentioned where he saved a startup, in which he had a small financial stake, from bankruptcy court. The founding team approached him and wanted help to save the company from its current crisis:

> I had a small stake in the company, but the market was at the time very bad and the other shareholders had no interest in investing more in the company. However, the company had good customers, good products and a good technology in an emerging market. The founding team was very technically oriented. I contacted a Venture Fund and a few private investors, which I then

> introduced the company. In this case we more or less took over the company, in cooperation with the employees. We did it, of course, in a very friendly manner against the other shareholders, in that we let them join in if they wanted to. There was nothing hostile about it in any contexts.

This is also an example on how business angels use their network and credibility to facilitate further finance.

The involvement by business angels in order to facilitate further finance is not an operational involvement. It is not to say that the outcome is not valuable, on the contrary. The investor uses his network to gain access to the right people and utilize his credibility to obtain what is needed. They also use their expertise to structure deals. Raising further finance is in many cases a huge obstacle for startups, and having a business angel to perform this activity is very valuable. It is also perhaps the activity that is the easiest to assess, both in terms of what is done, the outcome and how it affects the startups.

**Potential outcome:** Further finance

**Degree of direct involvement:** Medium

**Recruiting**

The Business angels in this study report recruiting and the building of a complementary team as one of the most important activities they take part in. They use their knowledge in recruiting processes and also leverage their *Network* and *Legitimation* to attract competent people. This strengthens the startup both in terms of skills and credibility. Phil stresses this explicitly:

> The recruiting of employees is very important, especially for knowledge-intensive technologies, almost more important than the investment itself. You must hire the right people. We have networks with people we know which make it possible to do targeted recruiting. In addition we can evaluate job applications, do background checks and make some calls. I think the network is brilliant for evaluating applications. I think to the extent that we enter the recruitment process, our experience is very important. I've actually found new top leaders as well. I think the value of using business angels in recruitment processes are widely underestimated, especially if you are looking for leaders at top level. As the time goes the tasks of the management change and the entrepreneur's skills may no longer be adequate, and you need to recruit new people.

Grant elaborates how they searched for candidates with industry know-how and *legitimation*:

> The company was a spinoff from the university, and the team consisted of two post docs and a professor. However, the team lacked industrial experience, so we looked at what we could do to get that expertise. Through our network we found a retired, slightly older gentleman whom had co-founded a company in the same industry. Consequently, he knew the industry and the technology used today. Instead of using him as a consultant, we challenged him directly to a permanent position of 15-20%. Then we used him as the face of the business and he strengthened the team with industrial expertise, network and credibility.

Ned also underlines the importance of bringing in the right kind of expertise:

> To take your business to the next step involve bringing in investors with the right expertise, building a board of directors and the right skills around the company.

However, Ned´s view on recruiting differs from simply hiring new personnel, and he focuses on building an investor team with the expertise needed to complement the skills of the entrepreneurs:

> You have to do the janitorial work internally, and then it's good to have co-investors with the kind of expertise the startup needs, whether its industrial know-how, marketing or legal advice. Many entrepreneurs and investors use advisory boards to build credibility and acquire expertise, but I've learned that it often works very poorly in real life. However, if you get people to invest their own capital they will care more about whether your business goes well or not, both because they think it's fun and it goes a little prestige in it when they have a stake, but also because they want to make money.

Ned has even in some cases experienced that one of the investors has been "recruited" to a position within the investee company:

> We turned the company around and we inserted a new leader. One of us actually went in and led the company.

Business angels support and take a role in recruiting activities in order to attract the right employees and the valuable resources they bring i form of expertise, experience and credibility. This is to build a team with the competence needed to grow the business. However, it could possibly involve demoting the entrepreneurs to a different role, for instance from CEO to CTO. This changes the dynamic in the startup, and is something especially the entrepreneurs should be aware of. Are you ready to let someone else be in charge of the startup?

**Potential outcome:** Expertise, experience, credibility, network

**Degree of direct involvement:** Medium to high

## Level 3 - Operational Management

Operational Management activities include activities that are direct and definite work tasks. Typical activities may be soliciting customers, developing products or services or other daily work tasks on an operational level. Arron elaborates on how and why they focus on being an operational investor:

> Being actively involved for me involves not just being part of strategy meetings and taking a couple of phones. We are operational owners. If you invest in early stage companies, you must be operationally present. In my opinion that is also one of the things that characterizes business angels. You do not only invest capital, one also brings with expertise, and it is only natural. Business angels are cheap to get, but they provide a tremendous value.

### Administrative management

Administrative management is a hands-on and direct activity, and it include getting people together to accomplish desired goals and objectives using available resources efficiently and effectively. It comprises planning, organizing, staffing, leading or directing, and controlling the venture on an operational level. Many of the investors performing this activity take permanent employment in the investee company for a period of time, which can also be argued to be a prerequisite for performing this activity.

Arron is, in his own words, an operational owner, not just an active owner. He takes permanent employment in the investee company. Arron explains:

> One of us always used to take a position at the board. We tried to be actively involved that way. However, there is something else to sit and work with the entrepreneurs in the company, and it's incredibly important to be operational. There is so much risk and uncertainty, so that if you're not a little detail-oriented, it is difficult to know whether or not to invest more money into the venture. We've been so operational that I have been hired as general manager. I have 100% employment in a company. Sometimes we also go in as general manager and sales manager. We do the job; we don't sit and wait for someone to tell us what to do.

Consequently, he always takes an active part in the administrative management of the startup. Grant also performs this type of involvement. He calls it early stage management:

> We believe that especially within the segment we operate, which is technology companies, you have a gap when you look at the early phase. You have inventors, scientists, idea, concept and stuff like that. And eventually there is a need for more industrial management and someone who knows the market and the industry. It's about having someone to push it into the industrialization-/market-phase and you need someone who has done it before, and who are able to attract both pilot customers, capital, etc. which is the early stage management we want to contribute with. We lift them up and out, and make them ready for growth and venture capital. We often take the position as the general manager. We expect a 50-60% capacity per case. We go in heavily. That's really our model. We take part in the daily operation to accelerate this type of technology companies. You need to be where the decisions are made on daily basis.

However, some investors only do this in times of crisis, as elaborated by Ned when he saved a company from bankruptcy court:

> We turned the company upside down, installed a new manager (recruiting), I took a position at the board and took the part as active owner. We managed to flip the company and achieve positive result. This was based on the very active participation from my point of view. We helped to restructure and build the company up again after they had ended up in financial problems. It has turned out to become a nice story.

**Potential outcome:** Daily management, controlling and supervision
**Degree of direct involvement:** High

**Sales & customer meetings**

Sales and customer meetings is different from customer processes as this activity is a direct involvement towards potential customers while the other is a transfer of know-how. In addition, the investors do not actively utilize their network in the same way. For instance, a salesman make calls to people that is not necessarily in his network.

Arron explain the importance of getting involved in sales in the investee company:

> Early stage companies need so much more than just money, and in 90% of the cases we have invested we have actively taken part in sales and marketing. The entrepreneurs have expertise in technology, cost efficient products, etc. but very few have an understanding of the commercialization. Most people believe that if the product is good enough, it will sell itself.

> However, the world will never work like that. Sales are completely independent of the product you have. There are no products that sell themselves today. [...] Before you attract investors, there is usually a "cleaning job" to be done, primarily concerning sales and marketing. Thus we make calls and we open doors that were not otherwise possible.

Neil also take part in sales, but in a different manner and not so direct as Arron:

> I'm always on the lookout for potential customers, and whenever I'm in meetings or meet people in different settings I have the investee companies in the back of my mind and hand out business cards. We also use some the companies we invest in as suppliers in the projects our contracting company is involved in.

In this respect she is not who may be seen as employed in the sales department as Arron. His sales activities are not as direct, but are however very operational.

**Potential outcome:** Sales, credibility

**Degree of direct involvement:** High

## Inter-organizational channels

### Network and legitimation

*Inter-organizational channels,* meaning ways to interact with the external environment, consist of *Network* and *Legitimation*. *Network* and *Legitimation* has in previous research been reported as value adding activities performed by business angels. However, findings in this study suggest that these are not activities performed by the investor, but rather that the *network* may is seen as a resource pool and a channel in which other activities may be gathered and/or performed. Business angels *network* is a 'structural dimension' of *social capital,* meaning the contacts outside the investee company. This include for instance potential customers, suppliers or a professional support group.

*Legitimation* is the act of providing legitimacy, and it is the process of making something acceptable and normative to a group or audience. *Legitimation* adds value to the venture through the trustworthiness of the investor and increase to the overall value of the network and further on the *social capital.* Business angels investing in a company can be seen as a legitimation of the company, reducing the 'liability of newness' (Sørheim 2005). Accordingly, legitimacy and trust increases the potential value the *network* can offer. In this respect many of the reported activities in this study are performed through the network, and the outcome is based on the amount of legitimation the business angels possess (see figure 10).

All the private investors in this study have supported this. Their *network* and *legitimation* is utilized in order to perform different types of value adding activities to the investee company. For instance, they use their *network* to attract further finance, personnel, partners, potential customers etc. and their *legitimation* within their *network* effect the value of these activities. The value of the *network* and *legitimation* a business angel bring to the venture should not be underestimated. Ned stresses this importance:

> *Network*, *credibility* and *competence* is very important. That's what you should bring to the table, and it is valuable for entrepreneurs who may have a very good idea and good technical skills, but who

lack all the other elements. It is completely out of their world, and it is important in order to grow the business.

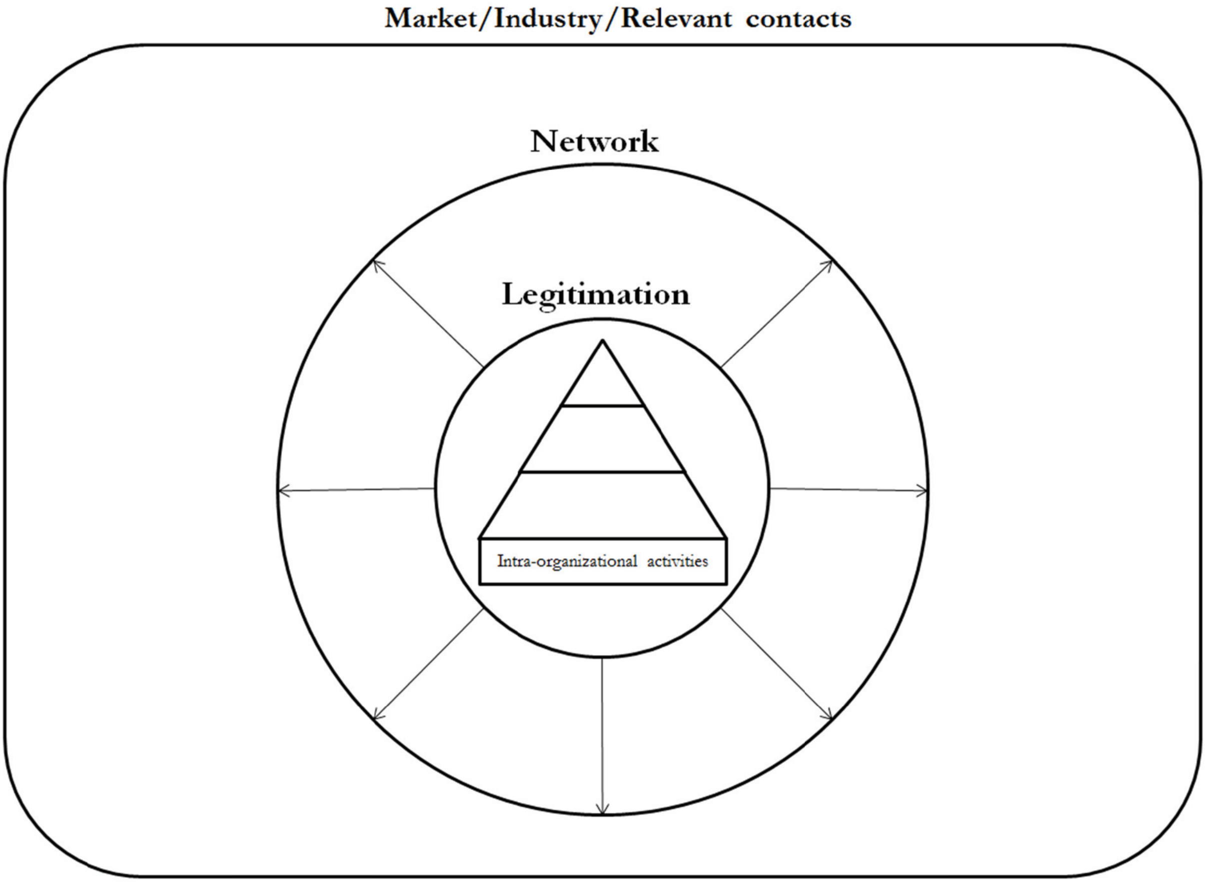


**Figure 10: Activities in a Larger Context**

## Examples

As explained, *network* and *legitimation* are not direct activities. *Network* is seen as a channel and resource pool in which other activities may be performed and obtained, while *legitimation* affect the value one can gain from the network. Phil explains the value of his involvement when it comes to *legitimation*:

> Small companies without a history and that believe "the sky is the limit". It is not given that guys like you (the authors) dream about working for these risky businesses. At the same time it is important that those kinds of businesses have good employees, the best ones. As a business angel I can reduce the perceived risk for new employees by adding history.

During the explanations of how the investors performed activities they often referred to how they utilized their *network* and *legitimation* to add value to the investee company. Here we present typical examples of how *network* and *legitimation* are utilized in order to perform other activities. The examples are short excerpts from the activities presented earlier:

## Strategic

**Structure of the board:**
Investors often use their network to attract competent board members and to build a complementary team to support the venture. Ned explains a traditional investor view:

> In many cases I have often sewn together investor teams and a board of directors, which I know, have an interest in the area, or sometimes due to financial reasons, but first and foremost someone who can contribute with something. And it has been everything from legal help, then I have brought lawyers into the board and also as investors, but it can also be an engineer who have technological competence and also spit in some money.

## Knowledge & Support

**Industry know-how:**
Industry specific investors report industry know-how as important, not only because they know the industry analysis, but also because they may utilize the combination of industry know-how and *network* to bring value to the venture. Arron explains:

> I have a strong network in the industry, I know all the business models and I can call the big players. I can trade, and know who to talk to. Then everything goes a lot faster and easier.

**Customer & Partner Processes:**
This activity is directly linked to the external environment. Grant explains how he utilized his legitimation in order to perform this activity:

> We got in place agreements with three prospective customers who wanted to buy our products provided that it met some given criteria. At that point we had actually documented the market since we had three contracts with customers who would use our technology before the product was finished. We had enough *legitimation* to make the deals.

**Further financing:**
Many investors utilize their network to attract further finance. We begin with Ned:

> I take an active role in the financial processes of raising additional capital, as I have a network and expertise in structuring transactions. I have an established network of investors and a relationship, which is also financial. This network consists of both private investors and venture funds that then have entered some of the projects I've been involved in.

Neil also utilizes his network and legitimation to attract finance. He explains:

> One of the companies we invested in was about to go bankrupt. They were looking for offices and help. At that time they had guaranteed with their own apartments in their bank. We then went to the bank to negotiate a loan of 1 million NOK, which wasn't a problem. However, we also wanted to delete the mortgage on the apartments. That proved to be a problem. Then we went across the street to our bank, where we got the loan and the warranty deleted without a

> question asked. That is one of the advantages of being with someone who's vaguely familiar. Things are so much easier. Today they have 30 employees, and a subsidiary abroad.

To summarize this activity we quote Grant:

> [...] Then we signed with a venture company. They said that they would not have invested if it weren't for us. We provided them with sufficient risk reduction.

**Recruiting:**
In this study recruiting of personnel is one of the reported activities performed by the investors, which is often utilized through the network. Phil explains how he uses his network to perform this activity:

> We have networks with people we know which makes it possible to do targeted recruiting, and I think the network is brilliant for evaluating applications.

This also goes for Grant, among other, who summarize how the investors often perform recruiting:

> Through our network we found a retired, slightly older gentleman whom had co-founded a company in the same industry. [...] We used him as the face of the business and he strengthened the team with industrial expertise, network and credibility.

## A Revised Framework for Value Adding Activities

We have in this study presented an in-depth overview on how the value adding activities are performed by business angels. We have also categorized the activities based on a previous framework, and revised it to include the findings in this study. The findings are presented in figure 2. Coherent with previous research, we have separated the activities between those who are *Intra-organizational* and *Inter-organizational*. The main difference being that the *Inter-Organizational activities* are often channeled out to external environment. However, the interviewees in this study did not report *Network* and *Legitimation* as activities they performed, but rather that they utilized their *Network* to perform the *Inter-organizational* activities. In addition, the candidates continually explained how they had the *Legitimating* power to make use of their *Network*, consequently, the *Network* increase in value based on the investors *Legitimation*. A conceptual framework *for Intra-organizational activities*, *Inter-organizational activities* and *Inter-organizational channels* are presented on the next page.

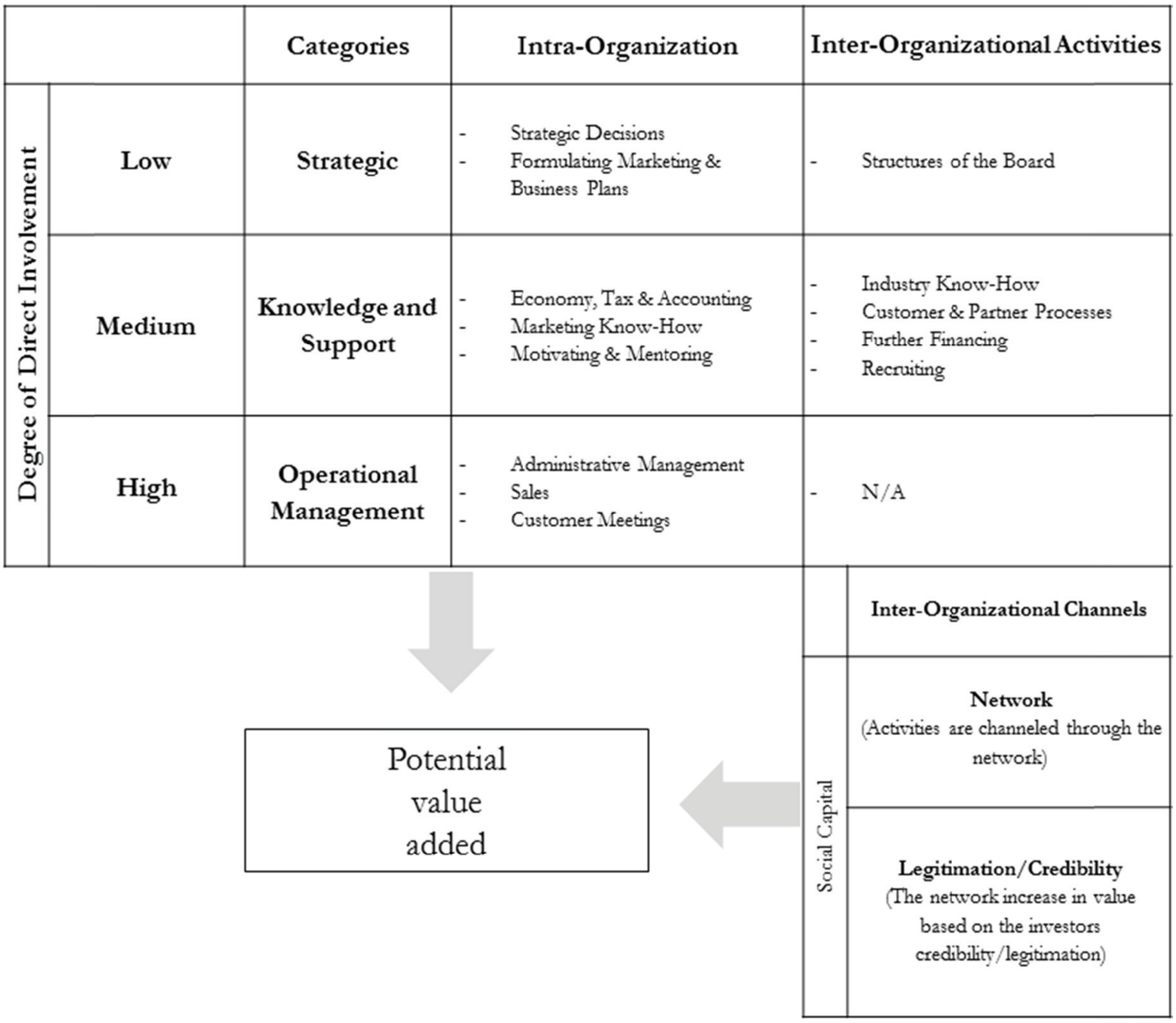


**Figure 11: Value Adding Activities & Value Adding Channels**

The activities are also organized based on a degree of direct involvement and according to type of activity. The boundaries between these are overlapping. However, a simplification is needed to illustrate the different activities business angels perform. Some require a high level of direct involvement (typically *Operational management*), while some only require board participating and consequently a low level of direct involvement (*Strategic*). Based on findings in this study and discussion with external contributors we also argue that the framework to a large extent explains the different value adding activities and that all activities performed by business angels may be categorized and placed in our framework, thus providing a clear overview of which non-financial contributions business angels bring to their investee companies.

## Future Research

In discussion with the different interview candidates we find that the outcome of the different activities differs and is not often realized to its full potential. Blake reports "the willingness to listen and change their (the entrepreneurs) behavior is not present". He does apparently have problems with both the transfer and implementation of his viewpoints. He also argued that only 80% of his advice was taken into consideration by the entrepreneurial team. Leaving a gap between potential value added and realized value added. Politis (2008) suggests that '... there may be a need to distinguish between potential value added and realized value added', owing to the fact that just because business angels have the potential to add value, does not mean that it can be effectively exploited by the investee company. We therefore suggest that the overall outcome of the value adding activities only is a potential value added, and that the involvement of a business angel does not automatically result in realized value (See figure 11).

It is indicated that the process of transforming potential value added to realized value added is bound by a set of *attributes* and *relational properties*, which may affect the value added. The gathering of factors is crucial because of the interconnected nature of them. The importance of this overall subject is highlighted by Politis (2008), stating that; '...how the value added contribution of business angels may be influenced by different conditions in the internal or external environment of the venture is an issue that is of great relevance to consider.' Politis (2008) further argue why this is in fact so. Firstly, it '...may enhance the scholarly understanding of the process in which their [...] value added contributions can become effectively implemented and incorporated in the ventures in which they invest'. Future research should therefore focus on how these actually affect the potential and realized value.

This brings us to the fact that different entrepreneurs need different types of help and support, but what kinds of entrepreneurs need which type of investors? And which activities should investors perform to different entrepreneurs. The findings suggest that experienced entrepreneurs will not benefit as much from an operational business angel as a first time entrepreneur with only technical skills. This is somewhat interrelated with the *attributes* of the investor, entrepreneur and the company. Future research therefore needs to address how the *attributes* of the entrepreneur and company affect what value adding activities the investor should perform.

There are also uncertainties in deciding where the activity adds value, and who is the receiver. Is it the company, or is it the entrepreneur? According to Politis (2008) perhaps the most crucial and important question in research on business angels and value added is the effect of their hands-on involvement on the performance of the business. To realize the potential value added by the business angels, the entrepreneur have to receive this value and handle, effectuate or apply the advices to the operation of the business. Further research need to address how the transfer of value is, and what affects it, in order to answer the question like; Do the value added contributions of business angels actually matter, and what kinds of value added contributions matter the most? (Politis 2008) This questions does not only require to find proper measures for firm performance, but also an understanding of what affects the transfer of knowledge (value) from the investor, through the entrepreneur and to the venture.

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# Paper 3: What Influence Value Added?

**Authors:**

Lars Dybvik
Marius Monsen Ragnøy
Ragnar Andreas Severinsen

Norwegian University of Science and Technology
Department of Industrial Economics and Technology Management

## Abstract

This study assess the factors influencing the value adding activities business angels perform to their investee companies. In addition, we explore the 'black box' of realizing potential value into valuable output for the venture. Through a conceptual theory-building study, based on theoretical models from other disciplines combined with qualitative data from a multiple-case study, we find that the value adding activities are largely dependent on the ventures life cycle and the receptivity of the entrepreneur. However, the main finding in this study is that active involvement by business angels does not necessarily result in valuable outcome for the venture. Where most previous research have almost taken at face value that active involvement business angels directly result in non-financial value for the ventures, we find that the process of realizing potential value is highly influenced by the entrepreneur's ability to acquire, assimilate, transform and exploit this information, namely the absorptive capacity of the entrepreneur.

# Introduction

Business angels includes all private investor which decide himself/herself to invest their own money and experience in entrepreneurial SMEs with which they have no family connection, and choose to have an active role in the further development of the venture (e.g. Sørheim 2000; Mason and Harrison 1996). They are known for not only contributing with financial capital to their investee companies, but also human and social capital that they have acquired throughout their professional lives (Kelly 2007). Through their contribution, they wish to earn 'psychic income' (Freear *et al.* 1995), support the next generation of entrepreneurs (Mason & Harrison 2002), in addition to manage the potential return as well as reduce agency risk (Ardichvili *et al.* 2002).

Recent research has tried to explain how business angels might add value, in terms of the content of the value that is being exchanged between the entrepreneur and business angel (De Clercq & Manigart 2007). The content of this exchange have been gathered based on empirical studies by several researchers (e.g. Ehrlich *et al.* 1994; Harrison & Mason 1992, 1996) in several value adding roles and activities. In addition, Politis (2008) identified different value adding roles to a set of value adding activities based on 14 empirical studies between 1992 and 2005.

Consequently, researchers have to some extent an understanding of *how* business angels might add value to the venture or entrepreneur in terms of content and added value. But what is still largely unanswered is *why* some business angels attempts to contribute with added value and fail to do so, while others thrive, given apparently similar conditions (Politis 2008).

One of the reasons for why this is an underdeveloped field lies in the key-assumption underlying the term 'value added' (Macht 2011), which indirectly implies that contributions are positive for the venture with positive outcomes (Large & Muegge 2008). Thus, there may be a need to distinguish between potential value added and realized value added (Politis 2008), owing to the fact that just because business angels have the potential to add value, does not mean that it can be effectively exploited by the investee company. Consequently, it is the contribution that is acquired and exploited by the company that is the true value added - the realized value that may increase the performance of the venture.

## The aim and contribution of this study

This paper seeks to answer 'what affects the value added by business angels'. This issue is twofold; firstly, we assess contextual factors and conditions which influence and determine which value adding activities business angel perform and further on the potential value added. Politis (2008) emphasized in this regard that business angels' involvement in the venture greatly depends on the life cycle of the venture, and that this topic is highly overlooked. Similarly, the entrepreneurs` receptivity towards involvement has proven in a recent study (Macht 2011) to play an important role in whether or not the business angels wish to contribute. These two contextual factors, life cycle and receptivity, will be addressed in as two major determinants of the business angel's involvement, thus the potential value.

Secondly, we address what influence the process from potential to realized value added. Previous research have, to a large extent, taken at face value that there is a causal connection between active involvements by business angels and realized valuable outcome for the investee company. Similar to Politis (2008), we argue that there is a need to separate between potential and realized value added, as this is a process influenced by the entrepreneurs' ability to acquire and exploit advice from the investor. De Clercq and Manigart (2007) presented a conceptual model that displays this chain of value adding graphically (Figure 12). As previous studies have forgotten that advice and sharing of knowledge have to be acquired, assimilated and exploited in order to add value to the venture, there exist a 'black box', which we aim to shed light on (De Clercq & Manigart 2007).

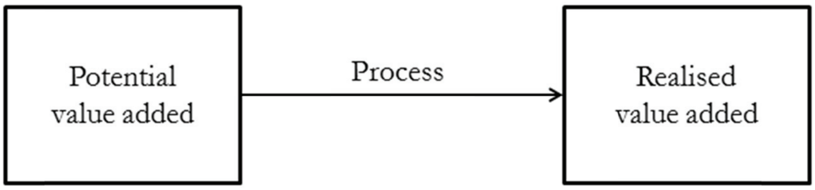


**Figure 12: Potential & Realized Value Added**

Thus, if we are to consider the effect of the value added by business angels we have to have an understanding of the process from a potential input to a realized output. If not, the highly important variable contingent upon the entrepreneurs' ability to exploit and utilize external advice will unfortunately be lost. How can we then know if the potential value offered by the business angel were to increase the performance of the venture? And how may we know whether or not non-financial contributions from business angels are in fact valuable?

The main contribution of this paper is thus to present a conceptual model that shed light on the different aspects and elements in the process of successfully implementing the potential value added offered by business angels. This may also in turn build a foundation for future studies regarding the effect of value adding activities, in addition to be a contribution to how business angels may improve how they offer their expertise and skills, and successfully implement advice and share knowledge with the entrepreneur.

We will firstly present the methodology for this paper. Secondly, we present a frame of reference that summarizes factors that may influence potential value added. Thirdly, we chose two of these factors, venture's life cycle and the entrepreneur's receptivity, and elaborate in light of theoretical models and empirical data how these may influence the involvement and potential value added offered by business angels. Fourthly, we explain how the process of realizing potential value added may be influenced by the entrepreneur's ability to acquire, assimilate and exploit external information (labeled absorptive capacity by e.g. Cohen & Levinthal (1990)). Lastly we summarize and discuss findings concerning both subjects and present a conceptual model that contains the different elements from potential to realized value added, in addition to what may influence them.

# Methodology

The research design for this study is analytical conceptual theory building, based on theoretical models from other disciplines, which are combined with qualitative data from a multiple-case study. This is to develop a conceptual model that describes what influences the value transfer from business angels to entrepreneurs and ventures. This is consistent with Eisenhardt (1989) who emphasizes that qualitative data can make a significant contribution to theory development when key themes are weakly developed. The authors conducted a literature review during fall 2011, and a multiple-case study during spring 2012.

The emergence of the themes addressed in this paper emerged after analysis of empirical data together with gaps identified in previous research (Politis 2008; De Clercq & Manigart 2007). It was evident that theoretical models from other disciplines were to be applied in the context of this study in order to develop a conceptual model.

## Data collection

In this study we have used three sources of data:

- Qualitative data from semi-structured interviews with business angels
- Previous research on different influencing factors on value added
- Two theoretical models (Churchill & Lewis 1983; Zahra & George 2002)

The empirical data has been collected by interviewing ten active Norwegian business angels. The empirical data contains 15 cases, and the interviewees were given the promise of confidentiality. The interview was open-ended and loosely oriented around a broad topic, to ensure that we were not influencing the different cases. However, the themes addressed in this paper were highlighted by several of the interviewed, especially the importance of the receptivity of the entrepreneur as a factor to assess.

The different influencing factors suggested by previous research were selected through snowballing technique, and the use of different databases with key phrases mentioned in core literature (Google Scholar, NTNU Bibsys). Due to the limited research on this topic, we chose to have a broad scope in order to achieve the best possible overview over a broad research field. Consequently, VC-studies were also selected (e.g. Sapienza 1992; Barney *et al.* 1996), in order to follow some of the leads from the more developed field of VC research. All relevant articles were collected in Mendeley database (a reference manager), and data for processing were structured in spreadsheets. The findings from the review of previous research were sorted in different categories, as some were to concern *attributes* of the investor, the entrepreneur or the investee company, or factors concerning the relations between them.

To cover some of the lack of theoretical underpinnings in this field of research (Politis 2008), two theoretical models were chosen to highlight how value added by business angels may be affected. The models were to address the varying nature of the venture's life cycle and the entrepreneur's ability to learn and exploit new external information. Concerning the first mentioned, we chose the 'Five-Stage model' (Churchill & Lewis 1983, as suggested by Politis (2008). She further emphasized that business angel involvement greatly depends on the life cycle of the venture.

The latter model was identified to be either theories concerning entrepreneurial learning or absorptive capacity. The authors conducted a literature search, assessing both theories. Absorptive capacity proved to be the most appropriate theory, because it to a greater extent considered the sharing of knowledge and the external provision of information without the experiential focus on behalf of the recipient, as opposed to entrepreneurial learning. Additionally, as absorptive capacity may be seen as a broader theory, it was more suitable for this highly underdeveloped field of research. Articles regarding this theory were then assessed (Cohen & Levinthal 1990; Zahra & George 2002). Zahra and George's (2002) reconceptualization of previous research on absorptive capacity, together with the distinguishing between potential and realized capacity (inspired Politis 2008) made the model highly suitable for this study.

## Analysis setup

The analysis of this study has been conducted in several steps, and some of them simultaneously. Data from the case study have been transcribed, then evaluated and sorted in different categories. They were further cross-analyzed with the selected themes in order to give new insight regarding what may influence value added. In parallel and sequential to this structuring work, we worked with theories possibly describing some of the gaps suggested in previous research. The most promising theories were then tested by first applying them and challenging the logical understanding, and then compared to the empirical findings. Additionally, a context giver that has extensive experience with the informal capital market in Norway tested the concepts.

## Limitations

First of all, the factors describing the entity and the relationships internally, do not take into account all elements in external environment that may influence. For instance, the characteristics of industry may be an important determinant of the venture's external environment, which indirectly may determine the internal structure of the venture and the process of realization of value added by business angels.

The empirical evidence in this study is weak, and may only be termed as 'illustrative' in preference to 'describing'. They are meant to illustrate and give new insight in the addressed themes. The lack of empirical data is due to that the interviews originally were collected for another study written by the undersigned.

Another critique was the lack of investor-entrepreneur dyads, which had given valuable information in this study regarding the relationship between the investor and entrepreneur.

## Frame of Reference

Previous research on both business angels and VCs has suggested several factors that may influence *when* and *why* an investor might add value. The different factors suggested may be categorized as *Attributes* of the investor, the entrepreneur and the company, and the *Relational Properties* between them. These are summarized in the following table. As an example, the *experience* of the investor is an 'attribute of the investor' and is reported in several studies (e.g. Madill *et al.* 2005; Sapienza *et al.* 1996) to influence the involvement, and also what the investor may contribute with. Similarly, all of the under mentioned factors may in some way influence the value added. The influencing factor, the description of how it may influence, and the corresponding studies are specified in given table.

| **Attributes and relational properties** | **Explanation/conclusion** | **Studies** |
|---|---|---|
| **Attributes of the investor** | | |
| Active vs. Passive | It is reason to believe that high degree of involvement influence value added positively. | Ardichvili *et al.* 2002<br>Politis & Landstöm 2002<br>Mason 2002<br>MacMillan 1988<br>Fried & Hisrich 1995<br>Macht & Robinson 2009<br>Sapienza *et al.* 1996 |
| Extensive vs. Limited experience | Four types of experience have been reported to be relevant;<br>Investment experience<br>Entrepreneurial experience<br>General Management experience<br>Relevant Industry experience | Madill *et al.* 2005<br>Sapienza *et al.* 1996<br>Mason & Harrison 1996<br>Aernoudt 1999<br>Freear *et al.* 1994<br>Politis & Landström 2002<br>Mason & Harrison 1996<br>Lumme *et al.* 1998<br>Tashiro 1999<br>Brettel 2003<br>Sætre 2003 |
| Lead vs. Non-lead | A lead investor may have a more active approach in contributing to the venture, and may affect value adding from other investors. | Zacharakis 2011<br>Sørheim 2005 |
| Group vs. Solo | Business angel groups usually have more resources than Solo business angels, consequently greater ability to contribute to the venture for a longer period. | Sohl, *et al.* 2003<br>Mason 2008<br>Harrison & Mason 2000<br>Fried & Hisrich 1995 |
| The degree of track record | The reputation and degree of track record may affect the investors ability to add value the 'liability of newness', and increase the likelihood of further finance | Sørheim 2005<br>Sapienza 1996 |
| Financial vs. social motivation | Business angels are usually motivated by financial returns, but there is reason to believe that their potential social motives increase the wish to add value. | Macht & Robinson 2009<br>Landström 1992 |

| | | |
|---|---|---|
| Industry specific vs. regional focus | Some entrepreneurs consider industry specific business angels as more valuable due to their industry specific knowledge. | van Osnabrugge & Robinson 2000<br>Mason & Harrison 2000<br>Landström 1993<br>Sætre 2003<br>Mason & Harrison 1996 |
| **Attributes of the company** | | |
| Early vs. Late stage | Different resources are needed at different stages, and business angel's ability to contribute may vary along the lifespan. | Gorman & Sahlman 1989<br>Flynn & Forman 2001<br>Meyer & Dean 1990<br>Sapienza *et al.* 1996<br>Fried & Hisrich 1995<br>MacMillan 1988 |
| High vs. Low level of Innovation | Presumably, the higher degree of innovation in the venture, the greater is the demand of value adding activities that could be provided by the business angel. | Barney *et al.* 1996<br>Timmons & Bygrave 1986 |
| High vs. Low level Performance | The degree to whether the company is performing relative to the business angels presumption may influence the business angels wish to add value and to contribute in the venture. | Gomez-Mejia *et al.* 1990<br>Sahlman 1990<br>Sapienza *et al.* 1996<br>Mason & Harrison 1996<br>Barney *et al.* 1996 |
| **Attributes of the entrepreneurs** | | |
| Extensive vs. Limited experience | The entrepreneurs experience may affect both the amount of value he receives and his ability to benefit from the received information. The different experience are;<br>- Entrepreneurial experience<br>- General Management experience<br>- Relevant Industry experience<br>- Team tenure experience | Barney *et al.* 1996 |
| High vs. low receptivity towards involvement | The entrepreneurs desire to involve business angels in the venture will affect the business angel's possibility to add value | Sapienza 1992<br>Sapienza *et al.* 1996<br>Barney *et al.* 1996<br>Macht 2011<br>Landström 1992 |
| **Relational properties** | | |
| Frequency of contact | The more interaction between entrepreneur and business angel, the higher is the likelihood for adding value in terms of sharing information that both can gain from, and the possibility of the business angel to be a part of the operation. | Mason & Harrison 2000<br>Landström 1992<br>De Clercq & Fried 2005 |
| Social match | Social, trusting relationships may increase the motivation for assisting the entrepreneur. It may also increase the likelihood of informal sharing of knowledge. | Kelly 2007<br>Nahapiet & Ghosal 1998<br>Sapienza 1989<br>Zaheer *et al.* 1998<br>Nonaka 1994<br>De Clercq & Manigart 2007 |

**Table 8: Attributes & Relational Properties**

These factors conclude what previous research suggests influence value added. However, the distinction between potential and realized value added (Politis 2008) opens up the possibility that most previous research solely have considered what influence *potential* value added. As opposed to previous research which almost believe that there is a direct link between business angel involvement and valuable output for the venture, we argue that there is a difference between potential and realized value added, and that if we are to describe what influence value added, we have to consider what influence *both* potential and the realization of potential value.

We will therefore shed light on the 'black box' (De Clercq & Manigart 2007), or the process from potential to realized value added, in addition to the *Attributes* and *Relational properties* that only considers what affects the potential value added. We further argue that the process is highly influenced by entrepreneur's ability to acquire, assimilate, transform and exploit this information, termed '*absorptive capacity*' (Zahra & George 2002; Cohen & Levinthal 1990). High absorptive capacity is a prerequisite for successfully exploiting advice, or potential value added, that may in turn increase the performance of the venture. However, the entrepreneurs' absorptive capacity might be relative to current context or situation (Lane 1997; Lane & Lubatkin 1998). Similar to 'a sponge that is slightly damp as opposed to one that is bone dry, the damp sponge absorbs water faster' (Alvarez & Busenitz 2001). Thus, if we are to describe 'what influence value added', we have to consider the entrepreneurs varying ability to exploit.

# Conceptual Development

In order to develop a conceptual model for the differing elements in value adding, and what may influence these elements, it is first of all important to have an understanding of what business angels may add, in terms of different value adding activities. Thus, different value adding activities identified by previous research builds a foundation for the further elaboration, and is the first step towards a conceptual model.

## Value adding activities

Previous research has agreed that business angels' ability to add value through non-financial contributions to a large extent is embedded in their experience as former entrepreneurs. Several studies point out that most of the business angels are cashed-out entrepreneurs (e.g. Wetzel 1981, Gaston 1989) and have acquired the kind of experience it takes to start and manage young companies (Aernoudt 1999) and possibly add value.

Business angels may add potential value in several different ways (e.g. Politis 2008; Ardichvili *et al.* 2002), and several researchers (e.g. Harrison 1992; Harrison and Mason 1996; Ehrlich *et al.* 1994; Sørheim 2005) have identified how they may contribute. The activities may be sorted in three different categories:

1. *Strategic* activities add value by focusing on setting the course for the venture by providing strategic advice to the entrepreneurs. Typical activities are helping with business model, business concept and be a part of Board of Directors.
2. *Knowledge & Support* activities include indirect activities such as providing assistance, mentoring, giving advice and contributing with knowledge to the venture and the entrepreneur team.

3. *Operational Management* activities include activities that are direct and definite work tasks. Typical activities may be soliciting customers, developing products or services or other daily work tasks.

These categories may be summarized in figure 13, where the different value adding categories and activities may be potential value added to the venture. These activities may either be performed through *Inter-organizational channels*, meaning through the *Network* or internally in the venture, thus *Intra-Organizational.*

| Degree of Direct Involvement | Categories | Intra-Organization | Inter-Organizational Activities |
|---|---|---|---|
| **Low** | **Strategic** | - Strategic Decisions<br>- Formulating Marketing & Business Plans | - Structures of the Board |
| **Medium** | **Knowledge and Support** | - Economy, Tax & Accounting<br>- Marketing Know-How<br>- Motivating & Mentoring | - Industry Know-How<br>- Customer & Partner Processes<br>- Further Financing<br>- Recruiting |
| **High** | **Operational Management** | - Administrative Management<br>- Sales<br>- Customer Meetings | - N/A |

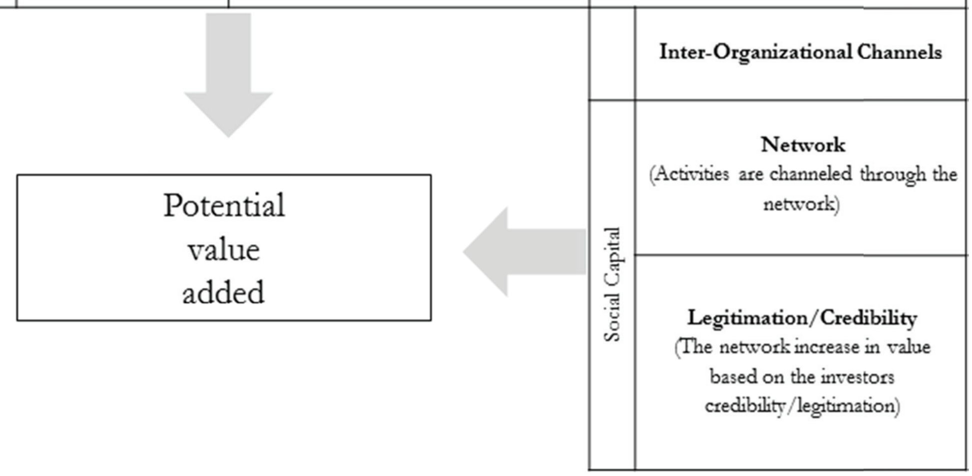


**Figure 13: Value Adding Activities**

Even though this framework provides a basis for the different activities business angel may perform, it does not address what influences the decision to perform a certain activity, and what affects the process of realizing potential value added.

In order to elaborate these addressed issues, we firstly address factors that influence which value adding activities that are performed, and secondly what affects the process of realizing potential value. Figure 14 illustrates both subjects. Additionally, it illustrates that all business angels possess a certain 'pool' of potential activities, which they may perform to their investee company. These different activities may be categorized using the framework presented above. During a process of decision making the business angel will take some factors into consideration, based on himself, the entrepreneur and the company, and decide to perform a certain activity, which leads to potential value added. The factors influencing this process will be further elaborated in Theme 1: *'Factors influencing the value adding activities'*, and the potential value added. Later the potential value added will undergo a process in order to be fully realized. What affects this will be assessed later in Theme 2: 'From potential to realized value added'. The value chain from *'Pool of potential activities'* to *'Realized value added'* is presented in figure 14, to illustrate the structure of this study.

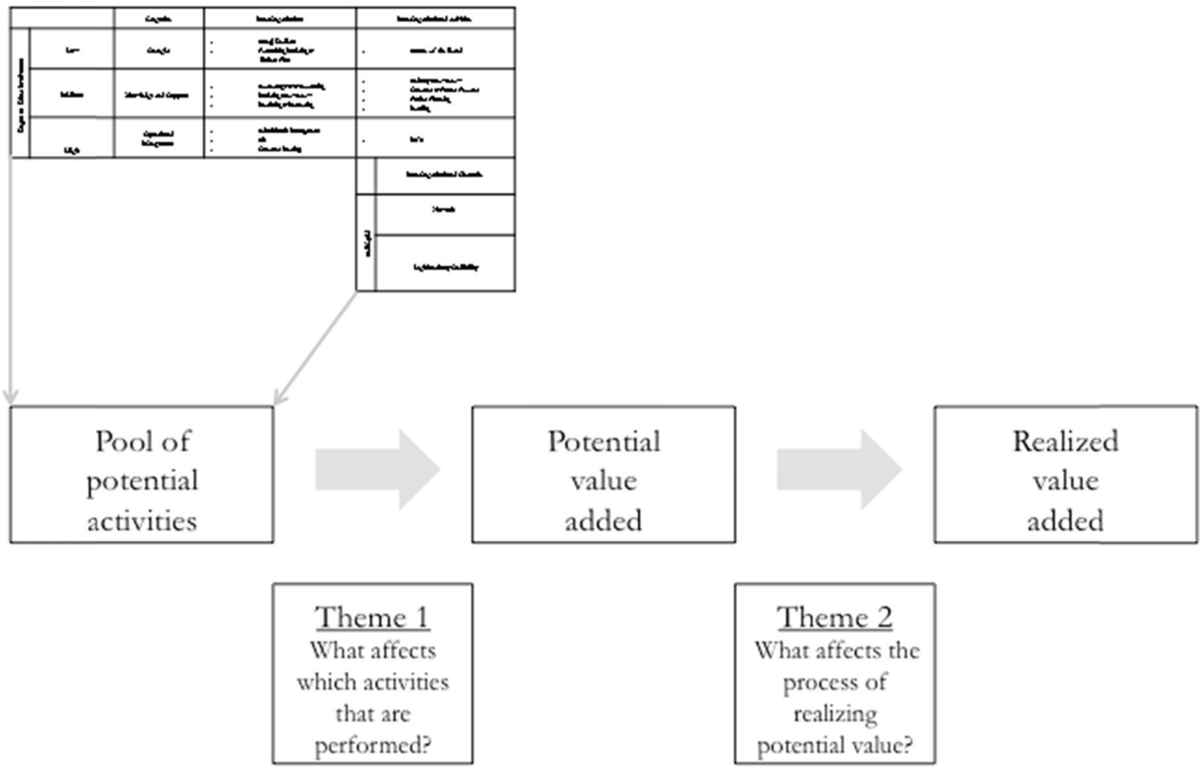


**Figure 14: From Potential to Realized Value Added**

## Theme 1: Factors influencing the value adding activities

Which activities business angels perform, and further on the potential value that may be provided are contingent upon several factors in the internal and external environment (Politis 2008). Previous research considers some factors, presented in this study as *Attributes* and *Relational properties* (table 8). However, Politis (2008) suggested several underdeveloped areas the research on business angel and value added, as opposed VC-studies. One of them was regarding: '... how the business angels' emphasis on various roles will change during the development of a venture'. She further argued that the first period after the investment often is characterized by high commitment and effort by the business angel, followed by a period of less involvement '... when the first emotional excitement drops'. Thus, the life cycle stage of the venture may be a central factor influencing potential value added (and is mentioned in VC-studies). Politis (2008) suggested that Churchill and Lewis (1983) may be an appropriate model to discover what might trigger the change of involvement from the business angel during the life of a venture. This paper will consequently address this issue in theme 1.1, both in light of empirical data, the *Attributes* and *Relational properties*, and the life cycle-model by Churchill and Lewis (1983).

De Clercq and Manigart (2007) identified a gap in previous research regarding how entrepreneurs may affect the involvement from their business angel. Macht (2011) tried to fill this gap by introducing receptivity of the entrepreneur as an influencing factor on potential value added. Her study showed that '... business angel involvement is severely affected by the involvement recipients'. She further suggested that '... visible characteristics should be the subject of further research in order to establish whether they are in fact determinants of the MDs' [meaning the receiving entrepreneurs'] levels of responsiveness'. This study interprets this to mean that receptivity may be determined by contextual factors. Previous research suggests that the most crucial contextual factors are the ones listed in table 8., the *Attributes* of entrepreneur, investor and venture, in addition to the *Relational properties* between them. This study will therefore address the receptivity of the entrepreneur in light of *Attributes* and *Relational Properties*. Consequently, two sub themes may be presented in theme 1:

- Theme 1.1: The venture's life cycle influence on potential value added
- Theme 1.2: The receptivity of the entrepreneur towards potential value added

## Theme 1.1: The venture's life cycle

As indicated by Politis (2008), little research has been conducted regarding life cycle stage and value added by business angel. However, some research has been undertaken regarding the varying involvement from VCs during the venture's life cycle. For example, Gorman and Sahlman (1989) suggested that the value added depends greatly on whether the VC invests in a late or early stage. Similarly, Flynn and Forman (2001) proposed that the type of involvement needed in the ventures vary during the ventures' life cycle stage, which affect the value added by the VC. For instance in the early stages, the venture is in need for negotiating various legal and governmental issues, and to a greater extent establish relationships with suppliers and distributors than in the later stages. Previous studies on VC report also that the *frequency of contact* is highest in the earliest phases (Sapienza & Amason 1993). Further, the managerial skills of the entrepreneur (who in most cases is not a professional manager) may not be enough to cope with the growing demands of the business (Meyer & Dean 1990). Consequently, Gomez-Mejia *et al.* (1990) proposed that the need for advice regarding general management would increase during the growth of a start-up, and therefore also the value added by VCs.

There is reason to believe that some similar occurrence may take place in ventures where business angels are actively involved. In order to elaborate what may change and influence potential value added from business angels during the life cycle, this study turns to the 'Five-Stage model' presented by Churchill and Lewis (1983) to get an understanding of the changing demands during the life of a business (Politis 2008), and how it may affect the involvement.

### The Five-Stage model

Churchill and Lewis (1983) presented a framework dividing the small ventures in five distinct stages; *existence, survival, success, takeoff* and *resource maturity*, where each stage has differing characteristics and venture needs. It should however be noted that the original model has been re-validated as a result of additional research, which concluded that not all ventures experience these stages sequentially. It was therefore proposed to rename 'stages' to 'phases', to emphasize the non-sequential nature of the model (Sullivan 2000). With that said, the model provides a tool with which assess the changing demands of a venture. For instance, how does the varying *Attributes* of the investor, venture and entrepreneur, and *Relational properties* between them influence the value added in different phases? Assuming that the business angel is involved in the venture in the survival phase and adapts to the changes throughout the different phases regarding what the venture needs; when and how do the business angel add value in the different phases?

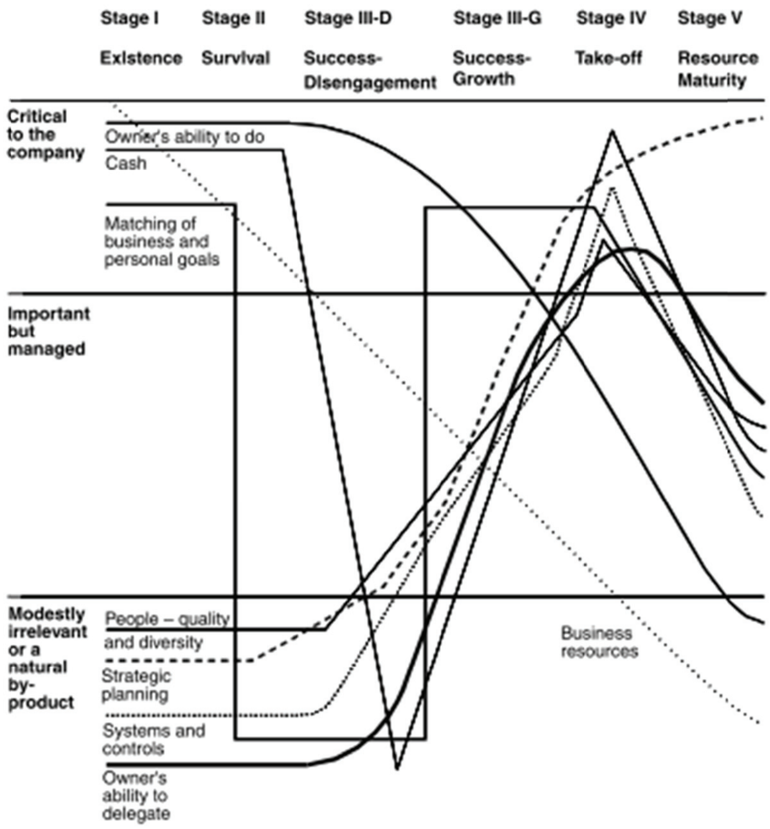


**Figure 15: Five-Stage Model (FSM)**

The different phases are illustrated in figure 15 above, where the importance of eight different factors differs throughout the different phases (Churchill &. Lewis 1983). These factors are listed as 'Owner's ability to do', 'Cash', Business resources', etc. These will be used further in the further discussion.

Although the venture may fail at any time, it is most likely to happen at one of the transitions between the phases (Scott & Bruce 1987). The business angel may be an important supporter in terms of sharing experience regarding what to expect in the next phase. This is valuable information for the entrepreneur (Sapienza 1992). In addition, the *frequency of contact* may in transition phases be higher, it is thus more likely that the venture will absorb knowledge, reputation, and network offered by the investor.

The previous *experience* of the investor and entrepreneur has different value throughout the ventures life cycle. In the early phases, business resources (the stuff of which success is made; market share, customer relations, and a technological base etc.) are extremely important, and the business angel can contribute with vital contacts gained through *industry specific experience,* as well as overcoming the liability of newness (Sørheim 2005). Business angels may also greatly contribute with their *entrepreneurial experience* in the early phases, through *strategic* value adding activities such as developing business models and plans.

Of the interviewed business angels, two of them greatly differed in their involvement in the early phases, especially in their involvement regarding development of business resources. One of them, Grant, is a business angel specialized in the very early phase of the venture, namely the existence and survival phases. Grant is normally engaged in the venture in 2-3 years. He mostly works with attracting governmental grants, strengthening the team and putting in place letters of intent with customers and partners. This reduces the 'liability of newness', which is important to attract further finance (Sørheim 2005);

> At that time we started the process of attracting investors, and by now we have done our "homework". The market is ready, the technology is ready, you have customer agreements and a solid team. You know the market, they have sufficient expertise, and we brought with us 5 million NOK in risk reduction. Then we signed with a venture company, and they said that they would not have invested if it weren't for us. We provided them with sufficient risk reduction.

Another business angel, Marc, is also engaged early in the venture's life cycle, but is relatively passive in the venture in the early phases. He is more a facilitator of the early development of the venture, and observes if the entrepreneur are suited for the commercialization the venture's product or service. Further, he stated that;

> I believe that one of my important features is to very early in the technology development be the one who compel and challenge the entrepreneur to create an economically valuable case. However, I do not get involved in that development.

Thus, comparing Marc with Grant's role, they greatly differ in their approach to the venture even though they operate in the same phases. Marc is not hands-on in the early phases, although he often contributed in the compilation of a business plan. This may be because they have different experience - Grant have previously worked as a business development consultant engaged in very early phases of ventures and have skills appropriate to that task, as opposed to Marc which has greater experience within financials, general management and business.

Marc's experience may be more applicable in the next phase - survival phase. Accordingly, revenues and expenses are becoming more significant in the daily operation in the survival phase. Thus, the handling and monitoring of more complex financials are becoming important, where the business angel may to a great extent contribute, either through financial advice (*Knowledge & Support)* or directly handle the financials (*Operational management)*. Marc, who has previously been a financial analyst, may then get greatly involved. *Strategic* advice is also becoming essential in this phase, where marketing plans and marking out the right course for the venture is important. In the survival phase, one may assume that the business angel is becoming highly involved in venture because of the broader range of possible potential value adding activities.

If the venture survives and enters the success phase, the need for *Management experience* is higher (Churchill & Lewis 1983). If the entrepreneur is less experienced in delegating, the business angel may contribute either indirectly by guiding the entrepreneur (*Knowledge & Support),* or directly (*Operational management*), filling personnel gaps in the management team (van Osnabrugge & Robinson 2000). If the management team is incomplete, taking part in the recruitment processes may become an important contribution. Here, the *legitimating* power of the business angel, influenced by the track record of the investor (Sørheim 2005), may come in handy, in addition to the *network*. The lack of management skills is especially conspicuous in HITVs, where the entrepreneur may be a competent scientist without the necessary skills in controlling, organizing, and managerial decision-making (Gomez-Mejia *et al.* 1990). Further, the success phase demands a choice of whether to continue or sell the venture. The business angel may be a supportive part in that process, and further be an important contributor in negotiating terms with potential acquiring companies.

In order to reach the next phase - takeoff - financial resources are important, and the business angels can contribute by facilitating further finance (e.g. Sørheim 2005). They may in this phase help the investee company in the process of acquiring VC funding and debt finance, making it easier to overcome funding problems (Madill *et al.* 2005). The business angels' *legitimating power* and *network* is important in this process. However, the possible dilution of equity on behalf of the business angel is high as a result an increased demand for financial resources. Increased number of shareholders and more professional management in the venture may result in a relatively passive business angel in the takeoff phase and later phases, and it is likely that they will just attend Board meetings (*Strategic activities*). The possibility for the business angel having cashed out by now is high.

In an attempt to recover some of the lack of time perspective related to the various activities reported in business angel research, table 9 presents some of the most important activities in corresponding phases, based on antecedently argumentation regarding experience usually acquired during the business angels' professional lives and the ventures' life cycle phases.

| | Existence | Survival | Success | Take-off | Resource Maturity |
|---|---|---|---|---|---|
| **Strategic** | • Help with the business concept or model | • Formulating, marketing plans<br>• Help with the business concept or model | • Strategic advice<br>• Testing and evaluating marketing plans | • Strategic advice<br>• Board of Directors | • Strategic advice<br>• Board of Directors |
| **Knowledge and Support** | • Industry know-how | • Management know-how<br>• Monitoring of financial and operating performance<br>• Industry know-how<br>• Marketing know-how<br>• Financial know-how | • Management know-how<br>• Monitoring of financial and operating performance<br>• Industry know-how<br>• Marketing know-how<br>• Financial know-how | • Monitoring of financial and operating performance | • Monitoring of financial and operating performance |
| **Operational management** | • Developing actual products or services<br>• Soliciting customers and distributors<br>• Selecting vendor for equipment | • Developing actual products or services<br>• Developing production or service techniques<br>• Soliciting customers and distributors<br>• Negotiating employment terms<br>• Contribute in management<br>• Selecting vendor for equipment | • Interviewing and selecting management team<br>• Negotiating employment terms<br>• Contribute in management | | |
| **Network (channel)** | | • Provision of potential suppliers<br>• Provision of potential customers | • Provision of potential suppliers<br>• Provision of potential customers<br>• Provision of potential investors | • Provision of potential investors | |
| **Legitimation (channel)** | | • Reduce liability of newness | • Reduce liability of newness<br>• Help to overcome funding difficulties<br>• Interface with investors<br>• Find other sources of funding | • Interface with investors<br>• Other sources of funding | |

**Table 9: Venture Lifecycle & Venture Needs**

As one may conclude from table 9 business angels tend to add most value before the venture enters the 'Take-off' phase, and that involvement increases towards this point. This may be as a result of the feeling of a 'honeymoon' (Fichman & Levinthal 1991), the 'consumed' potential contacts and advice, the greater uncertainty in the early phases, a result of expanding the venture's human capital and the equity dilution on behalf of the angel that may occur.

Further, other factors (*Attributes* and *Relational properties*) deserve to be highlighted because of the varying nature throughout the venture's life cycle. Firstly, whether or not the business angel works *solo* or is a part of a *group* may influence the duration of the business angel's involvement in the venture, due to the increased financial resources, thus less possibility of dilution, as well as the potentially greater experience, knowledge and skills angel groups might have (Mason 2005). An angel group may therefore have the ability to add value later in the phases.

Secondly, their financial motivation compared to the social as an attribute of the investor is likely to increase throughout the life cycle; analogous with business angels and later stage VC's different social motivation. Does this mean that a business angel who invested at an early phase would add more potential value due to more social motivation and wish to increase the entrepreneur's knowledge? As one of the interviewed business angels stated (Marc);

> I have to a greater extent synchronized interests with the entrepreneur. The VC does not have that.

Lastly, a trusting relationship between the entrepreneur and business angel, hence *social match*, may change during the venture's life cycle, as they get to know each other better (Sullivan 2000). As Phil, one of the business angels mentioned;

> It is not very often I have good direct acquaintance with the entrepreneur. It is often through other people I know.

The social match is important, because the motivation of sharing knowledge and experience is a highly personal decision, and to some extent triggered by their social connection with the entrepreneur (Kelly 2007). Quoting Marc;

> The partnership with the entrepreneur is extremely important. Almost as if he was my son, true friendship

Sørheim (2003) found similar evidence in his studies, suggesting that Norwegian business angels seek common ground in order to develop a trustworthy relationship. If the social relationship develops, it may be a motivation for potential value adding through informal interaction. This reasoning may especially concern indirect value adding, meaning *Knowledge & Support*-activities such as coaching, mentoring and sounding board.

Further, the entrepreneur's *receptivity* towards potential value adding may also be higher later in the phases as a result of a developed social relationship. This reasoning is in line with Sapienza and Amason (1993) that found evidence that the developing working relationship between VCs (although they invest at a later phase than business angels) and the entrepreneur converges their perspectives through repeated interaction, increasing the openness and trust between them. This result was especially evident in HITVs[1]. This effect is naturally limited if a trusting relationship existed before the investment, and if the relationship survives the early phases. However, what other aspects may influence *receptivity*, and how may *receptivity* influence potential value added?

## Theme 1.2: The entrepreneurs receptivity towards potential value added

Receptivity is an important attribute of the entrepreneur that may influence the amount of value added by investors (Macht 2011; Barney *et al.* 1996; Sapienza *et al.* 1996). It builds on the assumption that a business angel may not wish to contribute if he or she perceives that the entrepreneur does not appreciate or welcome their contribution. Macht (2011) also highlights this in her study that '... there is also the possibility that investee management does not welcome the involvement, which might result in a negative impact upon the ability of business angels to add value'. It was Landström (1992) who first mentioned the concept '*receptivity'* of the entrepreneur, but it has not until recently been mentioned as affecting the investees role in business angel value adding.

Macht (2011) made an in-depth case study on four business angel-entrepreneur dyads. Her results showed that entrepreneurs greatly differ when it comes to receptivity, and that responsiveness is required for business angels to add potential value. This is an important finding (and consistent with Barney *et al.* (1996)), when most previous research states the opposite, namely that entrepreneurs accept and utilize most investor involvement (Large & Muegge 2008). Her study found evidence suggesting that the receiving entrepreneur play a crucial role in the involvement from the business angel, in terms of whether or not the business angel add potential value, but also a mediating effect on the realization of that potential value. She argued further that the receiving entrepreneur seems to be a 'gatekeeper' in regard to business angels' involvement. This implies that receptivity on behalf of the entrepreneur not only determines the non-financial value that the business angel may contribute with, but also play an important role in the implementation of the potential value added - from potential to realized value.

Similar notion was expressed by one of the business angels interviewed in this study. Blake stated that he quite often experienced nonresponsive entrepreneurs, with hidden agendas and diverging motivation from his own;

> I have experienced in several cases [...] where the entrepreneur after meetings with the Board, does what he wants, no matter what was agreed upon. He may even work against the Board's resolution. He does not play with open cards.

Similarly, another business angel that was interviewed expressed that;

> If a business angel perceives that his advice is not in a way appreciated, he will think that he is wasting time.

In the field of VC studies, Barney *et al.* (1996) made a study regarding the openness towards and assessment of potential value added. Their study showed that the realized value added to some extent is contingent upon if the entrepreneur values the VC input and learning assistance. The results also showed that entrepreneurs with more industry experience and longer team tenure in the current venture assessed the advices from the investor more often. The opposite situation was when the entrepreneurs had little industry experience and had worked together before the current venture.

However, what about other contextual factors which may influence receptivity? How will the different *Attributes* and *Relational properties* influence the receptivity? This study will elaborate how previous empirical research suggests the different contextual factors influence receptivity, in light of empirical data.

**Attributes and Relational Properties affecting Receptivity**

Previous studies argue that the Attributes of the entrepreneur, business angel and venture, and *Relational properties* between them that may influence value added. Since the entrepreneur's receptivity plays an important part in the value adding offered (Macht 2011). These factors might also influence receptivity. The following section will therefore argue how the *Attributes* and *Relational properties* may influence the receptivity towards potential value added, thus the wish to exploit external advice.

**Attributes**

***Experience:*** Firstly, the entrepreneur has high or low receptivity towards involvement may be highly connected to the *experience* of the investor and the entrepreneur, meaning *relevant industry experience, general management expertise* and *entrepreneurial experience*, and his ability to actually share this experience and add valuable knowledge to the entrepreneurs' mindset. If the entrepreneur does not comprehend the presumed experience the business angel might have, or if the investor does not have experience relative to the entrepreneur, the entrepreneur will most probably be less receptive, than if the investor was perceived as a competent and experienced businessperson.

Further, low receptivity may also arise if the entrepreneur has an extensive track record and experience, and has acquired sufficient business know-how and management expertise, to further experience the business angels' involvement more as a distraction than as a valuable input. The opposite situation arise when the experience and track record of the entrepreneur is limited, and where the investor can contribute with a lot of knowledge and 'fill the gaps' (Murray 1996).

Although this logic may be obvious, the opposite situation may also occur. For instance, Macht (2011) did not find evidence for the assumption that the ratio between experience of respectively business angel and entrepreneur is approximately proportional to responsiveness and unresponsiveness. The entrepreneur may not have the prior related knowledge necessary to evaluate and utilize new information (Cohen & Levinthal 1990) and advice from the investor, thus not see the value of the experience shared by the investor. Consequently, an unfortunate situation may occur, that less experienced entrepreneurs do not have the ability to exploit, understand and value badly needed knowledge shared by the business angel. This may be illustrated by one of the business angels interviewed, Arron, who have prior experience with marketing and sales. He is operationally involved in the venture. The investee's entrepreneur, a scientist, did not value his knowledge as a result of ignorance:

> The scientist [...] would not be involved in sales. But he must still understand it. [...] They have little understanding of my job, which involves many phones, many meetings, contact sellers, market strategy and so on. And they just; "Oh my God."

Paradoxically, experienced venture CEOs and management teams that are in less need of outside assistance may be more capable of evaluating and leveraging the input of their investors (Sapienza *et al.* 1996). Further, evidence suggests that if the investor solely has investment experience compared to entrepreneurial experience, and is perceived as a financier more than a practitioner in the venture industry, the danger of resentment on the part of the entrepreneur would be great (Sapienza *et al.* 1989).

Connected to experience the *overall team tenure experience*, meaning the degree to which the entrepreneurs, or the 'new venture team', have worked together in previous or current venture may also influence receptivity. It is reasonable to assume that teams with extensive experience in working together tend to already have established operating patterns that may influence the receptivity negatively. However, Barney *et al.* (1996) found evidence for the opposite scenario, that in fact teams that had worked together for a long time valued the investors' involvement higher.

***Solo business angel vs. Group:*** Further, Mason (2008) points out the changing nature of the angel market, stating that angel syndicates, or business angel groups, are becoming increasingly significant. The question further is whether or not *solo business angels* versus *groups* may influence the receptivity towards potential value added. It is reason to believe that the ability to add value for an angel group is much greater compared to the single business angels, due to the broader range of business expertise and experience (Politis 2008; Mason 2008). Thus, based on the previous discussion of experience influencing receptivity, one would suggest that the receptivity is higher for business angel groups compared to solos. However, the entrepreneur may also feel more threatened by the angel group compared to the solos, with increased number votes in decisions on behalf of the investors. This may cause the entrepreneur to be less receptive.

Another interesting point were mentioned in one of the interviews undertaken by De Clercq and Fried (2005), where it was suggested that syndicates of co-investors was a great way to learn and share experience among them concerning a venture, which in turn increased the quality of the potential value added that they could contribute with. However, investors with different objectives was seen as a problem in this interview, and in one performed in this study. If the investors have diverging objectives, the entrepreneurs' receptiveness would potentially be higher towards one of them. The entrepreneur would probably use this for what it is worth, and put them up against each other. An unhealthy, mom-dad-'I want ice cream'-situation may develop, where the entrepreneurs' receptivity may be used in controlling and putting the investors up against each other.

***Regional vs. industry specific:*** One may suggest that *regional* focused investors, as opposed to *industry specific* investors, experience entrepreneurs with a limited track record. Sørheim (2003) proposed that regional investor often is considered as trustworthy having a positive reputation and track record from the venture's region. In addition, the geographical closeness may constitute the creation of 'common ground', simplifying the exchange of information between the business angel and entrepreneur (Sørheim 2003). In connection to the previous discussion, this may imply that the regional focused investors experience higher receptivity from the entrepreneurs, and are consequently to a greater extent enabled to add more potential value to the venture and entrepreneur compared to the industry specific investors. The social motives may also stand stronger than the financial motives on behalf of the regional investors, seeking to build regional infrastructure and help local entrepreneurs in succeeding, further implicating that regional investors are more active in the venture than industry specific investors.

***Performance of the venture:*** The *performance* of the venture may also influence the receptivity, owing to the fact that for instance when the venture is performing poorly, the entrepreneur would perceive a greater need for assistance from the business angel, thus be more receptive. If the venture performs well, one may expect that the entrepreneur would have a lesser need for assistance, consequently lower receptivity. However, previous research further argue that if a venture is performing well, it is likely that the entrepreneur will interpret this as a confirmation of the potential value added actually is aiding and benefiting the venture (Barney *et al.* 1996), thereby making the entrepreneur more receptive.

**HITV vs. LITV:** It is common for new ventures to attempt to establish a foothold in new markets through the development of technologically innovative products (Timmons and Bygrave 1986). As mentioned earlier, *HITV*s are often most interesting in the eyes of the venture capital communities, because of their potentially high returns. Furthermore, the development of high innovative technology place heavy demands on the entrepreneurs (Sapienza & Amason 1993; Pisano 1994). Consequently, one would suggest that HITVs have a greater need for becoming a learning organization to help support a competitive advantage, and be more receptive towards potential value adding. This is consistent with previous research on VCs, suggesting that potential value adding from VCs is more important in ventures that attempt to differentiate themselves based on technological innovations (Ehrlich *et al.* 1994; Sapienza 1992). Further, one would also expect that the entrepreneur is a competent scientist without the necessary skills in general management. If the entrepreneur perceives the absent of this skill, he or she would probably be receptive towards advice.

***Lead vs. non-lead:*** Gomez-Mejia *et al.* (1990) suggested that investors' shareholding levels affect investee responsiveness. If investors hold a large amount of shares, it is more likely that investees accept their involvement, as investors in such cases have more power to influence the investee. However, a conversation with a previous entrepreneur in the US said that the current amount of shares was not that influencing on the receptivity. Rather, the investor's financial power and ability to be a future financial source was more important. Thus, the receptivity towards investors with less shares, but had more money to invest was higher than the ones with a higher number of shares, but no ability to invest later in the venture's life cycle.

**Relational Properties**

***Frequency of contact:*** *A* property of the relationship between the entrepreneur and investor is the frequency of contact. Further, De Clercq and Fried (2005) argued that entrepreneurs are more receptive if involvement is of high quantity. It shows that the investor is committed, which is crucial in developing relational power that may enhance the receptivity towards potential value added (Fried & Hisrich 1995).

***Social match:*** The *social match* is a *Relational property*, and meant to cover the personal chemistry, social bond, and openness in communication. This plays an important role in the pre-investment period, but also in post-involvement as a likely influencing factor of the receptivity (Ring & Van de Ven 1992) the entrepreneurs have towards the investor. If the social tie between the investor and the entrepreneur is good, with a mutual appreciation of the relationship, trust and trustworthiness, the entrepreneur may be more receptive towards informative advices, and consider them more as a learning aspect than critique. Here, 'trust' can be seen as an attribute of the relationship between the investor and the entrepreneur, while the 'trustworthiness' is an attribute of the investor (Barney & Hansen 1994; Tsai & Ghosal 1998). Ned, in one of the interviews, highlights trust and encouragement as main determinants of receptivity;

> You have to win trust and build up the people you work with. Entrepreneurs need to feel like world champions and feel fantastic. [...] If you break them down, they are not receptive towards assistance, and everything becomes destructive. You create negative forces internally. I think it is very important from an angel investor's perspective, [...] to build trust, and if you succeed in that they will be receptive. I am aware of this before I invest. If I perceive potential conflicts between us I refrain from investing, no matter how interesting it is. I do not want to invest with only financial intentions in mind. I also want to contribute. The last thing I ask the entrepreneurs before I invest is: "are you happy?"

The same point of view was mentioned by Arron, emphasizing that the entrepreneur have to feel like a world champion, but at the same time have the ability to be "coachable";

> The entrepreneur has to be a world champion, have a great engagement and vitality. [...] But the entrepreneur also has to be "coachable" and receptive. I think this is connected to personality and psychological things. Some people match more than others, [...] so if they (the entrepreneurs) don't like me, they will be less receptive.

Macht's (2011) recent study did not find any evidence of the proposed factors; HITV, frequency of interaction, differing or complementary experience, and amounts of shares (lead vs. non-lead), but argued that some '… *invisible* characteristics [of the entrepreneur] may prove more insightful' when trying to find what influence receptivity. Thus, her study also indicated that the social connection between business angels and entrepreneurs is important for the receptivity towards external advice. She further proposed that a positive attitude towards external advice in general display higher receptivity. This is however not that surprising, that entrepreneurs who in general are responsive towards external advice more likely are responsive to external advice from business angels.

The receptivity towards potential value added further highlights an important theme, because not only does receptivity influence the motivation for business angels adding potential value added, but it is reason to believe that receptivity maybe to a greater extent influence the realization of potential value added. Blake, who experienced problems when the venture performed well and the investors began to request ability to delegate and take advantage of increased performance, highlights this;

> This often leads to conflicts between business angel and entrepreneur. We (the investors) then provide the expertise and willingness to implement the advices offered, but there is not willingness to listen and change their own behavior. [...] The entrepreneur is clinging to his post. As general manager thinks; this is my baby, it's me who will rule everything. They can listen to advice, but do not have to take into account.

The experiences Blake share indicate that the entrepreneur receptiveness towards potential value added do not automatically mean that the entrepreneur is willing to implement and utilize it. Macht (2011) support the notion that responsiveness may be an equally major determinant for whether involvement adds value to the venture. If the entrepreneur is willing and receptive to utilize potential value added from the investor, what determines their ability to fully exploit this information? This will further be addressed in the next theme.

## Theme 2: From potential to realized value added

While the previous theme have received some attention in the VC and business angel literature, little attention has been given to the process related to the transfer of potential value to either the entrepreneur or venture (De Clercq & Manigart 2007). However, Large and Muegge (2008) presented some insights from VC literature regarding the relationship between inputs and outcomes of value adding. They suggested that there are some factors that moderate this relationship. For instance, the level of VC involvement (MacMillan *et al.* 1988; Ehrlich *et al.* 1994), the fit between VC and management team (Perry 1988) and the life cycle of the venture (Gomez-Mejia *et al.* 1990). However, the results were inconsistent and more factors needed to be investigated in order to elaborate why some potential value are implemented, while others are not (Large & Muegge 2008). Because of the lack of research concerning this topic, De Clercq and Manigart (2007) used 'black box' as a metaphor for introducing the 'process-related issues'. The reason for this underdeveloped field of research may build on the key assumption underlying the term 'value added' (Macht 2011), that the contribution from investors is of direct and positive value for the venture. Thus, it seems as if previous research, especially in regard to research on business angels, to some extent has assumed that potential value added is realized value added.

This study argues that this assumption is not entirely wrong. Some of the potential value adding is directly addressed to the venture, meaning that potential value adding is realized value adding without any receiving intermediary. This intermediary (from now on referred to as the 'receiving entrepreneur') is often senior executive managers (Macht & Weatherson 2011), but may also be one of the others in the entrepreneurial or venture team. For instance*, legitimation* is a direct value-adding activity by for instance reducing liability of newness of the entrepreneurs and venture (Sørheim 2005). However, indirect potential value adding, in accordance with the describing term 'indirect', are dependent on an intermediary to exploit and realize the potential value added. This may be activities, such as mentoring and sharing of knowledge (*Knowledge & Support).* The degree of direct involvement is highlighted in figure 13.

So it is evident that especially regarding indirect value adding activities there is a need to distinguish between potential and realized value. This is further highlighted by Politis (2008); '... instead of treating value added as a simple transferring process, the distinction [between realized and potential value added] suggests that people and organizations can vary significantly in their ability to effectively implement and utilize the potential value adding benefits (Cohen & Levinthal 1990) that business angels may provide'. Consequently, this study argues that direct value adding is solely contingent upon the factors that influence *potential* value added, as opposed to indirect value adding activities that are also contingent upon the receptivity towards exploitation and the ability to exploit.

Macht (2011) have touched upon the idea that receptivity of the entrepreneur plays a crucial role both regarding if the business angel may add potential value, and which contributions and advice the receiving entrepreneur's wish to listen to and try to exploit. However, how is their ability to exploit the potential value added if they wish to be receptive? What are the conditions that make some entrepreneurs better in exploiting feasible advice from business angels?

Because of the lack of theoretical frameworks in the field of business angels, there is a need for using suitable models from other disciplines, as they ma be a contribution to this research field. It was Politis (2008) who first introduced the thought of applying theories involving potential and realized absorptive capacity (Zahra & George 2002). Absorptive capacity is a concept that is a suitable theoretical of handling the transfer and process of transforming potential to realized value added, as absorptive capacity is defined as the ability to acquire, assimilate, transform and exploit new knowledge in order to cope with the often constrained resources that growing new ventures have (Cohen & Levinthal 1990; Zahra & George 2002). Consequently, this study wish to apply the theories regarding absorptive capacity in order to get a further understanding of how entrepreneurs may leverage from knowledge shared by their business angels. Figure 16 illustrates the role of receptivity as a prerequisite for utilization of potential value added, and of absorptive capacity in the realization of potential value adding.

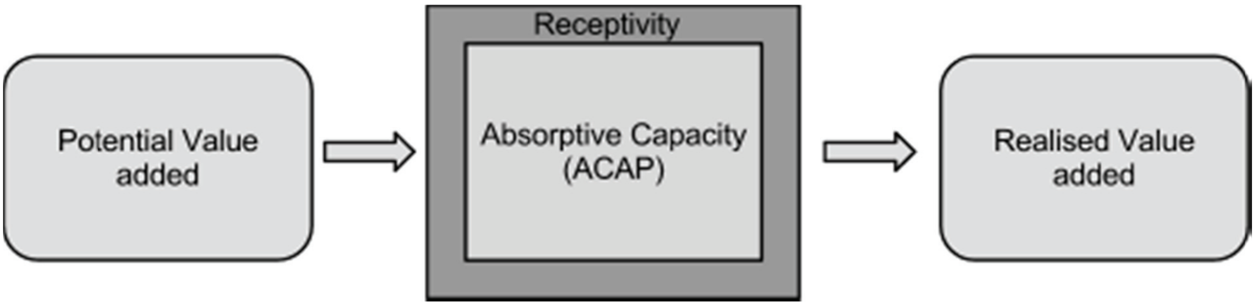


**Figure 16: Absorptive Capacity**

## Absorptive Capacity

The ability to absorb and use new knowledge is an important capability to secure future growth for a new venture (e.g. Phelps *et al.* 2007; Cohen & Levinthal 1990). Especially in fast growing industries, within high-tech, the ability to recognize external information, assimilate it, and apply it to commercial ends is critical for successful operation and adapt to changing market conditions (Cohen & Levinthal 1990). Cohen and Levinthal (1990) labeled this capability 'absorptive capacity' (ACAP). They argued that ACAP may be seen as a capability on the individual level and as a capability on the organizational level, thus the further discussion will not try to a great extent distinguish between these two levels.

The concept ACAP originates from knowledge management and organizational learning literature, and was re-conceptualized by Zahra and George (2002), where they distinguished between 'potential' and 'realized' absorptive capacity. Potential ACAP refers to the venture's capability to acquire or assimilate new external knowledge, thus the ability to identify, understand and value new information. Realized ACAP are the venture's capability to transform and exploit new external information, hence the ability to apply new knowledge into the context of existing knowledge, and to incorporate this transformed knowledge into the venture's operation. These four organizational capabilities (acquire, assimilate, transform and exploit) suggests Zahra and George (2002) build on each other to yield absorptive capacity - that is 'the dynamic capability that influence the firm's ability to create and deploy the knowledge necessary to build other organizational capabilities (e.g. marketing, distribution)'. These organizational capabilities further give a basis for competitive advantage (Barney 1991).

As previously stated, business angels provides to great extent new information to the venture and receiving entrepreneur. ACAP is then likely to play an important role in the transfer of this knowledge to the receiving entrepreneur as well as the venture as a whole. However, the ACAP of the entrepreneurs are not of any value if the entrepreneurs are nonresponsive to the knowledge and potential value shared. Responsiveness are required for involvement to add value (Macht 2011), thus it is not until the entrepreneurs are *receptive* towards potential value added that the 'amount' of ACAP may determine the realized value added to the venture.

However, high potential ACAP of the receiving entrepreneurs does not imply realized value added, and enhanced performance. Yes, high potential ACAP is a prerequisite for fully realizing the potential value of the information given by the investor, but it is not of great value without the ability to transform and exploit that information. Similarly, it is impossible for the entrepreneurs to exploit knowledge without first acquiring it. Thus, potential ACAP and realized ACAP are combinative in nature and build upon each other (Zahra & George 2002). Ventures differ to a great extent regarding the amount of ACAP (Gann & Salter 2000). It is argued further that differences in the *Attributes* of the entrepreneur and business angel influence the entrepreneur's potential and realized ACAP (Lane & Lubatkin 1998).

## Potential absorptive capacity

The ability to acquire and assimilate new knowledge is contingent upon the receiving individual's existing knowledge (e.g. Grant 1996; Cohen & Levinthal 1990). That is, the entrepreneur may to a greater extent recognize and value new knowledge from the business angel if he or she have some prior knowledge that may enhance the ability to understand and store that information (Cohen & Levinthal 1990). Consequently, transfer of knowledge is easier if the business angel and entrepreneur have knowledge in common (Lane & Lubatkin 1998), and have similar knowledge experiential characteristics (Argote *et al.* 2003). One of the interviewed, a previously experienced business angel, expressed that;

> I often experience that the ones (entrepreneurs) that knows a lot, also are the ones that I can greatly contribute to with my knowledge. Then you play on the same side of the field. [...] They understand, and have own solutions to the problems addressed. [...] The opposite situation rarely works.

This may also imply that the entrepreneur's potential ACAP, hence their ability to acquire and assimilate knowledge, may be improved if the business angel and entrepreneur share experience gained throughout the life of the venture. Events and situations happened in the past that the entrepreneur and business angels share and can relate to, may be a basis for increased potential ACAP and future mutual understanding of new information. This may in turn increase the value of the potential value added by the business angel.

However, the downside of knowledge transfer between an entrepreneur and business angel with relatively similar prior knowledge and experience is that the breadth of content that can be shared is limited. In addition, the entrepreneur's and business angel's acquired and assimilated information about and from the changing environment that their venture is experiencing would possibly have been narrow and less insightful. However, their potential ACAP would presumably have been higher if the knowledge offered by the business angel are complementary, meaning that the knowledge is related but at the same time different from prior knowledge (e.g. Cockburn & Henderson 1998).

The entrepreneurs may intensify their effort in acquiring and assimilating new external knowledge when the venture is experiencing important events such as the first sale or the first big contract with a customer, or when performance is poor (Zahra & George 2002; Kim 1998). This is accordance to previous research on business angels stating that receptivity towards potential value added are influenced by performance (Sapienza *et al.* 1996).

## Realized absorptive capacity

Realized ACAP are the capabilities (transformation and exploitation) that are likely to influence the venture's performance (Zahra & George 2002). That is, the ability to apply the assimilated external knowledge from the business angel to the venture's operations. Experienced entrepreneurs may be more fully able to take advantage of the connections, advices and legitimacy offered by the investor (Sapienza 1992).

Further, knowledge exploitation requires the sharing of relevant knowledge among the other entrepreneurs (Spender 1998) in order to promote mutual comprehension (Garvin 1993). The receiving entrepreneur may sometimes not be the right person in the venture to receive the advice from the business angel. As the venture develops the responsibility gets divided. The receiving entrepreneur's ability to communicate this information further to the target of the information, or the best person for exploiting that information is then important in order to realize the potential value added. It may seem as if the prior experience of the entrepreneur plays an important role in the entrepreneur's ability to utilize information and advice from the business angel

## Results and Discussion

This paper seeks to fill the gaps in previous research, termed the 'black box' (De Clercq & Manigart 2007), regarding what may influence and affect which value adding activities business angels perform (resulting in potential value added), and what affects the process of realizing potential value added. Accordingly, (Theme 1.1) how the venture's varying demands during the life cycle may influence the potential value added, and (Theme 1.2) the role of receptivity of the entrepreneur in terms of the degree of involvement and potential value added. Lastly, (Theme 2) how entrepreneurs may have differing absorptive capacity and ability to exploit new knowledge assuming that the entrepreneur is receptive.

To conclude the results from the different themes outlined in this study, a conceptual model is presented in figure 17.

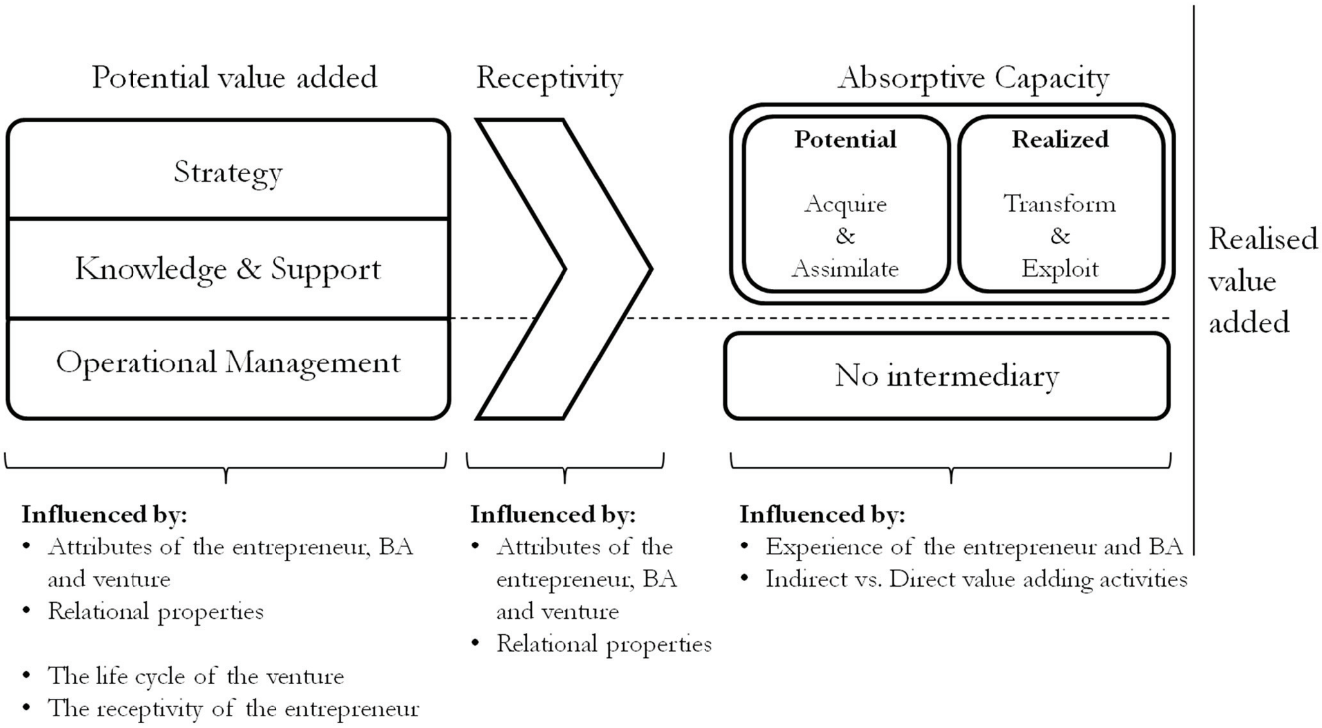


**Figure 17: Conceptual model for Realized Value Added**

The model is meant to build a foundation for future studies, as well as systemize this study's contribution in this avenue of research. This study has argued that the potential value added by business angels are influenced by the *attributes* of the entrepreneur, business angel and venture, in addition to the *relational properties* between them. The study have addressed two of these *attributes*; the ventures life cycle and the entrepreneurs receptivity, and argue that they play an important role when determining what and why business angels might add value.

Further, the receptivity is a gatekeeper in terms of the willingness to utilize information gained from *Strategic* and *Knowledge & Support* activities, in addition to the entrepreneur's receptivity towards involvement in the operational part of the venture, accordingly *Operational management*. However, as opposed to Macht (2011) which treated value added as a whole and did not make a distinction between different value adding activities, this study argue that receptivity behaves differently with differing value adding activities. When we distinguish between indirect and direct value adding[2], it treats receptivity as two different roles. In direct value adding there is no intermediary (receiving entrepreneur), and receptivity determines whether or not the business angel may contribute and offer potential value added. This is as opposed to indirect value adding, with an intermediary, where the receptivity also determines whether or not to acquire, assimilate, transform and exploit that contribution.

Entrepreneurial learning theory has not been of great focus in this paper. However, this study may contribute to a better understanding of how business angels may facilitate the entrepreneurial learning of their investee entrepreneurs. Previous research (e.g. Politis 2005) argues that entrepreneurial learning is experiential. This may imply that the notion of how business angels should share knowledge and experience should be in an experiential manner. Thus, the 'just-in-time' approach (where advice is given in response to given events) may be more suitable for sharing knowledge and advice than the approach where advices are given up-front (Sullivan 2000). This is in line with the previous discussion, which argued that the potential ACAP (ability to acquire and assimilate) is highest when the advisor and recipient have a joint experience of a given event during the venture's life cycle. Further, the elaboration of the value adding activities needed during the different phases in a venture's life (table 9) may also help the business angel in identifying when the entrepreneur reach a point and event in their development where different knowledge and advice are required (Sullivan 2000). Thus, it enables 'just-in-time' approach.

This is also in line with one of the interview candidates who argued that it is '... highly the business angel's responsibility that the relationship with the entrepreneur is characterized by mutual respect and trust', and that the investor also use their ACAP in order to enhance the quality of the contributions they offer. This may in turn increase the entrepreneurs' receptivity towards potential value added, and the realization of it.

## Implications and Future Research

The authors argue that this paper presents a conceptual model that have implications both for future research and for the parties concerned with successful transfer of knowledge and value in investor backed ventures.

Considering the latter, business angels may to a greater extent have an understanding of how they may increase the exploitation of the advice they are giving. The authors argue that the ability and willingness to exploit advice are contingent upon if the advice is given when the venture is in need for it. In addition, they may be more aware of what drives the entrepreneur's receptivity. Several of the interviewed mentioned that it is the investor's responsibility to achieve the satisfactory trust and respect that may foster receptivity, and the wish to exploit.

For future research on this field, several contributions may be mentioned. Firstly, the conceptual model presented may build a foundation for future research on value added, because it considers value added as a process, and distinguish between potential and realized value added (Politis 2008). This may in turn increase the scholarly understanding of the different internal and external factors that may influence value added, and how, and in what way they may influence.

Secondly, it supports the notion presented by Macht (2011) that future researchers should to a greater extent consider the role of the entrepreneurs receptivity towards value added.

Thirdly, this study argues that we have to distinguish between indirect (instructing) and direct (self-performing) involvement from the business angel, since the process of realizing the potential value of these involvements differ greatly. Accordingly, direct involvement is not contingent upon the entrepreneurs' absorptive capacity, as opposed to indirect involvement.

Thus, and lastly, future researchers should to a greater extent consider the entrepreneur's ability to not just be receptive or what the business angels might contribute with, but also the entrepreneur's ability to exploit the potential value given. Inspired by Zahra and George (2002), this study proposes a ratio between potential value and realized value added called the 'efficiency factor'. If the this factor is high, it means that the entrepreneurs have been receptive towards the potential value from the business angel, and have the ACAP to acquire, assimilate, transform and exploit this information to realized value added. Consequently, if this factor equals one, the potential value are fully exploited and applied in the venture's operations. This factor may be used in future studies for measuring the potential value of the knowledge and experience possessed and shared by the business angel, and the entrepreneurs ability to exploit that knowledge to enhance venture performance.

Further, the model presented in this study may be utilized by future researchers in two ways. Either it can be used to pinpoint if the investor's advice and shared knowledge actually is exploited in the venture, or it can be used to go into detail on why/why not this happens. Some recent studies indicate that advice offered is not followed, however more evidence is needed to substantiate this. This should be undertaken by qualitative data from entrepreneurs and investors in cases where it has been offered advice and knowledge, and where one may see whether or not these advices have been followed and exploited. The efficiency factor may be applied. If evidence point out that the efficiency factor is low (hence little potential value added has been realized), this opens an interesting field of study: why is this in fact so? We, along with other researches, argue that receptivity may be one answer. We have also addressed that the entrepreneur may not have the capabilities needed to implement advice. Are there other possible factors? If it turns out that the problem lies in the entrepreneur's inability to exploit, what may be the cause? In order to address this future researcher should choose cases where the efficiency factor is low, and interview both sides of the matter. Was it the entrepreneur's receptivity or ACAP, the disability to share information internally in the venture, or some other cause? These questions should be considered to enhance the understanding of how business angels may to a greater extent contribute in ventures.

# Notes

1. It is important to distinguish between High- (HITV) and Low-Innovative Technological Ventures (LITV) when analyzing the changing nature in a venture's life cycle (Churchill and Lewis 1983), in addition to the characteristic of the venture's industry. In the previous elaboration of the different phases, it has been emphasized HITV's life cycle rather than LITVs, due to the fact that most investment activities concern HITVs. Due to this fact HITVs have shorter duration in the different phases compared to LITVs, and may reach the success phase faster (Churchill and Lewis 1983).

2. The distinction between indirect and direct value adding is because some of these value adding activities may be seen as a direct value to the venture, meaning there is no intermediary between the potential and realized value added. For instance, when negotiating with a vendor, a business angel may either instruct and prepare the entrepreneur in how to negotiate, meaning what the entrepreneur should or should not say or do, or the business angel may participate himself/herself - former being the indirect value adding (*Knowledge & Support*), while the latter being direct value adding (*Operational management)*.

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