

# A Network Perspective on Business Angels

## - are casual acquaintances better than close friends

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### Introduction

Since the first article on business angels was published (Wetzel, 1981), studies regarding business angels have been focused on the characteristics of business angels, the investment process, investor involvement in portfolio firms, and policy issues to stimulate the business angel market (Mason & Harrison, 2000). Research has shown that the anonymity of investors as well as information asymmetry between investors and entrepreneurs creates an inefficient market (Freear et al., 1994). In order to solve the inefficiency problem, researchers and policy makers have turned their attention towards the role of syndicate investments and Business Angel Networks (BANs). However, these types of strategically created networks are not the only type of networks that business angels are part of. Business angels also have personal networks but it is not known how ties within these personal networks affect the business angels' investment process. It is hence not known if the strategically created BANs, compared to business angels' personal networks, actually play an important role and can decrease the market inefficiency.

It is known that business angels' personal network that consists of family, friends and business associates constitute an important source of information when business angels identify investment opportunities. Business angels not only come into contact with a large proportion of their investments through these ties, they also trust them and are more likely to invest in an investment opportunity presented by someone who is known than someone that is unknown. (Harrison et al., 1997; Mason et al., 1991; Mason & Harrison, 1994; 2000; Reitan & Sørheim, 2000; Stedler & Peters, 2003; Wetzel, 1983). Still, little is known of how these personal networks actually affect the business angels' investment process of finding, evaluating and managing investments. However, a relatively large amount of studies within the field of entrepreneurship research has investigated similar issues and this research ought to be applicable as business angels to large extent can be characterised as entrepreneurs (Gaston, 1989; Landström, 1993; Lumme et al., 1998; Hindle & Lee 2002; Vaekstfonden, 2002; Brettel, 2003).

Much attention in entrepreneurship oriented network research has been focused on Granovetter's (1973) strength of weak ties hypothesis. Granovetter (1973) argues that weak ties are more efficient than strong ties in spreading information and that it hence is important to nurture weak ties (Aldrich & Zimmer, 1986; Johannisson; 1987; Burt, 1992; Nohira, 1992; Ruef, 2002; Ardichvili, 2003; Jack, 2005; Aldrich; 1999). Weak ties are theoretically argued to create less redundant information and thus increase the reach of the focal person (Granovetter, 1973; 1983; Burt; 1992; 2000). However, the hypothesis has not been tested in a business angel context and outcomes of empirical tests in entrepreneurship context have shown mixed results. It may be that the theoretical arguments behind the importance of weak ties are somewhat exaggerated. The reasons behind this are many: (i) Few strong ties need less 'maintenance' than many weak ties. (Ostgaard & Birley, 1996; Jensen & Greve, 2002). (ii) High density networks consistent of strong ties diffuse information more rapidly (Greve, 1995). Valuable information may only be transferred to friends (Jensen & Koenig, 2002). (iii) Transfer of some complicated information

may only be possible through strong ties (Jensen & Koenig, 2002; Liao & Welsch, 2003;). (iv) The higher level of trust in strong ties means that information is more likely to be received and accepted (Liao & Welsch, 2003; Jack, 2005). (v) Network ties may have to be of certain strength to be able to mediate information from an indirect contact.

Furthermore, there are additional issues that may have affected the attempts to verify the importance of strong ties:

- Firstly, there may be differences in relative importance of strong and weak ties dependent on the stage of the entrepreneurial process (Greve, 1995). However, these internal differences are not tested for in most studies. This means that it is important to carry out studies with focus on different stages of business angels' investment process in order to find possible differences in the impact strong and weak ties have.
- Secondly, there is considerable ambiguity as to what constitutes tie strength (Krackhardt, 1992) and the concept has never been given a precise conceptual definition (Marsden & Campbell, 1984). Different studies have used different definitions and it is hence understandable that studies have shown mixed results. The reason why there has not been a consensus of how to define the strength of ties is related to the problem of how to objectively measure something as subjective as the strength of a personal relationship. This means that it is important to let respondents elaborate on their perceptions on different relationships, especially as there is no previous experience on the issue in a business angel context.

To summarise, it is known that business angels' social contacts influence their investment process. The strength of weak ties hypothesis offers a theoretical framework to investigate the issue of which impact different types of ties have at different stages of the investment process. However, as it has been difficult to empirically establish whether it is strong ties or weak ties that are most important in the entrepreneurial context it is not possible to currently raise expectations of which roles the different ties play in business angels' investment process. There are a couple of reasons that can explain why this may be the case:

### **Aim and contribution of the study**

The purpose of the paper is to reach understanding of how strong and weak ties affect business angels' investment process.

We know that different types of networks are important in the business angel environment and the primary contribution of the paper will be the use of network theory in a business angel context. This has not been done before and the study will hence render deeper knowledge and understanding of how business angels use different types of network ties at different stages of the investment process. Secondly, the study will also provide the field of network theory with further empirical evidence of whether it is weak or strong ties that are of greatest importance in an efficient network. Thirdly, the study will generate knowledge on whether different types of ties can play different roles at different stages of a process, knowledge that not only will generate further understanding of the empirical field of business angels but also supply the field of network theory with new insights. Fourthly, the study will supply policy makers with insights on whether support given to BANs is an efficient way to decrease market inefficiency.

### **Methodology**

As the current knowledge on the topic is limited an exploratory study with four business angel cases was chosen as the most suitable way of gathering data. One reason behind this choice is related to the absence of a conceptualised definition of strong and weak ties. In total 12 semi structured interviews have been carried out in order to get in-depth knowledge of how strongly

tied the respondents actually feel that they are to different individuals as well as to let the respondents elaborate on their investment process.

The four business angels that were interviewed were selected based on a mapping of their answers in a previous survey study. The logic behind the selection was not to identify a representative sample of business angels but rather to choose heterogeneous business angels that have different perceptions on different types of network contacts. The reason behind this principle of selection is related to the purpose of the study, which is not to draw representative conclusions but rather to generate greater understanding of how strong and weak ties affect business angels' investment process, making it possible to generate hypotheses to be tested in later quantitative studies.

Two different groups were formed. The first group contained investors that regarded family and friends, which can be argued to be strong relationships, to be most important. The second group contained investors that regarded BANs, media and contacting entrepreneurs, which can be argued to be weaker relationships, to be most important. After this initial categorisation, business angels that had not invested or only done so to a limited extent were sorted out. The reason behind this was to interview business angels that have a rich history of investments which increases the possibility to find patterns in the use of different types of network ties. Through this procedure four business angels were selected. Two of them were members of the local BAN and two regarded what was believed to be strong ties to be most important in the process of identifying new investment opportunities. All were recommended, and all were active investors.

### **Preliminary results**

The data has been collected and is currently being analysed. Some preliminary results show that business angels trust a few selected individuals whom they get involved with in all of their investments. These contacts are often business associates rather than friends and it was very clear that the respondents did not use any family members in their investment process.

Weak ties including ties to BANs are important at an initial stage of the investment process. BANs, acquaintances and companies trying to find financiers to entrepreneurial ventures are important as means to come into contact with investment opportunities. Investment opportunities are to some extent also found through closely tied business associates that the respondents frequently co-invest with.

In the evaluation stage of the investment process the respondents use a limited number of highly trusted strong ties to give second opinion. These ties are often business associates who also are friends. Employees and accountants to which the business angels have had a very long relationship are sometimes used to investigate the financial status of the companies. However, the respondents often go against the advice not to invest. This illuminates the high degree of independence that business angels have.

At the evaluation stage, the respondents in most cases support the entrepreneurs with their personal networks consistent of strong as well as weak ties. However, if a CEO is employed or if the support is given indirectly through a co-investor, this person is most often an individual to which the business angel has a strong tie.