“Entrepreneurs Heterogeneity and New Ventures Financing”

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Abstract

In this article we study the market for entrepreneurial finance, and use entrepreneurs' heterogeneity to explain the coexistence of different financiers like Venture Capital (VC) and Angel investors. This issue has become increasingly important because i. New ventures are the major source of growth in GDP and job creation, and ii. Some estimates suggest that Angel investors are as important as VC in financing new ventures.

We capture entrepreneurial heterogeneity by assuming that entrepreneurs are motivated by several motivational factors beyond the motivation provided by value considerations. Motivational factors may include, for example, entrepreneurs' attitude towards risk, their need for achievement, and benefits of control.

The difference between VC and Angel investors is that VC investors acquire better information. It seems natural that VC investors, being better informed, will dominate the market and will wipe out the less informed Angel investors. With motivational factors, however, the outcome is different, as Angel investors offer entrepreneurs an avenue to better capture their motivational factor.

Our model yields several empirical implications: 1. Entrepreneurs only switch from Angel to VC investors. 2. Angel-backed ventures are smaller, have higher exit values and are less likely to be liquidated compared to VC-backed ventures. 3. Industries with more attractive characteristics are characterized by more Angel financing. 4. Boom periods are characterized by more Angel financing. 5. Locations with better entrepreneurial eco systems exhibit more Angel financing.