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PATIENT CAPITAL IN ENTREPRENEURIAL FINANCE: A REASSESSMENT OF THE ROLE OF BUSINESS ANGEL INVESTORS

Richard T Harrison, *University of Edinburgh Business School, University of Edinburgh, UK*

Tiago Botelho, *University of East Anglia, UK*

Colin M Mason, *Adam Smith Business School, University of Glasgow, UK*

Address for correspondence: Professor Richard T Harrison, Centre for Entrepreneurship Research *and* Centre for Strategic Leadership, University of Edinburgh Business School, 29 Buccleuch Place, Edinburgh EH8 9JS, Scotland, UK. Email: r.harrison@ed.ac.uk

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ABSTRACT

The debate on patient capital, particularly in the varieties of capitalism literature, concentrates on institutions and public markets. In this paper we take an entrepreneurial finance perspective to examine the investment attitudes and behaviours of business angels. These represent the biggest source of external risk capital for new and young growing companies and therefore play a critical role in entrepreneurial ecosystems. Drawing on both a detailed review of previous research on business angel investment time horizons, investor engagement and exit behaviour and new survey evidence we conclude that only a minority of angels could be defined as being exit-centric investors. It can be concluded that the vast majority of angels are patient investors in terms of investment intentions, engagement and exit behaviour, largely by default rather than intent. Most do not consider the exit at the investment appraisal stage nor the need for patience.

KEYWORDS: varieties of capitalism; voice; corporate finance; patient capital; business angels; exits

JEL CODES: G24; G29; G32

INTRODUCTION

Patient capital – capital held by owners who have long time horizons, allowing them to endure the uncertain early years of an investment and reap high returns in the longer term – is crucial for entrepreneurship, innovation, social (impact) investing and economic development. However, short-termism has been increasing in both the financial and corporate sectors (Van der Zwan 2014; Aspara et al 2014), raising concerns about the ongoing provision of patient capital to business ventures to support their investment plans and contribution to economic growth. This reinforces concerns which have been articulated in debates within the comparative capitalism and varieties of capitalism (VoC) literatures (eg Hall and Soskice 2001; Hancké et al 2007). These distinguish between liberal market economies (LMEs) and coordinated market economies (CMEs) as two basic types of capitalism based

on the relative extent of market coordination through investment in transferable assets (LMEs) vs. non-market or strategic coordination through investment in specific assets (CMEs) (Schnyder and Jackson 2010). In the VoC literature CMEs are distinguished from LMEs in a number of respects: bank lending is the primary source of external corporate finance; ownership is concentrated in tightly held firms; equity markets are smaller; strategic investors are more patient and provide firms with longer investment horizons; and corporate governance recognizes multiple stakeholders (banks, employee groups as well as equity investors) rather than relying on the market for corporate governance (for example, through the use of stock options to align owner and manager interests). LMEs, on the other hand, are held to be better for early stage investing because public markets provide an exit route.

However, recent research in comparative political economy is beginning to recognize that a new non-dichotomous framework for analysing financial systems and the nature of patient capital is required, and that we need to consider a wider range of investors (Deeg and Hardie 2016). In other words, the distinction between coordinated market economies characterised by long-term bank-based financial systems and corporate governance regimes that support patient ownership and discourage 'markets for control' (Pempel 2005, 571), and liberal market economies characterised by short-termism and the reliance on public information (Huo 2014), is being eroded as economies converge on a neoliberal model (Soederberg et al 2005; O'Sullivan 2005; Hardie et al 2013). As such, the availability of patient capital is held to have experienced systematic decline over the past two decades. In this paper we contribute to this debate by highlighting two gaps in the literature: first, the absence of substantive discussion of the intentionality (or otherwise) of patience; and second, the paucity of research into the relationship between attitudes toward exit and investor portfolio characteristics. We address these gaps by extending the research setting to the entrepreneurial finance domain.

As part of the debate over the theoretical underpinnings of financial markets (Jackson 2013) the patient capital debate has focused for the most part on financial institutions and actors (banks, bond issuers and holders, stock markets, pension funds, hedge funds). Other sources of non-bank finance, notably venture capital, provided outside public markets, remain almost entirely neglected (Klinger-Vidra 2016). However, the entrepreneurial finance literature acknowledges the patient capital issue in a number of domains. First, the provision of patient capital (through relational rather than market

transactions) is seen as a defining characteristic of the family business as an organisational form (Sirmon and Hitt 2003; Colli 2013). As such it provides a source of competitiveness (Arregle et al 2007), supports firm management to take a longer-term/bigger-picture view and provides the basis for its survivability. Second, there is an association of patient capital with the financing needs of social ventures (Hockerts 2006; Emerson et al 2007), including base of the pyramid venturing and venture philanthropy (Joy et al 2011). Third, the availability of patient capital is seen as a prerequisite for the emergence of new industries, technologies and clusters (Black and Gilson 1998; Zahra 1996; Markusen 1996; Sherman et al 1998). Fourth, research on business angels associates them with the provision of patient capital (Figure 1). This is typically defined in terms of their exit horizons (Sohl 1999) and in contrast to the shorter-term perspective of institutional venture capital (Block and Sandner 2009; Block et al 2010). Conventional wisdom, based archetypically on the distinction between VC and bank finance, sees higher returns as the compensation for higher illiquidity, longer holding periods to exit and high risk. By contrast, this representation of the entrepreneurial finance market suggests that investors with the shortest time horizons have the highest returns expectations. This has implications for our understanding of patience in this market, which appears to be more a matter of time horizon than returns, and for the dynamics of the relationship between investor and investee over the duration of the investment relationship, to which we return below.

INSERT FIGURE 1 HERE

In this paper we extend the literature on the role, nature and extent of patient capital in the financing of entrepreneurial ventures by examining business angel investment. Business angels are high net worth individuals (often successful cashed-out entrepreneurs) who invest their own money directly in emerging entrepreneurial businesses. As the main source of initial risk capital for such companies they play a critical role in the entrepreneurial ecosystem and have become a major focus of government support (OECD, 2011). According to research in the US, UK and Sweden business angel investment is between 8 and 15 times that of institutional VC (Sohl 2003), accounting for 30-40 times as many investments (Van Osnabrugge and Robinson 2000) and exceeding VC commitment to seed and early stage investment by a factor of 3 in the UK (Mason and Harrison 2000)[1]. In terms of scale, business angel investment in the UK is estimated at almost $1.5bn annually (Mason and Harrison 2000; 2010; 2011), in the US is estimated to involve annual investments of around $24bn

into over 70,000 ventures (Sohl 2015), and in Sweden has been estimated at over $11bn cumulative (Avdietchikova and Landström 2005). EBAN (2014) estimates that in Europe business angels invest €3 for every €1 invested by venture capital funds in the early stage investment market. Moreover, wherever evidence is available it shows that in contrast to venture capital investing angel investment activity either did not decline post GFC, or has been much quicker to recover and resume its growth trajectory (EBAN, 2014; Mason and Harrison, 2015; Centre for Venture Research 2009; 2015).

The relevance of business angel investment to the patient capital debate arises from: first, its economic importance in the evolution of new firms, industries, technologies and markets; second, its predominance (but not exclusively so) in LMEs; and third, the reliance of these investors on insider information communicated through trusted networks (characteristic of strongly coordinated capitalism – Huo 2014). Based on a review of the evidence on business angel investing and on the results of a recent research study, we conclude that in the contemporary entrepreneurial finance landscape business angel investment can be considered patient, both by default and by intent. Specifically, we highlight the circumstantial nature of business angel exits and distinguish between those investors who intend to exit (but exogenously may be prevented from doing so by the absence of exit opportunities) and those who do not intend to exit (or at least have not formalized their intention in terms of a time horizon). We make the following contributions in this paper: first, we introduce business angels as an investor type into the debate on patient capital; second, we systematically review the prior research on the extent to which business angel investors can be considered as suppliers of patient capital; third, on the basis of new empirical evidence we refine the conventional wisdom that business angels are patient investors by demonstrating that this is more often by default (in the absence of exit opportunities); fourth, we develop the implications of our findings for both academic researchers and practitioners.

BUSINESS ANGELS AS PATIENT CAPITAL INVESTORS?

Adapting Deeg and Hardie (2016) we identify three inter-related dimensions along which more and less patient capital can be distinguished. First, and fundamentally, patient capital will be long-term

rather than short-term in investment time horizon. Although the definition of 'long' is open to debate, and includes both measures of investor intent and of action, in the context of equity investment it is generally associated with intended holding periods of an extended multi-year or indefinite duration. In the discussion below, we will review the evidence on business angel investor attitudes to investment time horizons as reflected in their a priori expectations about anticipated outcomes and the exit process, given that this is the most common context in which the identification of business angel investment as patient capital is made.

Second, a longer-term investment horizon allows for identification of the extent and purpose of investor engagement in and with their investee companies. Specifically, this focuses on the extent to which they use voice (Hirschman 1970) to influence the management of portfolio companies to behave in ways that match investors' preferences, as an indicator of the degree to which this is patient capital. In essence, the greater the degree of voice, and therefore of engagement, exercised in pursuit of short term performance goals, the lower is the degree to which this can be considered as patient capital. However, this is subject to qualification by the purpose of being engaged and by the short-term reaction if investor interests are not met, such that it is possible that a long-term investor who is unengaged but is not exit-oriented may be defined as patient capital. Engagement can, of course, take various forms, including board seats (with or without holding a blockholder stake), direct discussions with and representations to management, and may be triggered by a number of factors, including shareholder legal responsibilities, the desire to influence performance (especially where this is weak) and the relative costs and ease of engagement/voice and exit (Hirschman 1970). The purpose of engagement is, generally, to influence management in the investee company to make decisions that are more rather than less consistent with the interests of the investor. However, it is impossible ex ante to judge the short- or long-term aims of, for example, venture capital or private equity investors, some of whom may be committed to their investments for the long term, prioritizing venture growth, while others may be more concerned with the sale of their investee company in the shortest possible time.

Third, the extent to which investors will exit if management does not follow their wishes represents the final dimension for characterizing patient capital. Following Hirschman (1970) there are two possible courses of action for engaged investors whose expectations are not being met: exit as a last resort after voice has failed; and loyalty, both conscious (a reluctance to exit in spite of disagreement with the organization), and unconscious (arising from the difficulty of recognizing

change, the escalation of commitment (Staw 1981) or the inability to identify an exit opportunity). Time horizon again becomes a factor here: the pursuit of long-term shareholder value is likely to be associated with loyalty rather than exit, while pursuit of short-term shareholder value is likely, but not exclusively so, to be associated with exit, on the assumption, of course, that markets are liquid and that exit is possible at any time. In the case of angel investing, as with venture capital more generally, a relatively high level of patience is the outcome of both a focus on growth rather than efficiency and financial engineering and the low likelihood of realizing value prior to exit (Deeg and Hardie 2016).

In the remainder of this section we use this framework to discuss the nature of business angel investing in entrepreneurial ventures, a hitherto neglected set of actors in the patient capital literature, before reporting on the results of a new analysis of angel investment preferences and actions.

Attitudes to exit

In the business angel research literature it has consistently been argued that angel capital can be construed as patient capital, relative to venture capital and other sources of investment, in terms of the anticipated holding period. First generation studies of business angels in both the United States and Europe suggest that business angels give very little thought to future exit routes, do not have clear exit plans at the time of investing and are relaxed about the timing of the exit. The evidence is somewhat more ambivalent on anticipated investment timescale and holding period (Gaston 1989; Harrison and Mason 1992; Landström 1993)[2]. The time horizon for the majority of angel investors is less than five years, with inter-country differences in exit opportunities (active stock markets, dynamic M&A markets and access to sources of secondary financing) accounting for observed differences. Investors, however, exhibit considerable diversity of expectations about the length of holding period, and other studies confirm that angels are rather less patient than commonly represented: between 50% in Finland (Lumme et al 1998) and 75% (Haar et al 1988), for the US wanted to exit in three to five years. In terms of the continuum between patience and impatience (Deeg and Hardie 2016) this suggests business angels are patient at a medium or higher level.

INSERT TABLE 1 HERE

The picture of angel investors as giving very little thought to the exit when they invest appears to be rather more consistent with the evidence. Exit considerations come very low in their investment criteria, or are not mentioned at all. In one study, for example, 'potential exit routes' was ranked 24th (out of 27) investment criteria by angels (Van Osnabrugge and Robinson, 2002). Although there is contradictory evidence from a more recent study of the most prominent US angel group which found exits to be much more highly ranked (Sudek 2006), reflecting the 'professional' approach to investing that angel groups are thought to adopt, the vast majority of managers of angel groups in our study area did not exhibit a strong exit orientation when screening investment opportunities. This is attributed by Gray (2011) to the widely held view amongst the angel community that "good investments will always find exits".[3] The same view has been articulated by the prominent UKentrepreneur, venture capitalist and angel investor Johnson (2012): "if the business works you will be spoilt with choice of exit." So, at least in terms of expectations, therefore, the extent to which business angel investment can be considered as patient capital is equivocal. First, a significant proportion of investors have a 3-5 year time horizon, others have a 6-10 year horizon or none at all. Second, their priority is to make good investments – which will in due course attract buyers, hence there is no need to focus specifically on the exit. Third, the exit is not a significant factor in their decision making process, a point to which we return later in this paper.

Engagement and Influence

The nature of the engagement between business angel investors and the businesses in which they invest, and its implications for the determination of the extent to which business angel investment is patient capital arises initially from the nature of the investment decision making process itself and from the ensuing pattern of post-investment relationships.

Studies of investment decision-making by both venture capital fund managers and business angels suggest that investors attach significant importance to the ability of management, in terms of skill, quality, track record and experience, and characteristics (Harrison and Mason 2002; Riding et al 2007; Sorheim 2012). Angel investment decision making takes into account a wide range of factors, including the characteristics of the market, industry features, extent of competition, product differentiation, rates of return expectations and external threats. However, management-related factors, specifically the quality of the entrepreneur, appear to play a major part in the investment

decision (MacMillan et al 1985). Furthermore, concern about the entrepreneur is the overwhelming reason why angels reject investment opportunities (Mason et al, 2016). For a number of commentators this has prompted the use of a racing analogy: 'there is no question that irrespective of the horse (product), horse race (market), or odds (financial criteria), it is the jockey (entrepreneur) who fundamentally determines whether the venture capitalist will place a bet at all' (Macmillan et al 1985, 119). This is particularly the case with business angel investors, who place greater emphasis on the entrepreneur, particularly at the early stages of the decision making process (Harrison and Mason 2002; Fiet 1995a; 1995b; 1996; Mitteness et al 2012). The key point of this analogy is to emphasise the role of the entrepreneur in managing risk and generating returns for the investor.

The implications of this can be most clearly seen in the assessment of risk by investors, and its implications for the power dynamics of the investor-investee relationship, which in turn reflects on the nature and consequences of engagement from a patient capital perspective. As Harrison et al (2015) have indicated, business angel investing is a multistage decision making process of interaction between investors and entrepreneurs under conditions of risk (Maxwell et al 2011). For Fiet (1995) investment risk has two identifiable components: market risk, extended to a wider construct of performance risk by Das and Teng (1998); and agency risk, recast as relationship risk by Maxwell and Levesque (2011). Market/performance risk relates to the possibility that external or operational factors (for example, market changes, competitor behaviour, implementation failures, technology factors) may compromise achievement of a venture's declared objectives. Agency or relationship risk reflects the possibility that the entrepreneur may not achieve the same outcomes when spending the investor's money (through poorer decision making) than would the investor, reflecting both moral hazard (a divergence of interests between the two parties) and adverse selection (suboptimal decision making based on information asymmetries) (Maxwell and Levesque (2011).

Fiet (1995a; 1995b) suggests that venture capital fund managers and business angels will differ in their attitude to these sources of risk. Venture capital fund managers will be more concerned with market risk, that is, risk due to unforeseen competitive conditions affecting the size, growth and accessibility of the market. Business angels, on the other hand, will be more concerned with agency risk arising from the separate interests of the entrepreneur and the investor. This reflects the types of risk that they believe they are most competent to control. Venture capital fund managers have learned how to protect themselves from agency risk by using stringent boilerplate contractual provisions which allow them to replace an entrepreneur who under-performs, is guilty of

misconduct or is found to be incompetent (Bruton, Fried and Hisrich, 1997; 2000). However, market risk is less controllable through *ex post* contracting. Business angels, in contrast, attach more importance to agency risk, for four reasons. First, most angels have limited deal flow and lack comparative data to evaluate market risk. Second, angels do not have the same level of resources as venture capital funds to both collect and analyse (costly) market-related information (Fiet, 1995b). Moreover, the smaller deals that business angels make cannot support the high transaction costs that would arise from extensive due diligence and venture capital fund managers conduct significantly more due diligence than business angels. Third, contracts between angels and entrepreneurs tend to be simple and informal, making it harder for them to enforce sanctions. Finally, many business angels have prior industry experience themselves and therefore feel quite capable of assessing the market risks and so view the entrepreneur as the most potentially damaging contingency (Fiet, 1995a).

The implication is that venture capital fund managers will seek to reduce risk at the pre-investment stage by careful screening, due diligence and contracting arrangements (van Osnabrugge 2000). Engagement and influence is contract-based, designed to preserve and pursue the investors' interests. Business angels, by contrast, will manage risk by placing more emphasis on post-investment relationships, particularly through becoming actively involved in the business. In short, VCs may achieve their objectives despite their portfolio company managers; business angels can only do so through and with them.

Two conclusions emerge from this stream of research. First, business angels regard entrepreneur characteristics and experience as more significant influences than venture characteristics on the perceived riskiness of an investment opportunity. Business angels are therefore clearly betting on the "jockey" rather than the "horse" because, as one angel commented, "it's easier to change the horse [business idea] than the jockey [entrepreneur]" (Paul, Whittam and Paul, 2001: 13). Second, business angels rely for the most part on a personalised approach to information gathering and processing, rather than using third parties, in which the trustworthiness (Harrison et al 1997) of the entrepreneur becomes crucial.

This difference in risk assessment, investment decision making and contracting behaviour is reflected in the nature of the post-investment relationship between business angel investors and their investee businesses. Business angels are 'hands on' investors, contributing their skills,

experience and networks to their investee companies through a variety of formal and informal roles. Although motivated by financial expectations, it is widely reported that business angels are motivated also by non-financial considerations, including earning psychic income Freear et al 1995), supporting the next generation of entrepreneurs (Politis and Landström 2002) and extending their own entrepreneurial careers (van Osnabrugge 2000). They are also known to make a non-financial value-added contribution to the businesses in which they invest, partly to have a positive impact on the performance of their investee businesses (thereby increasing the prospect of a profitable exit), partly, as we have shown above, to mitigate agency risk (Ardichvili et al 2002) and partly in recognition of the incomplete contracts problem (Aghion and Bolton 1992) which recognizes the inherent incompleteness of financial contracts.[4] The non-financial capital contribution of business angels falls into two categories (Politis 2008): enhancement of the human capital stock of the venture through acting as a sounding board/strategic advisor and in a supervision and monitoring role; and contribution to the social capital stock of the business through facilitating resource acquisition and mentoring. These are primarily relational rather than contractual engagements, focused, as one business angel investor summarized it, on 'contributing to managing the business in which I have invested rather than managing my investment in the business'. However, there is no evidence in studies of the post-investment involvement of angels in their investee business that preparing the business for an exit is one of their value-added contributions. Indeed, this activity was not mentioned in any of the studies reviewed by Politis (2008) nor in a more recent study of the post-investment activities of angels (Fili 2014). As such, and consistent with the emphasis of the business angel investor on backing the jockey rather than the horse, this suggests that business angel investing can be considered as patient capital.

Exit practice and returns to angel investing

The final dimension that distinguishes more patient from less patient capital is the willingness and ability of the investor to exit. In this respect, business angel investors do exit their investments, notwithstanding their widespread failure to explicitly consider the exit event or timescale. This is because of the nature of angel investing which is based on achieving the return from a liquidity event rather than from an income stream. The types of businesses in which angels typically invest are new or early stage and initially loss-making, and which need to reinvest any profits to grow.

Indeed some businesses which achieve exits have never been profitable but have strategic value to the buyer. Angels typically exit via a trade sale with IPOs being rare (Carpentier and Suret 2015). The holding period for successful investments is four to five years. Failed investments, in contrast, emerge after about two years, confirming the investment cliché that 'lemons ripen before plums'. Mason and Harrison (2002) find that the moderately performing investments actually have the longest holding period, possibly because of the limited opportunities to exit. Often these investments are sold back to the management team, typically for a nominal price. Collewaert (2012) suggests that goal conflicts between angels and entrepreneurs positively affect both parties to exit, and that task conflicts increase the intention of entrepreneurs to exit. However, achieving an exit is now also increasingly challenging, in terms of the lack of successful exits or liquidity events and correspondingly lower investment returns (Gray, 2011), and longer investment to exit time horizons for those exits which do occur, up from 3 to 10 years between 2005 and 2015 (Waddell, 2013: col. 3697). The same problem has been highlighted in Canada (NACO, 2014) and the UK. Overall, therefore, the evidence suggests that if business angels are to be considered as a source of patient capital it is often patience by default rather than intent.

Summary

In this section we have reviewed the research on business angel investment using three interconnected dimensions of patient capital; the timescale over which investments are held or intended to be held; the nature of engagement and involvement with investee companies and the exercise of voice; and the decision to exit. First, in terms of timescale (intent), as many business angels expect to hold their investments for less than five years as do for six years or more or express no preference. This suggests that business angel investment is at best equivocally patient. Second, business angel investors are value-added investors who become actively involved in their investee companies. However, this involvement is more generally supportive of management in the pursuit of growth rather than controlling or challenging as the practice of voice would be understood (Gehlbach 2006). Given that discussion of the exit rarely features in this post-investment relationship, in this respect at least business angels may be considered as patient investors. Third, in terms of the exit practice itself (action), business angels typically exit and realise their capital gains within three to six years; the main exception is in cases where the investment is significantly underperforming, which constrains the options for exit (IPO and M&A are much less likely in such cases). On this measure, business angels are less patient investors. However, there is one important

qualification: in the patient capital literature exit is a signal of a divergence of views between investor and investee, with costly consequences as the benefits of organisational membership are forgone (Gehlbach 2006), whereas in the business angel case it may more often be a manifestation of an alignment of views (both the investor and the investee seek a return). What none of this research, however, has addressed is the intentionality of patience on the part of business angel investors; that is, the extent to which they specifically consider themselves to be patient investors. Nor has prior research discussed the relationship between attitudes to exit (combining the first and third aspects of patient capital discussed above) and the characteristics of investor portfolios. We address these two issues in the remainder of this paper.

METHODOLOGY

The empirical results come from an exploratory qualitative study involving 30 individual business angels in Scotland and Northern Ireland[5]. The choice of study region reflects a number of key features (Harrison et al 2010, 213-215). First, the two economies are in each case dominated by a small number of large internationally competitive organisations in financial services, oil and gas, utilities and transport. Second, there is a weak middle market corporate sector (companies with a market cap of £100m-£250m. Third, the development of an entrepreneurial, technology based, economy has been a long-standing focus of economic development policy. Fourth, there is relatively little institutional venture capital managed and invested in the region. Fifth, and partly in response to the general absence of VC, Scotland has the longest established and most evolved business angel market in the UK or continental Europe, and because of this the main Northern Ireland angel group is affiliated to LINC Scotland, the regional trade body for angel investors. The participants were mid-aged (average of 56 years) males with entrepreneurial experience (57%). They are experienced investors, with on average 12 years of investment experience, and they have made a total of 473 investments (a median of 10 investments each). The invisible nature of the business angel population (Wetzel, 1983) means that it is not possible to test any sample of investors for its representativeness. However, comparison with two recent UK surveys (Mason and Botelho, 2014; Wright, et al 2014) indicates that woman investors are underrepresented (0% vs 14%) and the sample is more experienced (median of 10 vs 5 investments). However, given that “the informal venture capital market is not differentiated on gender lines” (Harrison and Mason 2007, 464), the lack of gender diversity is not a problem. Equally, the sample includes investors with limited

experience (one-third had made 5 or less investments) as well as the more experienced (one- third had completed 15 or more deals).

The data were collected in two stages. First, semi-structured interviews on investment and exit strategies were undertaken. The open-ended questions were coded and then grouped into themes to identify whether patience was seen by respondents as being a necessary quality to be an effective business angel. Second, participants were asked to complete a verbal protocol (Ericsson and Simon, 1993), to provide information on their decision making processes. Verbal Protocl Analysis (VPA) has been extensively used to study the decision-making process of business angels (Harrison et al 2015) and in particular the criteria used to screen potential funding opportunities. The approach used here is similar to that used in previous studies, with participants asked to "think out loud" while reading a potential funding opportunity[6]. The focus is on the initial screening stage and the decision whether to reject the opportunity at this point or to invest time and effort in getting more information. Previous research suggests that business angels reject between 80% to 90% of the opportunities that they see at this stage (Riding et al, 1993). Investors were instructed to verbalize their thoughts, without explaining them or providing verbal descriptions (Ericsson and Simon, 1993). The verbalisations were recorded and transcribed. Transcripts were partitioned into discrete thought units which were categorized using a coding scheme that contained ten codes, eight relating to precise investment criteria and two reflecting an action or something other than an investment criterion (Table 1).

INSERT TABLE 1 HERE

The analysis of the transcripts involved three steps: (1) breaking down the verbalisations into 'thought segments'; (2) coding each of the thoughts segments based on the specific investment criterion being considered; and (3) calculation of frequency counts of each investment criteria. The second step can be considered as the most critical since there are no objective independent techniques to analyse the data (Bainbridge and Sanderson, 2015). To ensure validity and reliability of the coding the thought units were categorised using an elaboration of an established coding scheme (Zacharakis and Meyer 1995; Harrison et al 2015; Mason and Botelho, 2016). All the transcriptions were independently coded by two authors. While this methodology is not without its drawbacks, not least because as Bainbridge and Sanderson (2015, p.165) emphasize, "asking people to 'think aloud' is asking them to do something unfamiliar and awkward", verbal protocol analysis is considered an

effective method if certain conditions are fulfilled (Ericson and Simon, 1993). This research meets all the conditions required[7].

FINDINGS: BUSINESS ANGEL PATIENCE, EXIT EXPECTATIONS AND PROCESSES

Stage I: Patience and time horizons

We conducted two cycles of analysis based on the over-arching category of 'need for patience.' During each cycle we read and re-read the narratives closely for examples of how the investors understood patience and the impact this had on their investing practice. The first cycle of analysis was important in ascertaining the interpretive potential of the narratives and in providing a broad overview of how investors understood patience. The second cycle offered a more critical interpretation of the findings as we examined the narratives for evidence of the impact and pursuit of patience. This identified where patience was articulated by investors reflections, and provided a deeper and more nuanced understanding of investor's understanding and practice of patience. To present a coherent analysis of the findings, each emergent theme is discussed in detail and illustrated with fragments of the narrative to indicate how the interview dialogue informed the discrete themes (Pratt, 2009).

Only 43%of the respondents mentioned 'patience' in their interview responses. Three themes emerged from our analysis of the remaining transcripts[1]. The first theme addressed the *need for patience.* Investors emphasised the intrinsic nature of patience in investing in early stage businesses. This they attributed to three issues: the size of the company, which needed to reach a certain scale to be attractive to a purchaser; the time taken to build financial value; and the role of experience in recognising the need for patience. The second theme addressed the *importance of value creation*. Investors recognised that achieving an exit required effort to create sustainable value, and their immediate priority was to build a company's value instead of focusing on achieving an exit. They highlighted four issues in particular: investor effort to overcome the liabilities of small scale; investor

[1] The full evidence table is available in the Supplementary Data accompanying the on-line version of this paper.

contribution to build the business and make a contribution to society (Sullivan 1994); investor value-added contribution to the development of the venture; and the recognition that an exit was a fundamental part of the investment process and was needed to recycle wealth in new investments. The third theme to emerge concerned *attitudes to the exit*, and we found contrasting views about how patient angels need to be about exits. Five specific issues were highlighted: the limits to patience; the role of patience in the investment decision-making process; the importance of learning the need for patience from experience (Harrison et al 2015); the opportunity dependence of patience as something determined not by investor preference but by external circumstances; and the role of resilience and determination in coping with enforced patience. In summary, these angels either do not articulate any awareness of the patient capital concept at all, or are patient investors less by choice than by default through force of circumstances.

Stage II: Exit orientation

From the semi-structured interviews we conclude that a substantial proportion of angels did clearly recognise, first, that patience was an inherent requirement of being an angel investor, and, second, that they had to be proactive in supporting the growth of their investee if an exit was ever to occur. This is complemented by the analysis of the verbal protocols. This shows the extent to which angels are exit-centred at the point when they are considering whether or not to make an investment. This is measured by the number of their thought units that referred to the exit as a proportion of all their total number of thoughts. A high exit score indicates strong exit-centeredness and low patience, a low exit score suggests higher patience.

The exit as an investment criterion was ranked lowest of the eight specific investment criteria, accounting for only 4% of the total thought units (Table 2). A significant proportion of investors (40%) made no reference to exits while screening an opportunity. The proportion of exit-related observations ranged from 0% to 15% with an average of 3%. If this is defined as the threshold level of an exit-centred approach then just 37% of the sample can be defined as adopting an exit-centred investment strategy. No statistical significance (Pearson correlation coefficients) was found between the exit score and various control variables related to angel characteristics[8].

INSERT TABLE 2 HERE

This variability in the exit-centredness of angels is reflected in the VPA scores and confirms the heterogeneity of the business angel population (Avdeitchikova, 2008; Lahti, 2011). To better understand the impact of this heterogeneity on patient capital, we use a dispersion measure to cluster the results along two dimensions: exit scores and number of years that the respondent has been investing (Figure 2). We have grouped angels into four quadrants using half of the range of values as a threshold level. Following Sarstedt and Mooi's (2014) approach to identifying groups within the data, we used the average portfolio profile in each quadrant to examine whether the four quadrants are able to differentiate the sample, on the basis of which we proposed an interpretation of the four groups.

The majority of investors (80%) are in quadrant 1 (low exit score, low years investing) on account of their low of exit-centred scores (below 7% of exit scores) and low levels of years investing (below 18.5 years), and 90% of angels are in quadrants 1 and 2 (low exit scores), confirming that regardless of investment experience the vast majority of angels are not preoccupied by the exit. This confirms the hypothesis that business angels are patient investors. However, it is still possible to identify differences within the groups of relatively patient and relatively impatient investors. The profile of investors in each of the quadrants reinforces both the heterogeneity of angel investors in terms of exit views and suggests that there are different reasons why investors are patient and impatient (Table 3).

Quadrant 1 (low exit score, lower years investing) comprises those angels with the lowest proportion of losses and highest proportion of investments still in their portfolios. Coupled with their lower average age of investing and lowest average age, these angels have not been investing for sufficiently long either to become impatient or to recognise the need to become more pro-active in their approach to investing. The investors in Quadrant 2 (low exit score, higher years investing) are both the most experienced and oldest, with the highest number of investments and second highest percentage of losses. However, greater investment experience has not resulted in the adoption of a more exit-centred approach. Comparing the angels in this quadrant with those in quadrant 1, these business angels have a much higher proportion of losses and are investing for a longer period. Rather than becoming more exit-centred over time, investors in this quadrant should be identified as patient by intention. Neither time nor outcomes have made them become less patient.

Quadrant 3 (high exit score, higher years investing) has just one angel – but it is noteworthy that this angel has the highest proportion of exited investments and the lowest proportion of investments in their portfolio. Unusually this angel also invests out of income rather than capital. This could be interpreted as being the outcome of an exit-centred approach to investing. What differentiates this quadrant from the previous two is the way the investment behaviour is very outcome-led and the level of exit-centeredness. Out of all investments made in this quadrant, 66% had an outcome (exited 33% and lost the other 33%). Hence, this quadrant can be characterized by being impatient by the desire to achieve an outcome, and in particular an exit.

Quadrant 4 (high exit score, lower years investing) has only two angels. However, they have the highest proportion of losses and have not achieved any exits. These angels have no SME experience (as entrepreneur or board member). Their exit-centred approach to investing could be interpreted as being on the basis of their need for exits. When compared with the third quadrant the portfolio behaviour is considerably different: these investors have the second highest number of investments still in their portfolio, have experienced more losses and were not able to recycle their money. Investors in this quadrant are impatient in terms of the need to achieve a better outcome.

INSERT TABLE 3 HERE

INSERT FIGURE 2 HERE

In summary, the vast majority of business angels are not particularly exit-centred and had achieved few exits. Just a handful of angels adopted a more proactive approach to investing. These angels, in turn, can be further divided into those who have adopted an exit-centred approach out of the need to achieve liquidity (these investors had not had any exits) and those who have a desire to achieve exits. The evidence therefore clearly indicates, in terms of exit behaviour, that the vast majority of angel investors are patient, but that this is often by default in the absence of exit opportunities.

CONCLUSION

The debate about patient capital and its demise has focused for the most part on institutions and markets. In this paper we have drawn on the entrepreneurial finance literature to examine systematically the extent to which business angel investors, the main source of external equity funding for new and growing unquoted entrepreneurial ventures, are a source of patient capital. Based on a review of the literature on their investment time horizons, engagement and involvement with their investee companies and exit practices and experiences we conclude that the conventional wisdom that business angels provide patient capital is not unequivocally demonstrated. We conclude therefore that they do so more by default than intent. This conclusion is reinforced from the results of the empirical study reported above. The three levels of analysis undertaken provide new evidence that business angels are relatively patient investors in terms of their long-term initial investment intentions and their engagement in the pursuit of growth. In addition to demonstrating that angel investors are not a homogeneous investor class in these terms, we conclude from the analysis of their experience of exit that they are often patient by default, in the absence of an opportunity to exit. Given that patience/impatience is a continuum not a binary divide (Deeg and Hardie 2016) we add to the patient capital debate in contemporary political economy by highlighting differences in the nature and degree of patience within as well as across investor categories.

Based on our exploratory research we can identify a number of questions for further research that build on our focus on the intentionality of patience and the relationship between attitudes to exit and investor portfolio characteristics:

- If business angels tend to be patient by default does intentionality (whether or not they explicitly identify the exit or not) affect investment outcomes?

- How prevalent are the different varieties of patient capital within business angels (patient by default, patient by intention, impatient by desire, impatient by need), and what determines which of these stances is adopted?
- What characteristics of the investment itself impact on how patient an angel investor is?
- What exogenous and endogenous factors impact the level of patience of a business angel?

- How does the lack of exits, and of opportunities for exit, influence business angels to become impatient investors (*impatient by need*)?
- Does attaining successful exits change investor intentionality and lead business angels to become impatient investors (*impatient by desire*)?
- Given that business angel investing is found across both LME and CME economies (and in economies outside the traditional VoC classification) does the intentionality of patience vary by region/country?

We can draw three primary conclusions from this preliminary analysis. First, the need for patience is highlighted by some angels as inherent in business angel investing with its focus on new and early stage businesses, with others emphasizing the time required to build a business that could be an attractive acquisition target. Second, the VPA results do not indicate that angel investors take the exit potential into account while making a decision on whether or not to invest. Third, patience is not a characteristic of all business angels; however, the lack of exit-centeredness (as indicated by the VPA scores) was more extreme than would have been expected on the basis of recent research which has highlighted the heterogeneity of the population. In terms of the three suggested dimensions of patient capital – timescale, engagement and influence, and exit – we draw three implications from our results. First, timescale matters, but future research needs to differentiate between intent and action (in terms of intent, business angels are more patient than their exit actions demonstrate in practice) and recognize variations in patience levels within as well as across investor categories. Second, engagement/influence and the practice of exit in the business angel context are more usually positive signals of investor-entrepreneur alignment, in the pursuit of long-term growth rather than short-term performance, than of conflict. Third, investor exit in angel investing is rarely driven by concerns over short-term performance, neither is it normally formally planned for. If the patient capital literature is to extend beyond the current focus on institutions and markets to entrepreneurial finance, the meaning and import of terms such as engagement, influence and exit will have to be reconsidered within the context of the intentionality and situationality of time.

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Figure 1 Timescale and return expectations in entrepreneurial finance: the conventional view

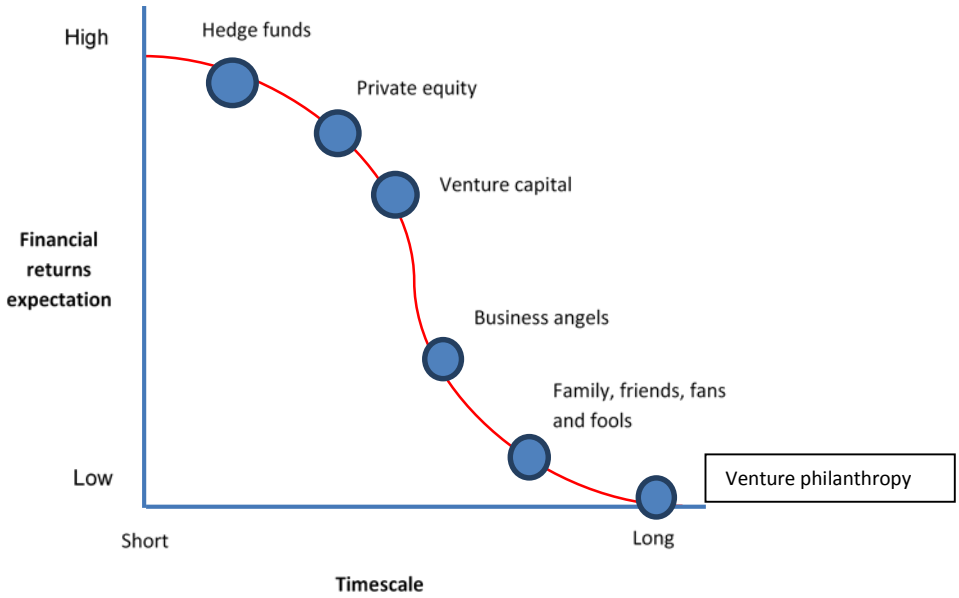

Figure 2 Exit Score vs Years Investing

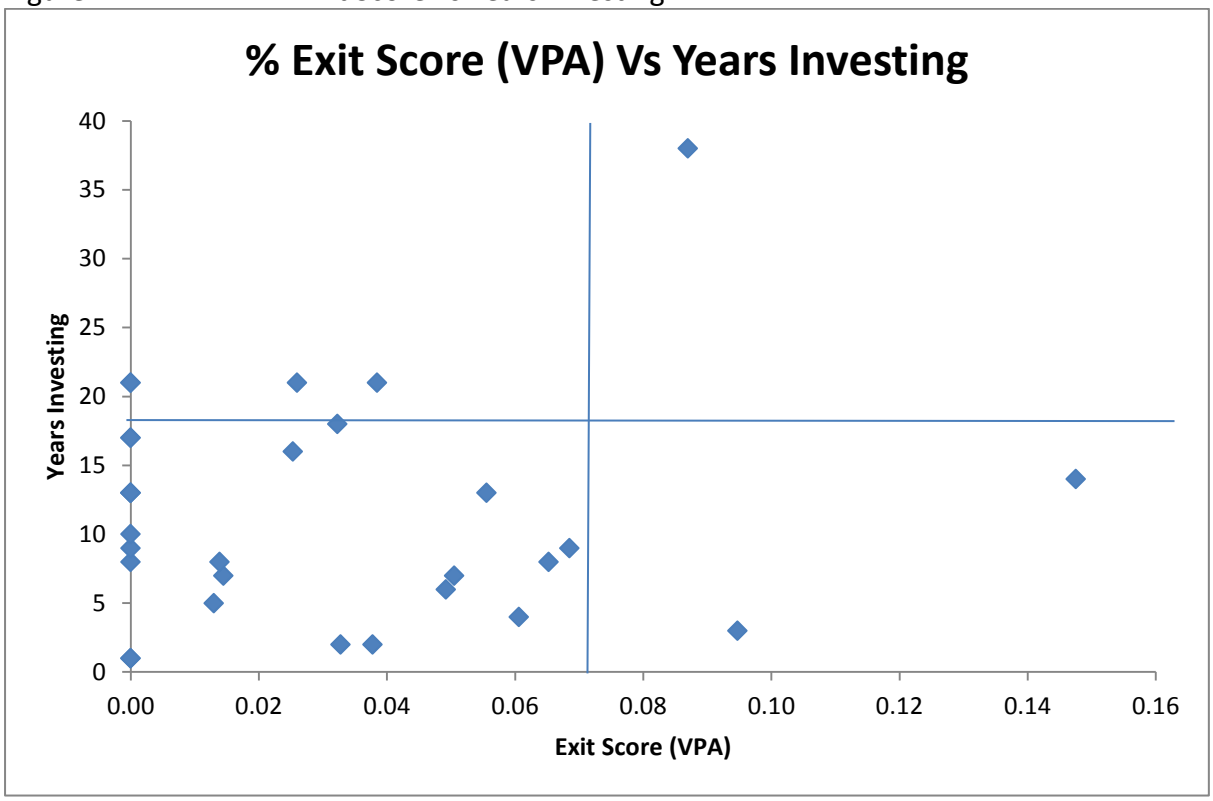

Table 1 Thought segments classification

Investment Criteria	*Description*
1. THE PEOPLE	Issues regarding: the entrepreneur, management team, the inventor. Their background, experience, qualities, etc.
2. PRODUCT	The nature of the product: technical aspects, intellectual property protection, competitive advantages, design, etc.
3. MARKET	This includes points on market: organization, growth, competition, geography, size, etc.
4. BUSINESS PLAN	Specific comments on the plan: length, presentation, content missing data, etc.
5. EXIT	Who? When? How much? Type of exit. Existence of an exit plan
6. FINANCIAL CONSIDERATIONS	Amount of investment, amount raised, future funding needs, valuation, equity share, cash-flows, valuation, etc.
7. INVESTOR ATTRIBUTES	Issues regarding investment fit, investment experience
8. ATRIBUTES OF THE BUSINESS	This includes a broad scope of issues: e.g. strategy, business model, risks, operations, time frame, etc.
9. OTHER	Comments on any aspects of the business which cannot be coded in any other category
10. ACTION	Specific comment on what to do next.

Table 2. Verbal protocol analysis: thought units classified by investment criteria

	Criterion		%
9.	OTHER	54	3%
5.	EXIT	59	4%
4.	BUSINESS PLAN	128	8%
7.	INVESTOR ATTRIBUTES	139	9%
1.	THE PEOPLE	159	10%
10.	ACTION	164	10%
6.	FINANCIAL CONSIDERATIONS	188	12%
3.	MARKET	231	14%
8.	ATTTRIBUTES OF THE BUSINESS	238	15%
2.	PRODUCT	255	16%

Table 3 Profile of the investment behavior in each of the four quadrants

	Quadrant 1	Quadrant 2	Quadrant 3	Quadrant 4
N	23	4	1	2
N investment	14	35	6	7
% of each quadrant	77%	13%	3%	7%
Exit	2	5	2	0
% of Exit in the portfolio	17%	14%	33%	0%
Losses	2	13	2	3
% of losses in the portfolio	15%	36%	33%	43%
Still	9	18	2	4
% of investments still in the portfolio	68%	51%	33%	57%

Supplementary Data Table (Online version only)
Evidence Table: Business Angel Investor Narratives on the Need for Patience

Theme	Issue	Exemplar
The intrinsic nature of patience	Size of investee companies	*"I've never seen exit as being a big issue for companies. I mean people get very concerned about how you're going to do an exit. I reckon if you've got a business that's earning £8 million or £10 million somebody will buy it."P4*
	Time to build saleable firm	*"So immediately you look at it and you think, right, if stage one is a year or two years, stage two is another two years, then there's three years trading, that could be seven years. So after seven years it's got a three million profit, the company's going to be worth 50 million after seven years and they're talking about an early exit, well what's an early exit? Two years, eighteen months? What proportion of 50 million are they going to get after eighteen months and how's that going to compare to an investment*

[1] According to the latest UK data (BVCA 2015) £36m was invested in seed, start-up and early stage VC and a further £50m in later stage VC in 2014, out of total VC/PE investment of £8,643m.
[2] We discuss evidence on actual holding periods to exit below.
[3] This point was made by the gatekeeper of one of the leading Scottish business angel groups to two of the authors in an interview in the mid-2000s.

[4] Note that we differ in this argument from the Aghion and Bolton (1992) formulation that "Both agents have potentially conflicting objectives since the entrepreneur cares about both pecuniary and non-pecuniary returns from the project while the investor is only concerned about monetary returns." In the situation we describe, unlike the institutional VC situation for example, the business angel is also concerned about non-pecuniary returns from the project. This in part underlies the pattern of responses we record in the empirical work reported on below.

[5] Business angels were identified through the angel groups of which they were members. These angel groups are coordinated under the aegis of LINC Scotland, the trade association for angel investors in Scotland. One member of LINC Scotland is an angel network based in Northern Ireland: 7 respondents are drawn from that network and 23 from the Scottish-based groups.
[6] Participants were presented with a business plan summary and asked to evaluate it as they would normally do. To safeguard company's confidentiality, a fictitious name was used. Additionally, the location of the firm was also erased and participants were asked to assume that it was located 'close by' to where they worked. This assumption took into account previous research that emphasizes the importance business angel investing in local ventures (Van Osnabrugge, 1998; Sudek, 2006). The business plan was for a medical instruments company that had £100,000 of equity already committed and was looking for an additional £500,000 of funding. The firm was at pre-revenue stage and owned its IP. The business plan included a brief sub-section (4 lines in a 7 page document) with some information about exit (time to exit, type of exit, expect valuation).

[7] The information reported must be the focus of attention; the task is not highly routinised by habit; there must be only a short time between performance and verbalisation; verbalisation does not require excessive encoding; reports are oral; subjects are free from distraction; instructions are clear; and completeness in reporting is encouraged.

[8] Control variables used: age, number of investments, years investing, investments in the portfolio, number of exits, number of failures, number of opportunities screen in a year, yield rate.