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EXPLORING THE INFORMAL VENTURE CAPITAL MARKET: WHO BECOMES AN INFORMAL INVESTOR AND WHAT DETERMINES THE AMOUNT THEY INVEST? (SUMMARY)

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SUMMARY

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Principal Topic
In light of the current economic crisis, banks and other financial institutions have become more and more reluctant to provide financial capital for new ventures. Therefore the importance of informal investors for entrepreneurial activity and new business venturing has increased. Several studies extensively describe and analyze the characteristics and behavior of informal investors. Light has been shed on the factors determining the propensity of individuals to make informal investments in businesses owned by others. However, less research focuses on investment volumes of these informal investors. This paper aims to fill this gap by jointly investigating the determinants of both the prevalence and the investment volumes of informal investors.

Method
We investigate the determinants of investment volumes of informal investors using data of some 130,000 individuals in 31 highly developed countries – including some 1,500 informal investors – that participated in the Global Entrepreneurship Monitor (GEM) in the period 2002-2006. The aim of this paper is to describe the determinants of the prevalence of being an informal investor as well as the amount invested. We estimate a Heckman selection model using a two-step estimation approach, accounting for the (possible) interrelationship between the prevalence of being an informal investor and the amount invested.

Results and Implications
In the estimation model, we distinguish between micro-level and macro-level determinants. For the micro-level determinants we find that involvement in entrepreneurial activity – whether ongoing or having resulted in exit – increases the probability of becoming an informal investor. Regarding the amount invested, informal investors who currently own a business, or who think they have the skills to start a new business are likely to make a higher investment. Focusing on the macro-level variables we find that a country’s level of entrepreneurial activity increases the supply of informal investors but not the average invested amount. Nevertheless, at the macro level these results together imply a positive relation between a country’s level of entrepreneurial activity and the total amount of informal investments. Hence, to some extent the demand for informal investments (indicated by entrepreneurial activity) creates its own supply. Our results also suggest that a higher level of formal venture capital investments leads to a more wide-spread distribution of informal investment volumes, but not to a higher total volume.

The paper highlights the importance of having (or from a policy perspective, developing) an entrepreneurial economy infrastructure as a means of increasing the supply of informal investments.

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