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ASPIRATION LEVELS AND TRADEOFFS IN BUSINESS ANGEL INVESTMENT DECISIONS (INTERACTIVE PAPER)

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INTERACTIVE PAPER

ASPIRATION LEVELS AND TRADEOFFS IN BUSINESS ANGEL INVESTMENT DECISIONS

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Principal Topic

Most interactions between Business Angels (BAs) and fund-seeking entrepreneurs end in failure. Research into the causes of this high failure rate has been constrained by the private nature of the BA-entrepreneur interaction. We take advantage of a rich set of videotaped BA-entrepreneur interactions to investigate whether BAs use rational decision-making approaches that consider all relevant information or use heuristics that trade off accuracy for efficiency in order to reject business opportunities early in the investment-decision process. In doing so we pay particular attention to the multiple criteria used by BAs to assess the potential of these opportunities in terms of investment return and investment risk, as well as the reasons used to reject these opportunities.

We hypothesize that BAs make trade offs between market potential, product adoption, protectability, and entrepreneur experience to reject opportunities due to insufficient return and that they also trade off between technology risk, operational risk, market risk and financial risk to reject opportunities due to excess investment risk. We also postulate that BAs do not trade off between investment return and investment risk when rejecting an opportunity, rather they reject opportunities that fail to meet an aspiration level for investment return as well as an aspiration level for investment risk.

Method

We test these hypotheses with data derived from observing unedited videotapes of the reality-TV show Dragons’ Den that feature five BAs considering over six hundred investment opportunities. Two trained observers coded each interaction (i.e., opportunity) for the reason offered by the last BA to exit the interaction to trim down the sample of opportunities to those where the BAs assessed the investment return and risk in order to make an investment decision. The observers also coded the eight criteria associated with the venture.

Results and Implications

We found BAs appear to reject opportunities that fail to meet an aspiration level for both investment return and investment risk, without trading off between them. These findings challenge the belief that BAs use a rational approach that trades off between return and risk and reveal instead the use of heuristics that limit the cognitive effort required to reject business opportunities. Specifically we develop a better understanding of which factors are compensatory and which non-compensatory. Improved understanding of the decision making process allows entrepreneurs to directly address deficiencies in their venture, BAs to improve the accuracy and efficiency of their decisions and governments to develop policies that might enhance success rates.

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