UNPACKING THE BLACK BOX OF INFORMAL INVESTMENTS: DEAL ORIGINATION, MOTIVATION, AND CONTEXT DEPENDENCE (SUMMARY)

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Principal Topic

The objective of the paper is to explore the nature of the relationship between an entrepreneur and an informal investor – a non-professional private investor (a family member, or a friend) – at the early stages of business development. Although informal investments have been acknowledged to be an important source of finance for starting businesses, the process of decision-making and its context have not been addressed so far. The study attempts to explore the motivation of an entrepreneur and an informal investor, their interaction, and the impact of external environment. It is emphasized that bonding social ties would impose biases on both actors, shifting their expectations, risk awareness, and the perception of responsibilities. Moreover, when alternative sources become less available, the importance of social networks grows, thus accelerating the occurrence of the phenomenon.

Method

Multiple-case embedded design was developed, where an entrepreneur and an investor formed a dyad. The data for each case are drawn from semi-structured interviews, complemented by other available information, for 7 dyads in Scotland from July 2012 till September 2013. The grounded theory approach was used to formulate 3 propositions, which were further operationalised into working hypotheses, and subsequently tested on the Global Entrepreneurship Monitor individual-level dataset for the UK (2007-2012).

Results and Implications

It is proposed that informal investors are the initiators of the deal, after becoming aware, through informal communication, of the difficulties that an entrepreneur is facing in starting a business. Bonding ties, underpinned by belief and trust, along with the availability of spare funds motivate an individual to make an investment decision. Entrepreneurs tend to consider informal investment as a “last-choice option,” to which they refer when alternative sources are not available. At the macro level, the propensity to become an informal investor was predicted by income level, type of relationship with the entrepreneur, and the phase of economic cycle: the higher the income level, and the closer the relationship, the higher likelihood for an individual to become an informal investor. With the occurrence of the economic slowdown, the impact of income becomes more substantial, and the effect of the relationship becomes less important.

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