

Entrepreneur's Experience as Business angels' and Venture Capitalists' Decision criteria

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Abstract. There are many business angels' and venture capitalists' decision criteria they apply when they are assessing business proposals of entrepreneurs asking for investment. Entrepreneur's experience and experience of his/her team are considered as the most important of all criteria related to the entrepreneur. Using theoretical literature analysis we investigated experience as decision criteria used by business angels and venture capitalists and some limitation of their usage. We found that there are many types of experience available and identified several limitations for applying them in the decision process. In the empirical literature, there are discussed various types of experience such as professional experience, industry experience, managerial experience, leadership experience, domain-specific experience, entrepreneurial experience, start-up experience, international experience, work experience, track record and functional experience (production, marketing, financial etc.).

1 Introduction

Business angel investors and venture capitalists evaluate business proposals from entrepreneurs who ask for their finance by many different evaluation criteria [1, 2, 3, 4, 5]. In some scientific papers are criteria listed explicitly [1], or all criteria are grouped into several key categories such as product&model, market, financial, team and other [6, 4]. Authors [7, p. 126, Fig. 2] in their systematic review of literature created a conceptual framework, where they have only three major investors' investment criteria groups: Management team, Business, Financial traction. These are very broad categories including tens of specific criteria. Based on a systematic literature search these findings are summing investment criteria from 54 scientific empirical studies. Entrepreneur and all related characteristics with him such as psychological profile, education, track record, experience, moral integrity, ability to cooperate and many others are generally considered very important. We are not aware of any scientific study describing the decision criteria of the

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business angel or venture capitalist investors, which is not considering entrepreneurs and team characteristics as important.

From many criteria related to the entrepreneur and his team, the experience is valued by investors highly. In general, it is assumed that any type of experience has positive effects on an entrepreneur's performance. Any experience is better than none but ten years in business are usually considered as extensive experience [8, 6, 9]. Importance of experience was proven by review study of authors [7], who list them at first place in decision criteria related to entrepreneur used by business angels and also by venture capitalists. For venture capitalists they [7, p. 126, Fig. 2] report them as "industry, domain-specific, leadership and professional experience" and for business angels, they report them as "experience of funding team". Very similar results of importance of experience were found by previous authors [5], who reports that from 13 studies describing angels investors' decision criteria, 11 had industry experience as criterion or 9 had a track record. More than half of them (7 from 13) had them both and none of 13 did report industry experience or track record as a criterion which is not taken into account. Specific terms used by [5] for describing experience were: "industry experience and track record".

From these review studies and individual empirical papers, we can draw two conclusions. Firstly we can say that that entrepreneur's experience is considered as very important by almost every angel and every venture capital group, which was investigated. Secondly, there is high variability in what is considered as experience and how are they measured.

Therefore our aim in this paper is at it follows: To describe the experience as decision criteria used by business angels and venture capitalists in the decision process about investment and to discuss several potential limitations for their usage.

2 Methods

We applied descriptive theoretical analysis, to outline the current situation in experience application as decision criteria in business angels and venture capitalists decision process. In the literature search, we focused on review studies and individual empirical studies. In scientific database search, we used terms entrepreneur, experience and combination of words entrepreneur and types of experience such as professional experience, industry experience, managerial experience, leadership experience, domain-specific experience, entrepreneurial experience, start-up experience, international experience, work experience, track record and functional experience (production, marketing, financial etc.)

3 Results

Our results section has two parts. In the first part, we will show what types of experience are used in literature. We could divide three blocks of literature which were used in this paper. First are theoretical studies, second are review studies describing business angels' and venture capitalists' decision process and third are empirical management studies.

In the second subchapter, we discuss the hypothetical limitation of experience use as decision criteria used by investors. There is also intensive theoretical – empirical limitation of experience effect. Business angels and venture capitalists should be aware of these effects when using an entrepreneur's experience as decision criteria. In sub-chapter 3.2 we will show some of the arguments.

3.1 Various type of experience

Firstly we will discuss the various type of experience. There are several proposals about how the experience should be classified and in many authors, we find overlapping in the contend. In some cases, the experience is defined vaguely and ambiguously. For example, some authors [10] when describing experience they are using a term such as “high credibility of entrepreneur/management team”. From this statement, it is difficult to identify what specific experience are there and it indicates that there are many types of experience behind this term. In this section, we describe the most frequent types of experience used by various authors. We identified more than 10 different types of experience which we describe in this or next subchapters. For example [11] in her review study concluded, that experience can be classified into three categories: prior start-up experience, prior management experience and industry-specific experience. Prior start-up experience is usually considered the number of companies created in the past by entrepreneur, which is in line with other authors [12, 13, 14]. Because a startup is mostly defined as a fast-growing company, better will be to define these experience with condition that contains fast growth of the venture. There are serial [15], or by some authors [16], labelled as repeat entrepreneurs, are those entrepreneurs, who created and run several ventures. Launching and running number of ventures generate entrepreneurial learning and unique knowledge which others without it do not have [14]. In scientific literature, we can find also the term “track record” [1, 3] which is probably equivalent to start-up experience. So the first type of experience identified in the empirical and theoretical literature, which entrepreneurs have, are start-up experience.

The second type of experience is management experience, which is defined as an experience of managing business or team of people in a specified period. Some authors [8] combine managerial experience with start-up experience, labelled them as specific human capital, which is defined as years working with young firms. For better understanding effects of experience, we do not recommend merging different types of experience into summary blocs. We could also speculate about the term Leadership experience used by some authors [7]. These could be probably managerial experience. Industrial experience [11] define as working in a specific industry for a specified amount of time. Industry experience as a term is uniformly used by all authors in the field and [7] review they listed this decision criteria on the first place in the category management team. Also as reported above, authors [5] found industry experience in 11 studies from 13 investigating decision criteria. Being on the first places in the lists in the review studies and high frequency of use indicate, that industrial experience is considered by investors as more important than others. And for industrial experience, there is an agreement on the use of the term by various authors.

In the empirical literature, we can find also the term entrepreneurial experience. This labelling is overlapping with startup experience. Entrepreneurial experience is by some authors defined by years in self-employment, or by a number of ventures created [17], which is the same definition for startup experience. We also identified other types of experience which are reported in business and managerial literature and all of them have positive effects on venture performance [18]. They are: Functional experience such as marketing, financial, production, research and development experience is another type of experience [19]. International experience defines [20, p. 681] as: “whether executives had worked abroad for at least a year”. In business literature, we can find also term working experience which is defined as wage work experience [21], or as work for others [22].

3.2 Problems with various types of experience

So many types of experience generate some specific problems. We will discuss them in the following paragraphs. The first issue is the parallel existence of various types of experience together. As we can see, there are many types of experiences an entrepreneur could have. We would like to stress, that these experience are not existing separately but the entrepreneur in his professional career gains different types of experience in a parallel way. To better understand the overlapping experience we could illustrate the problem with the following example. If the entrepreneur starts his venture and he is managing it and then after a few years starts another venture in the same industry he already has several different types of experience. First are industrial experience, then he has managerial experience, but also entrepreneurial experience. In the case of working with finance, or in production, the entrepreneur has plus functional experience in finance/production. If the company was active in foreign markets than he has also international experience. After all, this when entrepreneur asked what kind of experience he has, he had six different options to answer what type of experience he has (industrial, managerial, entrepreneurial, etc..) and all are true.

Second problem is that some authors merge different types of experience into broader categories. For example, term professional experience is used [7] as a broader term and could be interpreted as industrial experience probably with the combination of entrepreneurial experience, maybe with management experience. The same could be said about term specific human capital or leadership experience.

3.3 Limitations of applying experience as decision criteria

As was described above experience are considered as very important decision criteria with high weight in the decision process. But as with everything experience could have also negative effects. There are many different arguments about the limitation of applying experience as decision criteria. In the next paragraphs, we explain some of them.

First, we start with management experience, often operationalized as time spent managing people or resources is used as a proxy for general expertise in the business environment, had been often criticised for lack of validity and not only in the business domain [9]. Reasons for criticism are explained by the complex environment in which every enterprise exists [7]. In this complex environment, many very different factors have influence and some of them occur only once or very rarely, which does not provide necessary feedback. Infrequent events are more difficult to learn from due lack of repetitiveness and especially if they happened only once or a few times in their career. Running one company, of course, create specific managerial plus industry experience, but the knowledge of how to create another, different venture could be limited. Therefore the transfer of knowledge from one enterprise to another in a different industry is not a simple mechanical straightforward process. A large part of knowledge could not be applied to new condition. Applying uncritically experience from one enterprise to another, which operates in a different environment, could lead to serious setbacks and failures [15]. Launching the second venture in the different industry often seriously challenges the entrepreneur's knowledge and procedures from previous enterprise forcing him/her to reevaluate many things which he/she took for granted [15]. Therefore we could speculate that managerial experience has a lower effect than industrial experience. But the situation is not only black and white for the managerial experience. Failure, or performing deep under expectations,

can lead to a positive scenario to deeper thinking and deliberation. This could produce more sophisticated, structured and organized knowledge about how solid business opportunity and consequently business model looks like and which attributes it should have [14]. As was discussed above experience creates various types of knowledge. Specific knowledge about venture functions such as production, marketing, finance, research and development is very valuable, but are on the other side very limited to that specific domain. If an entrepreneur does have large experience in finance but lacks experience in production or all other domains, his/her knowledge is restricted. The same could be said about all other experience. This could be called not compensatory substitution of one type of experience by another. And it is our second limitation factor. The financial experience could not substitute industrial experience and vice versa. Therefore from entrepreneur, it is expected to have minimum experience from all types of experience because one type of experience could not compensate for missing another type of experience.

Third limitation factor for not relying on experience without careful consideration is not linearity of influence. The relationship between experience and performance is not straightforward and linear as mixed results show. Some authors [24] found out that previous start-up experiences were negatively correlated ($r = -.16^{**}$) with proceeding to due diligence. Or the ability to forecast future performance was weakly predicted by start-up experience $\beta = .068^{**}$ [25], even that previous start-up experience did not predict start-up survival [13]. On the other side Hsu et. al. (2014) found out that specific human capital (total years in start-up) is a significant predictor for positive angel decision, but others [13] did not found that it will predict start-up survival. Also, industry experience brings mixed results. Some authors [26] did not find that it, as a significant predictor, for passing first pre-screen evaluation process and did not correlate with status or level of any business characteristics and in other research [13] it was found out that industry experience has no significant effect on survival of a new firm.

These mixed results can be explained by the atypical relationship between experience and performance, which can be graphically illustrated with the U shape curve. In the large sample of 65 390 firms found out that financial performance of the second enterprise is falling, compared to first and then in the third, fourth starts to raise, thus forming specific U shape curve [15]. The very similar curve was found by other authors [15] in the relationship between the number of ventures founded and quality of business proposal applying for business angel investment.

4 Discussions

Entrepreneurs' experience is valued by business angels and by venture capitalist highly. Problem is that there are many types of experience which overlap in two ways. First is that entrepreneurs could have multiple types of experience together such as entrepreneurial, managerial, industrial and functional at once. And therefore the answer to the type of experience depends directly on how is the question about experience asked.

The second overlap is that many authors do not distinguish between some types of experience. Startup experience and entrepreneurial experience are theoretically different types of experience but several authors are using these terms interchangeably.

These problems with terminology and objective overlapping make it problematic in the identification of what experience are demanded. Not much is known about how business angels and venture capitalists interchange different types of entrepreneur's experience. Industrial experience seems to be considered as the most important, especially in the early stages of development. In the later phases of development, the managerial experience is valued also. But in summary, we could say that all types of experience are considered to be

positive. Experience should not be taken in the decision process without consideration and there are known several limitations of their influence. They are not interchangeable therefore compensatory decision process could not be applied. Also, there is empirical evidence that the influence of experience is not linear but has a U shape curve.

Recommendation for future research. For the better understanding role of experience as decision criteria, it is worthy to investigate all scientific papers where experience were listed and carefully and into detail check what kind of experience were described. Only after that, we could be sure what type of experience was demanded by investors and to conclude if their procedures are valid.

Acknowledgment

This paper is an outcome of one research project: "IT Management in Enterprises in Slovakia: International Standards and Norms Versus Individual Business Processes.", VEGA no. 1/0388/20-project share is 100%; led by doc. Ing. Anita Romanová, PhD

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