

Angles on Angels and Venture Capital: Financing Entrepreneurial Ventures

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Financing Economic Development in the 21st Century, 2nd Edition, Z. Kotval and S. White, eds., M.E. Sharpe, Inc: NY (forthcoming).

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Venture capital funds are concentrated in two states, California and Massachusetts, and in other financial centers. Forty-seven percent or more of their deals have been made in three regions: Silicon Valley, which has continued to have the largest percentage of deals since at least 1980, New England, and the New York metropolitan region (see Figure 3). The Midwest, LA/Orange County, the Southeast, San Diego, Texas, and the Northwest rank among the remaining more active regions. Angels are geographically more dispersed and are less likely to invest in ventures that are beyond a day's drive of their principal residence. California and Massachusetts are also major angel locations, and angels are to be found in increasing numbers in North Carolina, Colorado, the Northwest, Texas, and Utah (Sohl 1999).

For several decades, economic development policy has aimed to promote entrepreneurship and technology-based activity (Gittell, Sohl, and Tebaldi forthcoming). Some 30 states have state-supported venture capital funds, the first having been established in Massachusetts in 1979 (NASVF 2008). As of 2008, the funds had about \$2.4 billion in investment funds, a very small amount (1.3 percent) compared with the \$179.4 billion under management at private venture capital funds (NVCA 2010). The state-supported funds invest mostly in the seed and early stages, but some have made investments at later stages. From the late 1980s onwards, economic development organizations have encouraged local venture start-ups by means of business assistance programs, technical assistance, subsidized incubators, and tax breaks. A study of 394 regions in the U.S. identified entrepreneurship and innovation as drivers of the development of regional economies (Camp 2005). Angels and venture capital funds are very active in the financing of technology-based ventures, each group having committed a substantial majority of its funds to technology-based industries, especially health, biotechnology, and software (see Table 1).

A study by Gittell, Sohl, and Tebaldi (forthcoming) concluded, first, that over the last business cycle, 1991–2007, entrepreneurship had a powerful positive impact on employment growth during all stages of the cycle. There is evidence to suggest that while *levels* of technology concentration were negatively correlated with employment growth, the *growth* in technology concentration encouraged employment growth in Metropolitan Statistical Areas (MSAs). Expansion in technology concentration rather than its size creates the conditions favorable to job growth.

Second, the study found that there exists a strong link between entrepreneurship and technology-based activities, supported by a highly qualified work force (and through the financing by angels and venture capital funds; see Table 1). MSAs with growing technology-based activities and above-average entrepreneurship levels can be expected to add jobs more quickly than other MSAs. These results suggest that technology-based entrepreneurship is a more powerful job creator than entrepreneurship on its own, and especially than the generality of small businesses. Plummer and Headd (2009, p. 593)

found that there was little difference between the birth and death rates of ventures in rural areas and those in urban areas and concluded that “it would appear that rural counties are just as ‘entrepreneurial’ as urban areas.” If this is the case, and if the entrepreneurship is technology based, then it might be reasonable to extend the conclusions in Gittell, Sohl, and Tebaldi (forthcoming) to areas other than MSAs.

Such studies suggest that public policy encouraging economic development should be directed to the promotion and encouragement of technology-based and innovative entrepreneurial ventures. Evidence suggests that 30 to 50 percent of prospective entrepreneurs who take at least two real steps toward starting a venture actually do so and are helped by programs such as business assistance programs (White and Reynolds 1994). A diverse portfolio, based on varied technologies, might further strengthen the impact of these ventures and provide a greater degree of stability in growth patterns over time. Infrastructure support for technology and innovation through incubators, technology parks, local universities, and other institutions might further strengthen growth (Gittell, Sohl, and Tebaldi 2004). Underlying these policy tools are the more traditional ones of benign local and state taxing policies, favorable housing costs, a well-educated workforce, and the provision of social and cultural amenities.

There is another necessary set of supports: adequate sources of finance at the right time and in the most appropriate form. Entrepreneurial ventures, whether technology-based or not, will often require external private equity capital financing during their development. As noted above, venture capital firms tend to be based in California, Massachusetts, and other financial centers rather than spread out in smaller communities across the country (Muzyka et al. 1993; Sapienza, Manigart, and Herron 1992; Sapienza, Manigart, and Vermeir 1996; Sapienza and Timmons 1989). Angels tend to be more geographically dispersed, and many angels prefer to invest in ventures that are geographically close in order to be involved in a hands-on manner and perhaps also because they wish to foster economic development in their home area (see, for example, Aram 1989; Freear, Sohl, and Wetzel 1993; Landstrom 1992; Mason 1996; Postma and Sullivan 1990; Short and Riding 1989; Wetzel and Seymour 1981). Angels are not, however, spread evenly across the country and are not always where they might be particularly needed. They tend instead to cluster where entrepreneurial and technological innovation is intense. Angels need entrepreneurs and entrepreneurs need angels. This circularity is a challenge for local and regional economic development, which would benefit from seeking greater input and involvement from angels and venture capitalists as means of supporting local entrepreneurial initiatives.