Growth Entrepreneurship: Do we really understand the drivers of new venture success?

Executive summary - foreword

The UK has always had a reputation for innovation and in the 21st Century the significance of entrepreneurship in this country has major economic and social considerations. By producing and supporting knowledge-based ventures with high growth potential, the UK enhances its ability to create jobs and economic wealth. As well as bringing positive benefits to individuals and communities, it means that the UK can continue to compete on the world scale by producing first-class companies.

People with new scaleable business ideas need to be supported. They need to be given a chance. Whether they have successfully built a high growth business before or they have had no experience of bringing a new product to market, the idea itself must be given the opportunity to succeed.

In 2001, SEEDA established the Enterprise Hub Network, a flagship programme to accelerate the rate at which entrepreneurs, companies and academic researchers could produce successful businesses out of new ideas and concepts originating in the South East of England.

In 2006 the Enterprise Hub Network conducted research amongst its members to explore their views about entrepreneurship and how they had been supported. Although the Enterprise Hub Network provides a range of high value hands-on services, the overriding view was that networking and access to finance were two aspects that they valued the most.

Business networking is not that well developed for start-ups in the UK. This is a key role of the Enterprise Hub Network. It can speed up the development of networks for the entrepreneurs it supports, allowing them to tap into a strong network of partners such as the HEIs, 60 business mentors, personal networks, as well as insider knowledge programmes. This needs to be extended to provide more connections particularly with the investment community and corporates.

The research also revealed that over 40% of respondents would pay far more attention to the finance and business planning as key elements of their business if they were starting out again. Funding is very closely linked to human capital which is why SEEDA commissioned an independent review of fundraising and the understanding of entrepreneurs and entrepreneurial teams. The intention is to explore ways of ensuring that investors and entrepreneurs are better prepared when making decisions about high growth potential companies.

The research paper entitled Growth Entrepreneurship: Do we really understand the drivers of new venture success, reviews the literature available on two key aspects of entrepreneurial activity, the investment decision making process adopted by VCs and business angels and secondly the various attributes of successful entrepreneurs. The findings of the research are highlighted below and include some conclusions and recommendations for debate today.

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Venture capital and decision-making

- Venture capital is broadly defined as capital which is not secured by assets and is invested in or loaned to a company by an outside investor. It is often referred to as risk capital since it is not only unsecured, but generally lacks liquidity as well. Venture capital is important because it helps companies to start and grow, especially those which need sizeable injections of finance and support at critical periods in their early stage development and periods of expansion.
- In recent years the supply of start-up and early stage equity finance has become more dependant on the high net worth/business angel community, as venture capital funds are no longer able to accommodate a large number of small deals with heavy due diligence requirements. Venture capitalists (VCs) are now making larger investments in later stage deals and as a result, companies may well have an issue raising funds of between £250,000 and £1 million. This is a gap being filled by business angels, a level up from other sources of funding such as founders, family and friends.
- Despite the importance of venture capital to business funding, there is a surprising amount of guesswork involved in assessing whether or not to support a new or growing company. Research suggests that VCs still lack a strong understanding of how best to make investment decisions with only a small percentage of them employing specific guidelines and techniques.
- Furthermore, although VCs place a lot of emphasis on the importance of the entrepreneur and entrepreneurial team, their understanding of what makes a successful entrepreneur and team is sketchy. Some rely on the fact that the entrepreneur has succeeded before. Others will see an entrepreneurial team as a group of individuals with a strong track record. Research suggests that neither of these approaches is particularly correct.
- And whereas VCs and business angels conduct a level of due diligence given the resources at their disposal, they do not conduct the detailed investigations one would expect, often relying instead on their ‘gut feel’ to assess the competencies of the entrepreneur and business proposition.
- As a result, neither VCs nor business angels have a particularly high success rate among their investments.

Entrepreneurs and entrepreneurial teams

- Although entrepreneurship is widely regarded as the process of creating wealth, the terms ‘entrepreneur’ and ‘entrepreneurial team’ mean different things to different people. There are different types of entrepreneurs, who suit different types of ventures. These individuals display different personality traits from the need for achievement through to the propensity to take risks.
- Given the significance of the entrepreneur to the business, it is vital for the business angel to know exactly what individual and team they are dealing with.

- In the same way that an inventor is not necessarily an entrepreneur, an 'enterprising individual' may not have the skills and attributes to succeed in driving forward a high growth potential business. Likewise, an individual with a high IQ and excellent business management skills doesn't qualify them for the tag of entrepreneur simply because they have formed an idea for a new business.
- There is also the 'ultrapreneur' used to describe ultra high growth entrepreneurs capable of taking a venture from start-up to harvest in less than three years. Such individuals are considered to be born, not made. And somewhat fascinatingly, recent research shows that aspects such as dyslexia and high emotional intelligence have been found to have a strong correlation among entrepreneurs.
- Yet, with the entrepreneur so pivotal to the success of the company, the question is why this aspect of decision making among VCs and business angels is so based on gut feel when it comes to understanding the individual. Plenty of time is spent pouring over the business plan, but far less attention is paid to the capabilities and mind-set of the entrepreneur.
- Consider also the entrepreneurial team. A team of high performing individuals may get in each others' way if the personalities are too similar. Similarly a team that is too diverse and doesn't debate decisions in the interests of the business may simply implode.
- There is a natural tendency among entrepreneurs to build a network based on their friendships and immediate circle of contacts. This is not necessarily the best approach if certain skills and a balanced team dynamic for that company is required.

Conclusions and recommendations

- Despite the importance of business funding – for the company, the economy and the investor taking the financial risk – investment decision-making is still loosely based on aspects such as 'gut feel'.
- Research suggests that VCs and business angels are not adopting more systematic techniques to make better decisions. Whilst many investors will spend time focused on the business plan, the role of the entrepreneur is regarded as important but less emphasis is based on an investigation and understanding of this individual.
- There is scope for the development of a more comprehensive framework for making investment decisions. The relatively small supply of really good opportunities to invest in high growth potential companies makes it all the more important to get this framework right.
- As well as understanding the characteristics of the entrepreneur, the entrepreneurial team is also crucial. Business angels and venture capitalists need to adopt a more systematic approach to looking at teams.
- There is substantial scope for the further education and training of business angels on deal assessment.
- The individual entrepreneur's background/traits/skills may be undermined if they do not have a balanced team around them. Not all the members of the team necessarily have to be entrepreneurial, but an enterprising attitude is considered important.