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Business Angels' Perspectives on Exit by Ipo

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Business Angels' Perspectives on Exit by Ipo*

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Résumé/abstract

Nous analysons les perspectives selon lesquelles des anges membres d'un groupe structurés d'anges canadiens envisagent la disposition de leurs placements. Ces anges investissent des montants de l'ordre de 1,2 millions de dollar dans des entreprises technologiques et l'émission initiale est, de ce fait, une option de sortie envisageable. Toutefois, les anges énoncent une préférence marquée pour la cession en bloc de leurs actions à des acquéreurs stratégiques. Cette préférence est cohérente avec l'hypothèse des économies d'échelles : pour les entreprises innovantes, il est essentiel d'acquérir rapidement une taille suffisante à l'exploitation rapide des innovations, et l'acquisition par un joueur important du domaine est un moyen plus efficace d'acquérir cette taille que l'émission initiale. Toutefois, la réglementation des valeurs mobilières est également perçue comme un obstacle majeur aux émissions initiales.

We analyze exit-related perceptions of the members of a large, well-structured Canadian angel group. Because they invest in high tech deals larger than CAN$1.2 million, together with venture capitalists and a matching fund, these angels should consider the initial public offering (IPO) as a possible exit mode. However, they show a strong preference for the trade sale. This preference is consistent with the economies of scope hypothesis: getting big fast has become more important because large firms can fully and rapidly exploit innovations, resulting in more small firm acquisitions. Securities regulation is also perceived as a major impediment to exiting onto the stock market. Both reasons explain why IPOs are not considered an exit mode. Reluctance to exit through an IPO increases with angels' experience. Our observations have implications for entrepreneurs, business angels and policy makers.

Key words: *business angel, exit, entrepreneurial venture, securities regulation*

Codes JEL *: L26, M13, D81, G24*

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BUSINESS ANGELS' PERSPECTIVES ON EXIT BY IPO

INTRODUCTION

According to Mason (2006, p.3), business angels are *high net worth individuals who invest their own money, along with their time and expertise, directly in unquoted companies in which they have no family connection, in the hope of financial gain*. They are a very important source of financing for early stage companies (Sohl, 2012). Research on business angels has focused on their characteristics and the investment process. Previous evidence of angels' harvesting strategies is limited. How and why business angels expect to exit from their ventures, and the extent to which they invest in and monitor their investee firms according to this exit path are under-researched questions.[1] Generally, researchers analyze exits according to investors' outcomes (Mason and Harrison, 2002; Wiltbank et al., 2009; Roach, 2010).

Three recent interrelated observations reinforce the pertinence of this research topic. First, the business angel market is changing, partly as a result of institutionalization. Angel groups and the evolution of the venture capital (VC) market seem to lead angels who invest conjointly to move away from seed financing and to invest larger amounts (Amatucci and Sohl, 2006; Sohl, 2006; Freear and Sohl, 2012; Sohl, 2012; Gregson et al., 2013). Accordingly, they should become more interested in exits than in the past. Second, several practitioners urge angels to rethink their exit mode (Peters, 2009; McKaskill, 2010; Gray, 2011). According to Mason (2011c), who refers to the concept of 'early exit' developed by Peters (2009), it is increasingly common for angels to exit through a trade sale, i.e. to sell their whole stake to another firm or private investor over a short period. VC investment formerly requested to reach an initial public offering (IPO) is thus no longer necessary. However, empirical evidence of this trend is scarce. Third, the significant decrease in IPOs in North America and the UK has become a real concern for policy makers. As one of the factors proposed to explain this decrease, the exit strategy of private equity investors deserves attention. (IPO Task Force, 2011; Mason, 2011c).

Our main objective is to determine, from business angels' viewpoint, how and why angels expect to exit, and how their experience influences the two previous questions. We also expect to contribute to the understanding of the processes that underlie entrepreneurial growth, as suggested by Wright and Stigliani (2013). This study relies on a survey conducted in a business angel group in Canada. This research method is common in the area of business angels. Surveys have been used to study and rank business angels' investment (Sudek, 2006) and decision process (Feeney et al., 1999), factors that influence the supply of informal venture capital (Mason and Harrison, 2000), determinants of the value-added contribution advisors offer entrepreneurs seeking funding (Lahti, 2012) and business angels' strategies (Sohl, 2006). This article is structured as follows. Part one summarizes the purported reasons for changes in the angel market and exit mode and decline in IPOs, and explains why business angels can provide valuable insights into this matter. Part two presents the survey and the respondents. We present the results in Part three and our conclusions in Part four.

BUSINESS ANGELS, EXIT AND IPO

THE EVOLUTION OF THE BUSINESS ANGEL MARKET

The common wisdom is that angels invest well below the minimum deal sizes considered by VC funds in seed and start-up businesses (Mason, 2009, p.539). Indeed, deal amounts for individual angels are estimated at between CAN$22,000 and CAN$100,000 in Canada (Farrell, 2000) and less than £100,000 in the UK (Mason, 2011a). After angel funds run dry, entrepreneurs seek funding from venture capitalists (VCs), whose dollars and connections lead the start-up to an IPO

(Ibrahim, 2011). For angels, VC often represented an important source of follow-on funding for their investment (Amatucci and Sohl, 2006, p.96). Even if the typical angel-funded deal is too small to consider issuing an IPO, angels may continue to hold their investment and even participate in subsequent financings round together with VC, to be able to participate in the exit (Freear and Sohl, 2012). This strategy requires an amicable working relationship between angels and VC funds (Amatucci and Sohl, 2006, p.96) and a long-term involvement with the firm. Indeed, Wiltbank (2009) indicates that the average time from the angels' investment to successful exits is about eight years.

After the downturn of 2001, VC returns have been poor, particularly in Canada. This has had two interrelated effects on the angel market. First, institutional VC investors have shifted their investments away from early-stage ventures to focus almost exclusively on more mature, far less risky investment opportunities (Pierrakis and Mason, 2008). This shift in the risk capital market has contributed to a growing equity gap for early-stage ventures (Sohl, 2006; Gregson et al., 2013). Second, the relationship between angels and VC became more complicated. As explained by Amatucci and Sohl (2006, p.101), several investments have been devalued in later rounds, thus diluting them. Consequently, angels now provide additional rounds, and reallocate their investment toward post-seed rounds. They have also become more sophisticated. They now require that entrepreneurs use their investment in a way that will let them reach an exit event (Amatucci and Sohl, 2006).

A parallel notable change in the angel market is the growing number of angels who invest in different kinds of formal and informal structures. The increase in the number of groups, alliances and associations in Europe and North America has been significant (Sohl, 2012; Gregson et al., 2013). Highly organized groups focus on post-seed investing (Sohl, 2012, p.21). Even if the angels participating in groups remain a minority, this institutionalization raises concerns about the availability of early-stage funding.

The group whose members participated in this study shares many characteristics of the Canadian structured angel market described by the Canadian National Angel Capital Organization (NACO, 2013). Created in 2008, this large Canadian group had 110 members at the time of the study and is growing rapidly. The government has provided CAN$20 million to set up a matching fund that grants co-investments on a deal-by-deal basis. On June 2013, the group's members had financed 22 firms, reinvested in three of them and exited from two. In 18 cases (82%), the deals involved a co-investor, generally a small VC fund. The proportion of co-investors is higher than the 55% estimated at the Canadian level, a likely effect of the local implementation of numerous small government-sponsored VC funds. Since its implementation in 2011, the matching fund has supplemented the angels' investment in 12 projects and kept a provision of CAN$0.5 million for each project to be able to back a second round. The average total deal of the members of the group is over CAN$1.2 million, and the average angels-only deal is CAN$484,000. In 2012, the corresponding Canadian average values are CAN$2 million (median of CAN$1.5 million) for the total deal and CAN$314,000 (CAN$506,000 in 2011) for the angels-only deal (NACO, 2013). The proportion of investees that have reached the revenues stage is 76%, which fits the 74% proportion reported at the Canadian level in 2011 (Mason, 2011b). The other funded firms are close to the beginning of the revenue stage. Two of them have beta versions running, and three already have ready-to-sell products or services. The group invests mainly in information and communication technologies including social networks (13 deals) and medical devices (5). All the financed start-ups are innovative companies with sizable growth potential. The type of deals financed by the group's members probably explains why the exit is an important dimension of the decision process. The entrepreneurs are asked to devote one of the ten slides comprising their first pitch to the angels to their exit strategy, including potential acquirers. It is generally accepted that individual *angels are more concerned with making their investment a success than with how to exit* (Freear and Sohl, 2012, p.233). However, we can confirm that the studied group's members devote much attention to the terms and conditions of the deal and to exits.

The situation described above is a good illustration of the concerns of several researchers that the institutionalization of the angel market is likely to move the angels away from the seed and pre-seed capital (Freear and Sohl, 2012). It is also likely to influence the angels' exit strategy. In particular, VCs are involved at the first round of angel financing. This limits the potential conflict between angels and VCs during the later financing rounds mentioned by Amatucci and Sohl (2006) and eases the path toward any kind of exit. The first financing round involving angels implies significant amounts of money for the firm, and the co-investors, including the matching fund, can easily back the angels in a second round. The large number of members in the group gives them the opportunity to reinvest significant amounts in a subsequent round as suggested by Mason (2011c, p.22).

BUSINESS ANGELS EXIT STRATEGY

Successful exits of private equity investors consist in IPOs or trade sales. IPOs are not common events for angels or for VCs, yet IPOs can generate the huge returns required to get a positive average on the skewed angel return distribution: 10% of the exits provide 90% of the cash returned (Wiltbank, 2009, p.15). Indeed, angels' success stories like Amazon, Google, Apple or Body Shop are often used to illustrate the potential returns of early investing for exiting via IPO (DeGennaro, 2012). Sohl (2012, p.28) writes that the IPO is a viable opportunity for business angels. Based on the results of Johnson and Sohl (2012) and Bruton et al. (2009), he observes that the angel-financed companies are significant participants in the IPO market. Chahine et al. (2007) report that business angels and VC own on average 6.68 percent and 4.27 percent respectively of total equity in their sample of 444 French and UK IPO firms. Using archival data of a law firm to analyze high tech funding, Goldfard et al. (2012) report proportions of IPO exits of 10.5% for VC-backed firms, 3.1% for angel-alone backed firms and 2.7% for mixed deals. Gregson et al. (2013) report the same number of successful exits through trade sale as through IPOs in an angel syndicate studied in Scotland. Bruton et al. (2010, p.499) analyze the IPOs on the junior markets in the UK and in France. The proportion of IPOs with VC ownership is estimated at 8%, double the proportion of IPOs involving angels. Analyzing the angel investor performance project dataset, DeGennaro (2012) determines the fate of 391 angel-backed firms and reports 121 cases of failure (31%) and 56 cases of exit through an IPO (14%). Overall, angels participate in the IPO market less frequently than VCs, albeit at a significant rate. Although the numbers and proportions are small, the economic impact should not be ignored.

Analyzing the exit from the business angels' viewpoint is also of particular interest because they have often constructed their wealth by exiting from one or several successful ventures (United Nations, 2009, p.21). They can thus provide rich insights into the exit strategy. Analyzing the Canadian situation is particularly interesting because this country enables firms to access a venture stock exchange at an early stage of development (Carpentier and Suret, 2012). The median gross proceeds of non-resources and non-financial firms that list on the Canadian Venture Exchange from 1997 to 2011 is CAN$1.6 million, close to the amount of the angel deals. Moreover, small firms that list on this market when they report revenues exhibit a life expectancy higher than the one reported for firms listed on the NASDAQ (Carpentier and Suret, 2011).

EXIT CHANGES: EXPLANATIONS

Globally, the number of IPOs is in sharp decline. Three explanations have been proposed, but none has been widely adopted yet. The first refers to the strategic dimension of innovative companies, and has been described as the economies of scope hypothesis by Ritter et al. (2012). The second rests on the regulatory burden of small public companies. A third hypothesis proposes that market conditions explain the low frequency of IPOs. These three explanations are not mutually exclusive. They are not specific to angels but concern all private equity investors.

The strategic dimension and the economies of scope hypothesis

The economies of scope hypothesis is grounded in the observation of *a gradual structural change going on for the last few decades that favors big firms at the expense of small firms* (Ritter, 2013, p.8). Ritter contends that getting big fast is increasingly important, mainly in the technology industry, as a consequence of globalization and improvements in communication technology. In other words, the synergy effects are increasing because of the acceleration of innovation. In this context, a strategy where a small independent company grows with its own resources and ultimately makes an IPO is less optimal than the alternative strategy of growing big fast. This strategy can be accomplished most efficiently through a merger with or an acquisition by a large company that can fully and rapidly exploit innovation (Merrill, 2009; Ritter, 2011; Gao et al., 2012). As underlined by Mason and Harrison (2006), most of the emerging high tech companies are unable to either make the required organizational and personnel changes or to raise the financing needed to develop their own market. Some of these companies will be sold to larger established firms. From the outside investors' viewpoint, such a strategy implies a trade sale because a small innovative company is worth more as a part of a large organization than as a single entity. A trade sale allows the investors to benefit from the synergetic effects. Indeed, Gray

(2011) contends that business angels think that trade sales are more profitable exits than IPOs. Peters (2009, p.32) writes that *the optimum strategy for tech start-ups today is to design the company (…) so everyone is aligned around the idea of a company acquisition in the under $30 million range*. If angels really endorse this perspective, the following propositions should be verified:

> P_1: Business angels prefer a trade sale exit to an IPO exit

> P_2: Business angels prefer a trade sale exit because of strategic considerations in line with the economies of scope hypothesis

Regulation and market structure

The IPO Task Force report (2011) links the low frequency of IPOs to the cumulative effect of different regulatory actions that increased costs for emerging growth companies seeking to go public, and reduced the amount of information available to investors about these companies. Such regulatory events include Sarbanes Oxley, decimalization, the Financial Services Modernization Act (Gramm-Leach-Billey) and the Global Settlement. In the US, the cost of an IPO reached $2.5 million, and the ongoing compliance costs are estimated at $1.5 million per year (IPO Task Force). Oesterle (2006, p.369) maintains that *the high cost of IPOs depresses venture capital in the United States*. In Canada, direct costs are lower but underpricing reaches 45% for smaller issuers (Kooli and Suret, 2003), which induces a significant additional cost.[2] If securities regulation is a strong deterrent for IPO exit, business angels should agree with our third proposition:

> P_3: The requirements, delays and costs induced by securities regulation is a primary deterrent for IPO exit.

Market conditions

The explanation related to market conditions is threefold. First, since the burst of the Internet bubble, the long-run performance of second market IPOs has been very poor in the US (Ritter, 2011) and in Canada (Carpentier et al., 2010). Such poor returns are likely to deter investment in new IPOs, because investor sentiment is one of the significant determinants of the demand for IPOs (Derrien and Kecskés, 2009). A second dimension of the market condition is related to the huge amount of cash held by the world largest technological companies, estimated at $290.89 billion in 2011, for a total market capitalization of $1.445 trillion for the ten largest companies, including 8 US companies.[3] This concentration in cash is a possible reason for the high valuation observed in trade sales.

A third dimension is associated with the low level of listing requirements on the TSX venture exchange (TSXV). Firms generally list at an early development stage, before they report any revenues. Liquidity on the junior market is very low. This is likely to create a reputational and liquidity effect and a difference in valuation between the Canadian and US markets. Part of our survey is devoted to estimating the angels' perception of the quality of the Canadian stock market. Accordingly, we attempt to determine whether business angels agree with the following proposition:

> P_4: The reluctance to exit via IPO is explained by the poor perception of the Canadian venture exchange.

Why should experience matter?

The group includes angels with different backgrounds and experience, but a large majority of them have exited from their own firms. However, less experienced angels are likely to have a more limited knowledge of the intricacy of exiting than experienced angels who have invested for several decades in more than 10 ventures. We expect that angel-investment experience influences their perspectives on exit. Experienced angels are more likely to have analyzed the pros and cons of an IPO and of other exit modes, and to have contended with the intricacies of securities regulation. They are more likely to provide an accurate perspective on the differences between the exit modes in terms of value, delay and rate of return than less experienced angels. Note that experience is estimated by the number of investments, because we were unable to get accurate data regarding the number of exits per respondent. However, in the studied group, the exit strategy is an important part of the entrepreneur's pitch and decision process, as we observed during several presentations and discussions. Accordingly, we consider that the number of investments is a good proxy for the angel's familiarity with the exit problematic.

Accordingly, we posit the following proposition:

P_5: Business angels' perspectives on exit differ based on their angel-investment experience.

It is difficult to test these five propositions empirically. A survey is probably the only way to determine how business angels plan to exit and to what extent they validate the propositions mentioned above.

METHOD AND RESPONDENTS

We survey the 110 members of a large Canadian group,[4] using the Internet, from October 18, 2012 to November 20, 2012. This organization fits the description of a formally organized group (Shane, 2005) or formal angel alliance (Sohl, 2012). It has a paid manager and paid staff. The organization has a budget, partially granted by the government, a web site, and a physical location. The group's staff does due basic screening of deals, and manages logistics. The group has regularly scheduled meetings. Barriers to entry consist of significant annual fees (CAN$2,500) and the approval of a committee that checks the entrepreneurial background and the willingness and ability of new members to help the investees. According to the group's CEO, 95% of the members are former or serial entrepreneurs who successfully exited from one or several ventures. They fit the definition adopted by the governmental institution that manages the matching fund associated with the group: "Angel investors are successful entrepreneurs or former corporate executives who invest privately in innovative, high growth potential companies. In addition to providing their funds, angels can offer entrepreneurs their skills, experience, network of contacts and some of their time. Angels invest in emerging companies that are generally in the seed or start-up phase." Moreover, the group members are asked to verify their status of accredited investor according to securities laws. Accordingly, they must hold net assets of at least CAN$5 million. Wealthy people with an entrepreneurial background are very likely to have exited from successful businesses. Each member is responsible for his or her own investment decisions based on personal investment objectives and criteria, and there is no investment committee.

Before posting the questionnaire online, we pre-tested it with three angels and had several discussions with the CEO of the group, a skilled angel, to make sure that all terms would be easily and consistently understood by the business angels. The group's CEO then explained the research objective of the survey to the members during the monthly meeting in September. Second, the group's team sent an email to each member with a link to the survey and an explanation of the research objective. The first reminder was issued during the October meeting, and a second reminder email was sent to all members in November. We get a total of 35 answers, for a response rate of 32%. This rate is higher than that reported by Lahti (2012) in a similar context (20%).

The final questionnaire has four sets of questions. The first part explores the business angels' characteristics and their general perspectives on exit. The second part examines the dimensions related to the economies of scope hypothesis. The third part is devoted to the regulatory dimension. The fourth part includes the questions related to perceptions of the Canadian stock market. The respondents answered most of the questions on an agree/disagree scale. They could also make comments in response to open questions.

All respondents but 4 have made previous angel investments. Virgin angels share the characteristics of active angels but have not entered the market (Mason, 2011a). However, we include the 4 virgin angels in the survey for the following reasons. They have the entrepreneurial background requested by the group, they are actively involved in a costly and time consuming approach to investing. Specifically, they attend meetings, presentations and training and discussions organized by the group and pay the membership fees. Thus, we consider that they have entered the market. Nevertheless, we analyze this sub-sample independently in the part of the study devoted to the influence of experience.

35% of the respondents have more than 12 years of experience as an angel, and 31% have invested for 2 to 12 years. Eleven angels have invested in more than 10 firms (31% of our sample), eleven in 4 to 10 firms, and 12 angels financed 0 to 3 firms. Thus, most of our respondents are experienced angels. However, a third of the sample is composed of relatively new angels, which allows us to analyze the experience effect on exit strategies. The majority (27 or 77% of respondents) of the business angels has never exited through an IPO, and 3 experienced only one. Five angels have IPO-exited two or more times, and one angel four times.

Approximately one angel out of four has experienced IPO exit, and the total number of reported IPOs is 17.

RESULTS

GENERAL PERSPECTIVE AND STRATEGIC DIMENSIONS

We asked the angels: After making a private investment in high growth firms, which exit mode is better? The choices are between trade sale, IPO, both are equivalent or I don't know. We received 35 answers, including 5 'I don't know.' Fifty-one percent of respondents think that the trade sale is the best exit mode. This indicates a clear preference among business angels for non-IPO exit. The IPO exit choice constitutes only 17% of the answers. This proportion is in the same range as the ratio of previous IPO exit. This first part of the analysis confirms that angels generally consider trade sales as their most likely exit mode. The likelihood of an IPO exit is low, in line with the recommendations and observations of McKaskill (2010) or Peters (2009).

Insert Table 1 here

Table 2 shows the answers to the questions related to the strategic dimension as an explanation for the choice of the exit mode. Overall, business angels confirm the economies of scope hypothesis: the decrease in IPOs is linked to the growth strategy of the start-ups. Sixty-six percent think that it is hard for a small innovative firm to develop a new market on its own. Only two respondents strongly disagree. Twenty-one respondents (60%) estimate that the development strategy of the firm in which they have invested rests on acquisition by another firm in the same field. These results are consistent with the recommendations and observations of Peters (2009), Gray (2011) or McKaskill (2010). They also partially confirm Ritter et al. (2012)'s assessment that the change in the exit mode is a symptom of a structural move.

Responses to the statement that, considering the pace of innovation, only large international firms can take full advantage of a given innovation are mixed. About 46% of respondents strongly or somewhat disagree. These disparate results could be explained by the fact that acquirers of angel-backed start-ups are rarely big multinational firms but rather medium-sized entities that operate in a comparable field or that have developed complementary products.[5]

Fewer than one respondent in two thinks that the IPO has become a scarcely used exit mode because it is hard for a small innovative firm to develop a new market on its own. This result shows that, in addition to the strategic dimension, other factors probably explain the decrease in IPOs. Some of these factors seem associated with the demand side of the IPO process, which we explore with two questions. About 66% of the respondents think that there is little demand among investors for IPOs of innovative firms. Approximately 75% strongly or somewhat agree that the lack of intermediaries (underwriters) interested in small public offerings is a major obstacle to IPOs. These two elements are linked: there cannot be many intermediaries in a market with small demand and minimal supply. Sixty-three percent think that the costs and drawbacks of IPOs largely outweigh their advantages.

This first part of the survey indicates that business angels confirm propositions 1 and 2. They prefer to exit through a trade sale rather than through an IPO, and they associate their preference for trade sale with strategic considerations, in line with the economies of scope proposition. However, other factors probably contribute to explaining why IPOs are not considered a favourable exit mode.

Insert table 2 here

THE PERCEPTION OF SECURITIES REGULATION

Table 3 shows that 60% the respondents think that securities regulation is a major obstacle to IPOs, while 28% do not know or are neutral. Eighty-three percent think that writing a prospectus and the processes associated with IPOs incur huge costs for small-sized issuers. Ongoing listing requirements applicable to reporting issuers (listed companies) generate significant costs and delays, according to 74% of the angels. Most of the angels estimate that the costs resulting from securities regulation have increased during the last decade. The majority (52%) of the angels thinks that securities regulation is unduly detailed and complex. The surveyed angels share a negative view of securities regulation.

Overall, business angels' responses convey a negative perception of the costs, delays and intricacies associated with securities regulation, especially those associated with IPOs. This negative perception probably influences business angels' exit decisions. This result is consistent with our third proposition that the requirements, delays and costs that securities regulation induces for IPOs is a primary deterrent for exiting through an IPO.

Insert table 3 here

THE PERCEPTION OF THE CANADIAN STOCK MARKET

Because of its low listing requirements, the TSXV can be an option for private investors who are looking for early exits. Forty-six percent agree somewhat with the statement: I have a positive view of the TSXV (Table 4). Only one angel agrees completely. Seven angels disagree, including 3 who disagree completely, while others are neutral. Thirteen respondents think that, in general, the TSXV is inefficient. Those who consider this market inefficient also tend to have a negative opinion of this market. Eight think it is efficient and 14 are neutral or do not know. Overall, the perception of the TSXV is mixed. The main problem of this market seems to be the lack of liquidity of its small listed firms.

For 75% of the respondents, the lack of liquidity of the Canadian market is an important obstacle to correctly valuing small- and medium-sized firms' stocks. Most of the business angels (72%) think that value and liquidity are higher on an American stock exchange. Only two angels disagree, 8 are neutral or do not have an opinion. Fifty-one percent of the respondents think that, when possible, it is better to launch an IPO on an American stock exchange than on a Canadian exchange. The business angels' opinions are thus consistent with our fourth proposition, that the reluctance to exit through an IPO is explained by the characteristics of the Canadian stock market.

Insert table 4 here

RESPONDENTS' COMMENTS

Two open questions allowed the respondents to express their general opinion about the two main dimensions of the survey. We first transcribed each of the comments in a grid. Then, we grouped the similar comments and report the number of respondents who share the same opinion in Table 5.

The first question is related to obstacles to exiting via an IPO. The most cited obstacle is the huge cost of IPOs (10 answers), certainly linked to securities regulation (6). The second obstacle is illiquidity (9), probably because firms that access the stock market are too small to justify an active market (5). This lack of liquidity and the small size of the firms entering the stock market are linked by some angels to the low value of IPOs, which are not as attractive as strategic acquisitions. This quote by one respondent illustrates this point: 'Innovation is hindered by investors' mistrust and misunderstanding. Several of these firms access the market too early, unaware of what is needed to generate short-term expectations. [This leads to] low offer price and/or large subsequent price drop (…). Except if a firm has a stated profitability and a growth (and/or acquisition) plan, I do not see how an IPO could reach the same value as a strategic acquisition by a known firm searching to improve its strategic position.' Only one angel mentioned the low availability of VC as an obstacle to the development of potential IPO issuers. Overall, the business angels' comments about the scarcity of IPOs are consistent with some elements of the three propositions mentioned above. Strategic acquirers offer higher values (the economies of scope hypothesis), regulation incurs high costs (regulation proposition) and market conditions are not favorable. However, the respondents referred to general rather than cyclical market conditions.

The second question is: In your opinion, why do VCs, who were previously the main originators of IPOs, now prefer trade sales? Three main reasons emerge from these answers: the significant advantages of trade sales, IPO costs and market characteristics and conditions. Trade sales are considered to provide higher value in a shorter time by 7 angels. Typical comments are: 'Trade sales are easier to conclude, can be done quickly and generally provide a favorable rate of return or several opportunities, because large firms now prefer to buy small firms with developed concepts or products than to develop them internally.' Another respondent explained that: 'Venture capitalists invest in very innovative companies that can change consumption habits, create a new market or dominate a part of an existing one. A strategic investor has the resources to reach such goals and to exploit innovative potential. A public market has neither this capacity nor this objective.' Overall, the comments are perfectly in line with the economies of scope hypothesis. One angel mentioned that strategic investors are the only ones who can correctly value an innovation.

Seven respondents link the decrease in IPOs to the characteristics of the process, in terms of delays and costs. There is a perception that the costs and the complexity have increased. The structural and cyclical market situations are cited by 5 and 6 respondents respectively. Structural problems are mainly associated with the lack of liquidity on the secondary market, a problem directly linked to the very small size of new listed companies. Small listed companies are not followed by the analysts, do not raise funds, rapidly become neglected stocks, and their returns on the secondary market are low (1 answer). For one respondent, one of the reasons why firms list too early is the lack of VC to fill the financing gap until the IPO. A second structural dimension of the market mentioned by the angels is poor performance following the implementation of tax incentives for IPO stocks during the 1980s and the 1990s. The cyclical dimension is related to the low level of stock market activity during the study period, and the quest for security by several investors after the 2007 crisis.

Essentially, respondents' comments confirm the dual origin of the rejection of IPOs as an exit mode. The economies of scope and the high regulatory burden jointly explain the low propensity to consider an IPO exit. Further, the implementation of an active stock exchange devoted to emerging companies is not an acceptable solution for business angels. This market is clearly perceived as inefficient and illiquid. This seems to be an important signal for the proponents of a regional stock exchange as a way to ease the financing of small companies (Amini et al., 2012).

Insert table 5 here

ANALYSIS BY ANGELS' EXPERIENCE

We divide the 34 respondents who answered the question about the number of investments they have already made (independently or as a member of a business angel group) into three groups. The 22 experienced angels have made 4 investments or more, and we create a group with the virgin angels. We present the results when differences appear between experienced and less-experienced angels.

Table 6 and 7 show the results. We group the answers "both are equivalent" and "I don't know". As expected, virgin angels frequently answer that they do not know or that both choices are equivalent. We do not consider their answers in the discussion because of their small number. However, if virgin angels are grouped with less experienced angels, the conclusions of the analysis are unchanged.

Fifty-nine percent of experienced business angels prefer trade sales, versus 38% of the less-experienced angels. One out of four less-experienced business angels prefers the IPO exit, versus one out of seven experienced angels. There seems to be a link between the angels' experience and their opinion about exit.[6] About 50% of the experienced angels think that the trade sale provides better firm value, versus 13% of the less-experienced angels. 50% of these investors estimate that IPOs provide better firm value, versus 23% of the experienced angels. Nearly 64% of the experienced angels assess that trade sales give the fastest return on investment, compared with 38% of the less-experienced angels. For 68% of the experienced angels, the costs and drawbacks of IPOs largely outweigh their advantages. This proportion is only 50% for less experienced angels. About 86% of experienced angels, versus 63% of the less-experienced respondents, think that strategic considerations related to product or business development are pivotal to private investors’ exit mode. Investment experience seems to be associated with a net preference for trade sale exits, and for taking trade sales into account in the strategic development of the firms.

Insert table 6 here

Table 7 shows that 73% of the experienced angels think securities regulation is a major obstacle to IPOs. Only 38% of the less-experienced angels agree with that statement, probably because they have not experienced this regulation yet. 75% of the virgin angels do not have an opinion on this dimension. A larger proportion of experienced angels (82% versus 63%) estimate that ongoing listing requirements applicable to reporting issuers generate significant costs and delays. Almost twice as many experienced angels (59% versus 38%) find securities regulation unduly detailed and complex. Most of the experienced angels (64%) think that lock-up dispositions deter investors from participating in an IPO, versus only 25% of the less-experienced angels. Overall, experienced angels perceive the costs and requirements of securities regulation more negatively, and view them as an important obstacle to IPOs more frequently.

Experienced angels also perceive problems associated with illiquidity and value more negatively. The proportion of experienced angels who think that the illiquidity of the Canadian market is an important obstacle to correctly valuing small- and medium-sized firms’ stocks is higher (86%) than that of less-experienced angels (63%). Most of the angels think that value and liquidity are higher on an American stock exchange. The proportion of experienced angels is higher (82%) than that of less-experienced angels (50%). Our observation of differences between the angels according to their experience is consistent with our fifth proposition.

Insert table 7 here

CONCLUSIONS

We provide partial evidence of the investment strategy of a large and well-structured angel group working closely with VCs and a matching fund. A very small proportion of the investments done by the members can be considered as early stage. The group provides, with its co-investors, considerable financing to firms that have reached or are very close to reaching the revenue stage. Even if this evolution is not the main focus of the paper, our observation, combined with the fact that the studied group is not atypical in Canada, has several implications. The main one is the potential creation of a shortage of seed capital, a concern raised by several authors (Amatucci and Sohl, 2006, p.104). It is becoming important to determine if, and to what extent, angels in association act differently than individual angels, and why. Further, both the amounts invested and the development stage of the investees justify our analysis of the angels' exit strategy.

Angels acting in groups have a clear preference for trade sale exit. Our observations are consistent with Peters' (2009) proposition that an early exit is the best way for outside equity investors to generate a high rate of return. The findings have several implications. Entrepreneurs should be aware that the angels' objective, when they act in groups, is less and less of a long-term association with the new ventures. The sale of the shares after three to four years, Peters contends, can be fair for a serial entrepreneur. Such a rapid exit cannot be acceptable for entrepreneurs who are willing to cultivate their own firms over the long term and to link their careers to this venture. Accordingly, a clear discussion about the long-run objective of private investors is necessary before any commitment is made. For business angels, our results indicate that more attention should be given to the recommendations of Peters (2009). Early exits should be prepared for. This includes considering the selection of the investment proposals, the structure of the deal and the development strategy. The extent of a structural shift or a temporary phenomenon grounded in stock market activity and cash availability in large firms remains to be determined.

The respondents agree that the preference for trade sales comes from the capacity of strategic acquirers to rapidly exploit innovation and to create synergy effects. In such a context, most of the efforts made in a country to develop and finance high growth companies are likely to be ultimately captured by the large firms. The creation of new large firms that can anchor the creation of new clusters can become problematic. In a small country like Canada, most of the acquirers are likely to be foreign firms, which implies that the country loses part of the investment in its efforts to foster innovation. Early exits are not necessarily totally negative. Some of the newly acquired wealth can be reinvested, together with the accumulated experience, in multiple entrepreneurial activities, as evidenced by Mason and Harrison (2006). However, the total lack of IPOs is not good news for a small economy; complementary research in this area is warranted.

The securities regulations and the high costs of IPO also explain the reluctance of the respondents to consider the flotation as an exit mode, even if Canada has one of the most accessible stock markets in the world. Regulatory changes should probably be made to obviate the regulation burden assumed by small listed firms. However, several angels have mentioned the lack of liquidity in the secondary market as a strong negative argument against the use of a junior stock market as an exit vehicle. Any regulatory easing on such a market is likely to reduce information and decrease liquidity. We observe the following paradox. Whereas angels generally consider the lack of liquidity of the market as a deterrent element for IPOs, they also contend that the securities regulation is too heavy and detailed, and requires too much from small issuers. However, there is evidence that disclosure has a significant positive effect on liquidity (Lardon and Deloof, 2012). It is difficult to argue for a concomitant increase in liquidity and decrease in disclosure requirements. For academics, our results indicate that the classical growing path, from love money to angels, VCs and IPO, is becoming an exception.

To our knowledge, this study is the first survey dedicated to the exit strategy of business angels. We cannot rule out that we have studied a particular group, and more evidence is required before our conclusions can be generalized. Further studies should pay more attention to the impact of exit choice on investment proposal selection and to the strategy suggested, or imposed, on investee firms. Finally, our observation that the angels' perspectives on exit change with their experience deserves confirmation and explanations.

NOTES

[1] We agree with Coad (2013) that the term successful exit or even continuation would be more appropriate in the case of initial public offering or acquisition involving the sale of a start-up, because the entrepreneur is likely to stay involved in the venture following the event. We use the term exit because it is the most commonly used term in the literature devoted to private equity investing.

[2] Exit by trade sale also incurs costs assumed by the buyer but ultimately factored into the final price paid to the seller. They are associated with the due diligence process and legal fees. Such costs are also present for an IPO, together with other large specific costs like brokers' fees, costs associated with the preparation of the prospectus, underpricing, delays of 12 to 24 months, and costs associated with ongoing requirements. Some costs can be incurred if the seller has to find a buyer. However, the potential buyers are generally firms operating in the same sector and are easily detectable. Moreover, numerous recent acquisitions of emerging high tech companies in Canada have been initiated by the buyers. For these reasons, we consider that the costs of the IPO are larger than those induced by a trade sale.

[3] Based on the financial statements of the 10 largest technological companies in the world, including 8 US-based companies. Source: TNW: Big Money: The Companies with the Biggest Cash Piles in Tech, accessed on line June 6, 2013, at http://thenextweb.com/insider/2011/08/22/big-money-the-companies-with-the-biggest-cash-piles-in-tech/

[4] We do not delve into the various forms of angel associations and the differences between groups, network and other forms of alliances.

[5] In another study, we observe that a substantial majority of the acquirers of venture capital-backed companies in Canada are medium-sized firms. Similar information is not available for angel-backed firms, and we cannot determine if the same situation prevails. However, discussions with the group's members and team allow us to conclude that acquisition by a large multinational firm is the exception and not the rule.

[6] The small number of observations by class does not allow statistical tests.

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TABLE 1 After making a private investment in high growth firms,

	Trade sale	IPO	Both are equivalent	Don't know	Total
which exit mode is better?	18 51%	6 17%	6 17%	5 14%	35 100%
which exit mode provides better firm value?	14 40%	11 31%	3 9%	7 20%	35 100%
which exit mode gives the fastest return on investment?	20 57%	10 29%	3 9%	2 6%	35 100%

TABLE 2 Do you agree with the following statements?

	Strongly disagree	Somewhat disagree	Neither agree nor disagree	Somewhat agree	Strongly agree	Don't know	Total
It is hard for a small innovative firm to develop a new market on its own	2 6%	4 11%	6 17%	18 51%	5 14%		35 100%
The initial public offering has now become a scarcely used exit mode because it is hard for a small innovative firm to develop a new market on its own	6 17%	1 3%	6 17%	13 37%	4 11%	5 14%	35 100%
There is little demand among investors for IPOs of innovative firms	1 3%	3 9%	2 6%	16 46%	7 20%	6 17%	35 100%
The lack of intermediaries (underwriters) interested in small public offerings is a major obstacle to initial public offerings	1 3%	2 6%	3 9%	16 46%	10 29%	3 9%	35 100%
The costs and drawbacks of initial public offerings largely outweigh their advantages	1 3%	3 9%	4 11%	10 29%	12 34%	5 14%	35 100%
Strategic considerations related to product or business development are pivotal to private investors' exit mode		1 3%	5 14%	10 29%	16 46%	3 9%	35 100%
Considering the pace of innovation, only large international firms can derive the full advantages from a given innovation	2 6%	14 40%	6 17%	9 26%	3 9%	1 3%	35 100%
The development strategy of the firm I have invested in rests on acquisition by another firm in the same field.		3 9%	11 31%	14 40%	7 20%		35 100%

TABLE 3 Do you agree with the following statements related to the regulatory dimension?

	Strongly disagree	Somewhat disagree	Neither agree nor disagree	Somewhat agree	Strongly agree	Don't know	Total
Securities regulation is a major obstacle to initial public offerings.	1 3%	3 9%	4 11%	13 37%	8 23%	6 17%	35 100%
Writing a prospectus and the processes associated with initial public offerings incur huge costs for small-sized issuers	1 3%	2 6%		12 34%	17 49%	3 9%	35 100%
Ongoing listing requirements applicable to reporting issuers (listed companies) generate significant costs and delays.		2 6%	3 9%	12 34%	14 40%	4 11%	35 100%
Securities regulation is unduly detailed and complex.		5 14%	4 11%	9 26%	9 26%	8 23%	35 100%
Lock-up dispositions deter me from participating in an initial public offering.		7 20%	4 11%	12 34%	5 14%	7 20%	35 100%
The costs resulting from securities regulation have increased during the last decade.		2 6%	2 6%	8 23%	13 37%	10 29%	35 100%
Securities regulation related to insider trading is applied poorly in Canada.		4 11%	5 14%	12 34%	1 3%	13 37%	35 100%

TABLE 4 Do you agree with the following statements related to the Canadian market?

	Strongly disagree	Somewhat disagree	Neither agree nor disagree	Somewhat agree	Strongly agree	Don't know	Total
I have a positive view of the TSX Venture exchange	3 9%	4 11%	10 29%	16 46%	1 3%	1 3%	35 100%
In general, the Canadian small- and medium-cap market is efficient.	4 11%	9 26%	6 17%	8 23%		8 23%	35 100%
The liquidity of the Canadian market is an important obstacle to correctly valuing small- and medium-sized firms' stocks.			2 6%	16 46%	10 29%	7 20%	35 100%
When possible, it is better to launch an initial public offering on an American stock exchange rather than on the Canadian exchanges.	1 3%	5 14%	3 9%	13 37%	5 14%	8 23%	35 100%
Value and liquidity are higher on an American stock exchange than on the Canadian stock exchanges	1 3%	1 3%	2 6%	17 49%	8 23%	6 17%	35 100%

TABLE 5 Analysis of the angels' comments to the open questions

Explanatory factor	Number of citations
What are the main obstacles to exiting via an initial public offering in Canada?	
Huge cost of IPOs	10
Illiquidity	9
Securities regulation	6
Firms accessing the market are too small to justify an active market	5
No demand for the stock	4
Too long process	4
Lock-up dispositions	3
Valuation	3
Other factors	3
Total number of explanatory factors given by 26 respondents	47
In your opinion, why do venture capital investors, who were previously the main originators of initial public offerings, now prefer trade sales?	
Trade sales are quicker	7
Huge cost of the IPOs	7
Cyclical market conditions	6
Illiquidity	5
Complexity of the IPO process	4
Too small firms	4
Other factors	6
Total number of explanatory factors given by 27 respondents	39

TABLE 6 Distribution of the answers by angel-investment experience

Angels who made	0 investments		1 to 3 investments		4 investments or more	
	Number	Proportion	Number	Proportion	Number	Proportion
After making a private investment in high growth firms, which exit mode is better?						
Trade sale	1	25	3	38	13	59
Initial public offering	1	25	2	25	3	14
Both are equivalent or I don't know	2	50	3	38	6	27
Total	4	100	8	100	22	100
After making a private investment in high growth firms, which exit mode provides better firm value?						
Trade sale	2	50	1	13	11	50
Initial public offering	1	25	4	50	5	23
Both are equivalent or I don't know	1	25	3	38	6	27
Total	4	100	8	100	22	100
After making a private investment in high growth firms, which exit mode gives the fastest return on investment?						
Trade sale	2	50	3	38	14	64
Initial public offering	0	0	4	50	6	27
Both are equivalent or I don't know	2	50	1	13	2	9
Total	4	100	8	100	22	100
The costs and drawbacks of initial public offerings largely outweigh their advantages						
Disagree	0	0	0	0	4	18
Agree	2	50	4	50	15	68
Neutral or I don't know	2	50	4	50	3	14
Total	4	100	8	100	22	100
Strategic considerations related to product or business development are pivotal to private investors' exit mode						
Disagree	1	25	0	0	0	0
Agree	2	50	5	63	19	86
Neutral or I don't know	1	25	3	38	3	14
Total	4	100	8	100	22	100

TABLE 7 Distribution of the answers by angel-investment experience

Angels who made	0 investments		1 to 3 investments		4 investments or more	
	Number	Proportion	Number	Proportion	Number	Proportion
Securities regulation is a major obstacle to initial public offerings						
Disagree	0	0	0	0	4	18
Agree	1	25	3	38	16	73
Neutral or I don't know	3	75	5	63	2	9
Total	4	100	8	100	22	100
Ongoing listing requirements applicable to reporting issuers (listed companies) generate significant costs and delays						
Disagree	0	0	0	0	2	9
Agree	2	50	5	63	18	82
Neutral or I don't know	2	50	3	38	2	9
Total	4	100	8	100	22	100
Securities regulation is unduly detailed and complex						
Disagree	0	0	1	13	4	18
Agree	1	25	3	38	13	59
Neutral or I don't know	3	75	4	50	5	23
Total	4	100	8	100	22	100
Lock-up dispositions deter me from participating in an initial public offering						
Disagree	1	25	1	13	5	23
Agree	1	25	2	25	14	64
Neutral or I don't know	2	50	5	63	3	14
Total	4	100	8	100	22	100
The liquidity of the Canadian market is an important obstacle to correctly valuing small- and medium-sized firms' stocks						
Disagree	0	0	0	0	0	0
Agree	2	50	5	63	19	86
Neutral or I don't know	2	50	3	38	3	14
Total	4	100	8	100	22	100
Value and liquidity are higher on an American stock exchange than on the Canadian stock exchanges						
Disagree	0	0	1	13	1	5
Agree	2	50	4	50	18	82
Neutral or I don't know	2	50	3	38	3	14
Total	4	100	8	100	22	100