THE IMPORTANCE OF KNOWLEDGE AND SKILLS TRANSFER IN THE PRIVATE EQUITY, VENTURE CAPITAL AND ANGEL INVESTING PROCESS

S.W. Cadle*, J.H. van Rooyen*

Abstract

New business development is one of the most important contributors to economic growth, job creation and economic prosperity of any country. The successful creation of new ventures is a difficult process with many risks involved. The reward of a successful venture is such that many investors are prepared to accept a certain level of risk in the hope of achieving high returns on their capital invested. Many different aspects contributing to the success of a new venture and specifically the importance of the transfer of knowledge and skills in the investment process, was researched. Venture capital investment in the broader sense, including angel investing, venture capital and private equity investment, are important contributors to economic growth and prosperity. Venture capital and Angel investing are seen to be risky ways to invest. However, the risk may be reduced through the active involvement investment process thereby transferring knowledge. The investor is not only a provider of funds but also the provider of knowledge and skills to assist the venture to become successful.

The literature review included the results from research recently conducted in the United States of America and Europe. This research highlighted factors, other than merely having a good business idea, that influence the success of a new venture. The global research clearly indicates that the active involvement of the angel investors, venture capitalists and private equity investors in new ventures, through the transfer of knowledge and skills, determines the success of the investment in new business development.

The survey that was done in the SA venture capital environment support this outcome although the SA venture capital market sector is in the early stages of development and focuses on private equity investment and not so much new business development. The SA venture capital market discounts their risk through tangible securities taken in the investment process. Investments made are large amounts in well-established ventures with complete management teams where the investor's involvement is restricted to control and ensuring that the venture complies too the expectation of the providers of the funds. The SA market concentrates much more on control and monitoring as their counterpart in the USA.

The main objective of the study, to determine the impact of the transfer of knowledge and skills by the investor to the investee, is supported by the research done in the USA. The effect of the transfer of knowledge and skills is further supported by the effect on the long term return. The transfer of knowledge and skills and active participation increases the expected IRR. The findings are also supported by the literature research done indicating important elements needed to enhance the venture's chances of success.

Keywords: Venture, Angel Investor, Venture Capital, Entrepreneur

** Stellenbosch University, South Africa*

Background and Statement of the Problem

The creation of new ventures and businesses is determined for economical growth of any economy in the world. The entrepreneurial initiative to create new ventures and develop new markets enhances economic growth. Venture capital and angel investing are two of the most important facilitators of new business and job opportunities in the United States of America (USA) and the United Kingdom (UK). David Birch established in the late 1970s that 70% of the job creation in the USA economy occurred in small business firms with fewer than 100 employees. Small business has a major impact on the American economy where more than half of the major innovations occur in small firms (Bartlett, 1988: 11). The USA has an active venture capital market, where billions of dollars are invested on an annual basis, and according to Schetler, (2006: 49), business angels alone invest over $60 billion annually. Investors became cautious about the venture capital market after the collapse of the information technology bubble in the 1990s, but the subsequent withdrawal of

funds were temporary and increasingly more funds are made available in the USA for investment purposes.

Angel investors that prefer to be involved in the earlier stages of the development of a venture is not formalised in South Africa and exist only on an informal basis. The absence, or near absence, of angel investors restrict new business development, and therefore economic growth.

The SA venture capital market as defined by Barlett (1988: 2) and Benjamin and Margus (2001: 7) are still an incomplete investment market that concentrates mainly on later stage investments through fund managers. These investors are mainly fund managers with limited previous entrepreneurial or private sector experience. This restricts the transfer knowledge and skills from the investor to the venture invested in. The investor's main interest is the return on investment.

South Africa is an emerging country where the development of new businesses is needed to help create jobs. Establishing new successful businesses in all sectors of the economy will help grow the economy and will make the country more competitive globally. This will also satisfy at least the financial aspirations of the population and should contribute to greater political stability over the long term. Although research was recently done in the USA and the UK on the factors that affect the success of ventures, research is also needed in the SA context to determine the factors that may ensure the success of ventures.

Objectives of the study

The main objective of the study was to determine the impact of the transfer of knowledge and skills by the investor to the investee on the success of the private equity, venture capital and angel investments in SA companies registered with the SA Venture Capital and Private Equity Association (SAVCA).

A research questionnaire was sent out to all companies registered with SAVCA. The research questionnaire distinguished between the investor and investee. An attempt was also made to determine, according to the respondents, the factors that may contribute to the success of a venture and also how important the transfer of skills and knowledge is for the success of a venture.

A clear distinction between the research results in the different categories is made to focus and add the most value to the SA private equity, venture capital and angel investor's market.

The scope of the study was limited to South Africa due to the availability of funding. With more funding the study could have been extended to other countries where venture capital is practised. The transfer of skills and knowledge in each country and the specific application thereof in these countries could shed further light on this topic. It should also be mentioned that the venture capital organisations in most countries do extensive research each year in many different fields of the venture capital investment market. They therefore do not survey fields that have already been thoroughly surveyed. This means that a direct comparison between countries and their success rate in venture capital is not always meaningful.

Literature review

The venture capital era began in earnest in America in 1946, after World War II, when General Georges Doriot, Ralph Flanders, Carl Compton and others organised American Research and Development (ARD), the first public corporation specialising in investing in illiquid securities of new business. General Doriot defined venture capital by categorising it in the following six points (Bartlett, 1988: 2):

- Involvement in new technology, new marketing concepts, and new product application possibilities.
- Significant, although not necessarily controlling, participation by the investor in the company's management.
- Investment in ventures staffed by people of outstanding competence and integrity.
- Product processes that have passed at least through the early prototype stage and are adequately protected by patents, copyrights and trade secret agreements.
- Situations which show promise to mature within a few years to the point of an initial public offering (IPO) or a sale of the entire company.
- Opportunities in which the venture capitalist could make a contribution beyond the capital dollars invested.

The above definition is summarised by Benjamin and Margulis (2001:7) where they define venture capital as "the business of building businesses". The definition means a commitment to contribute more than money to the company. Venture investment involves building and financing successful self-sustaining companies which include the transfer of their knowledge and skills to the investments made in order to increase the success rate of venture investment and reduce the risk thereof.

The commitment to contribute more than funds became difficult, since investors/fund managers are more interested in a return on their investment than in the management and development of the company. Venture capitalists started to select only investments where the entrepreneur already had the management team in place, as well as all the entrepreneurial and marketing skills. Venture capitalists moved away from small and early-stage investments to investments in companies in a later stage of development where the investment is much larger. The early-stage venture was left in the cold and many good investment opportunities were left in abeyance. This movement in the marketplace created the opportunity for individual venture capitalists, seasoned entrepreneurs,

to become involved in the market once again. These investors called themselves “angels” and they are very active in the investment market in America, where over 200 000 are registered, with many others not registered. Angel investors will be encountered, formalised or not formalised, in almost every country where venture capitalists are active. The original venture capitalists with previous experience in venture development, management and investment returned in the form of angel investors. (Van Osnabrugge and Robinson, 2000: 17, Hill and Power, 2002: 222 and Sorhiem, 2005: 178) There is considerable need for venture capital and related investments, since in the United States some 70% of all new job opportunities are created through venture capital or angel investment (Bartlett, 1988: 11).

Over the years, and with the steady development of venture capital, venture capitalists and the corporate institutions developed criteria that a venture needed to fulfil before an investment would be made. One of these criteria is the company’s management skills, which is undoubtedly one of the most important aspects of any business. Benjamin and Margulis (2001: 59) defined and discussed the risk aspects of a potential investment. According to them managing risk is number one, and suggest that any investor should attend to the following questions before investing:

- Can management and personnel carry out the plan they so passionately present?
- Do they have the ability, experience, background, and track record to accomplish the forecast, sales and manage internal operations?
- Are they able to form a team within the ranks?
- Has any note of discord been struck among the members of the management team?

The need for a hands-on approach by investors is critical indeed. Carmelo Pistorio is a very successful Angel investor in Singapore with a hands-on approach. In the, Red Herring magazine of 20 April 2004, Anonymous D (2004: 1) it is stated that; “Mr Pistorio is something of a rare breed here; an angel investor with hands-on entrepreneurial experience to guide his seed companies. Money is not necessarily the hardest thing for a Singapore based start-up to come by, but experienced entrepreneurs to guide one along the bumpy road from concept to becoming a successful company is rare. This approach made Pistorio a very successful investor, with a success rate much higher than that of the average venture capital fund. Pistorio reduces the risks of venture capital and angel investing to an acceptable level and shows the importance of the direct involvement of the investor, the transfer of knowledge and skills, in investments made.

Professor William A Sahlman of the Harvard Business School stresses the importance of the involvement of the investor by stating that the monitoring oversight and advice (mentoring) that investors provide to their investee companies is an important element of financing of start-up companies (Benjamin and Margulis, 2001: 240). The investment of capital, skills and knowledge, in an entrepreneurial venture by venture capitalists, angel investors/private investors and other investors’ importance in the development and success of the venture is supported by De Noble, Ehrlich and Moore (1994: 69).

The level of involvement by an investor has been identified by Macmillan and Kulow, (1989: 27), Rosenstein and Bruno, (1993: 101), De Noble, (1994: 70) as well as Benjamin and Margulis, (2001: 10), as:

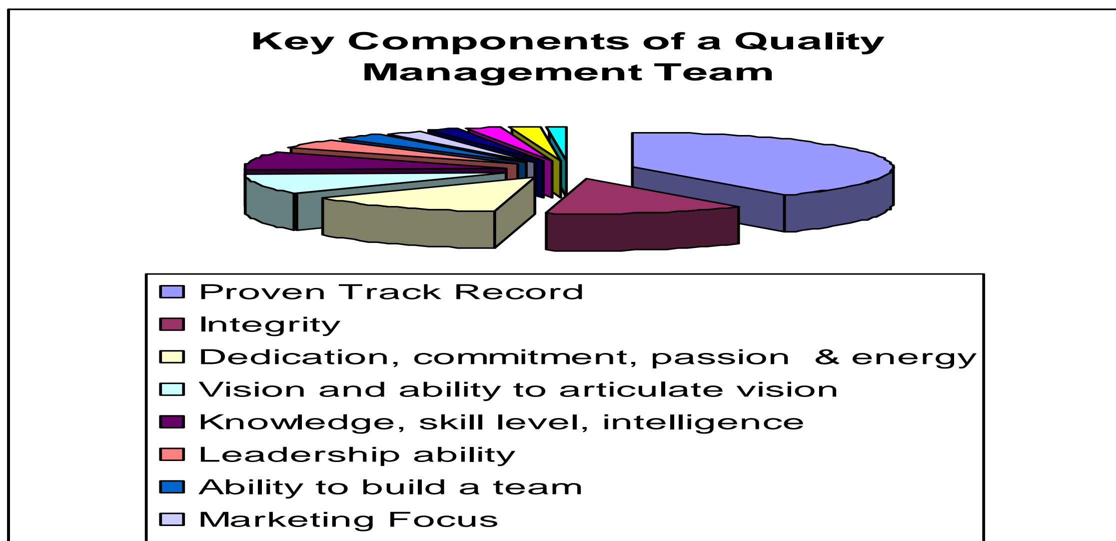
- Laissez faire – limited involvement
- Moderate – moderate involvement
- Close tracker – active involvement. The venture capitalist has a very strong presence in all the activities of the venture.

The investor will determine his level of involvement after evaluating the possible investment including his ability to support the needs of the venture and its management team as well as his own ability and willingness to contribute. Investor’s decision to invest will also be determined by the jockey of the venture. Investors will back the right entrepreneur which needs to be part of the management team to ensure that the venture has a high probability of succeeding. The passion and drive to succeed is always found in the jockey (entrepreneur) of a venture. It is stated that it is better to have a good jockey and management team than an excellent idea/venture without an excellent jockey. Investors put money behind people, not just behind concepts or ventures (Bartlett, 1999:45 – 46, Bartlett, 1988:2.8, Benjamin and Margulis, 2001:59, Hill and Power, 2002:222 and Wilmerding A, 2003:134).

The venture capitalist has a very important role to ensure that the management structure is balanced and correct. The new venture needs to be in a position to succeed. The entrepreneur must realise his shortcomings and has to be open enough to allow external inputs into the venture. The quality of the management team of any venture is the most important aspect determining its success or failure. (Franke et.al, 2005: 2) However, it would be unrealistic to expect all ventures to have a perfect and balanced management team in the early stages of investment. The cost of having a full management team in an early stage company may be detrimental to the venture's existence. In this regard angel investors fill the experience gap with great distinction. (Benjamin and Margus, 2001)

The entrepreneur/founder should also realise that he/she would need to have all the management qualities available during the earlier stages of development. External directors/advisors to advise him and his team should be appointed. The required management characteristics and there is elucidated in figure 1 below.

Figure 1. Required Management Characteristics and their Importance



Source: Own compilation from Hill and Power, (2001:231) and Hill and Power, (2002:118) as well as Gladstone and Gladstone (2004:6)

An investor tends to invest in ventures where the management team is well established and where the investor may be able to take control of the board of directors because of their financial backing in order to reduce the investor's perceived risk. Many risks surface when following this approach. The investor may through his/her actions eliminate the entrepreneur's drive and passion, which may be detrimental to the company. It is in the investor and investee's interest to ensure that all actions are taken to the benefit of all. The knowledge and skills of the investor is critical in any new venture and simply has to be utilised. The entrepreneur needs to be open enough to learn from the investor and the investor should make his knowledge and skills available to the entrepreneur and his team. Commitment is expected as much from the investor as it is from the entrepreneur and the management team. (Dana, Korot and Tovstiga, 2005: 11 - 12)

The entrepreneur and the venture capitalist have different needs and rate the importance of involvement and types of involvement differently. A study conducted by Macmillan and Kulow, (1989: 27 to 41) and followed up with further research by De Noble, Ehrlich and Moore, (1994: 67 to 81) highlighted the activities with the most and the least venture capital involvement. See Table 1 below.

The expectations of entrepreneurs and of angel investors related to their respective kinds of involvement differ substantially, although there are some similarities too. The six highest ranked involvement areas for angel investors and venture capitalists are similar, although not ranked in the same order. The entrepreneur, in short, expects investors to (Maier and Walker, 1987: 209, De Noble, Ehrlich and Moore, 1994: 80):

- Give advice on locating and attracting key management personnel to their firm.
- Provide financial and staffing expertise. The entrepreneur per se expects the investor to transfer his/her knowledge and skills to the venture.

The success of the venture depends on the inputs received from both the investor and the entrepreneur. The investor and the board of directors, as well as the management team, should be chosen and appointed with considerable care. It is a give-and-take situation where none of the parties involved should try to dominate the other. The difference in personalities and strengths creates the ideal platform for conflict, but is also the one aspect that may lay the basis for a strong combination. Many venture capitalists have realised that they cannot only be money managers and that they need additional expertise, knowledge and skills that would enhance the venture's chances of success. Many other initiatives have been implemented over the years, such as the concept of mastermind groups, where entrepreneurial ideas and business experiences can be shared, and the way corporates are becoming involved in this market (Carmichael, 2006: 1). The relationship between the investor, shareholders, directors, non-executive directors, the CEO, entrepreneur and the management team is interrelated and is a prerequisite for a successful venture. (Camp, 2002: 58 - 61). The management team and all other parties involved should have the ability to work cohesively in order to demonstrate their real strength.

Table 1. Rank Comparison of Venture Capitalist and Angel Investor Involvement in Investment Activities

	Venture capital funded entrepreneurs	Angel investment funded entrepreneurs
Activities of greatest involvement		
Interface with investor group	1	1
Obtain alternative equity finance	2	6
Monitor financial performance	3	2
Sounding board	4	3
Monitor operating performance	5	5
Formulate business strategy	6	4
Activities of least involvement		
Develop production or service techniques	20	19
Select vendors and equipment	19	19
Develop actual product or service	18	17
Testing or evaluating marketing plans	17	17
Replace management personnel	16	15
Develop professional support groups	15	17

Source: De Noble and Ehrlich and Moore, 1994: 75.

Sohl and Rosenberg (2003) researched the trends in the USA angel and venture capital markets after and before the 2000 investment bubble-burst. Their research started in the 10 years prior to the burst and followed on thereafter. The most important lessons learned, as researched by Sohl and Rosenberg, 2003:16 - 18, regarding the 2000 market collapse are as follows;

- The new VC funds started and the need for new fund managers exacerbated the already acutely thin layer of experience in an uncertain environment.
- The new participants had no experience of downturns and did not realise that this could happen.
- Many of the new entrants had garnered their wealth from public equity deal making, rather than cutting their teeth in the private equity markets or the more traditional angel route of cashed-out entrepreneurs. Public sector experience does not fare well in the vagaries of the private equity market for the following reasons:
  - Illiquidity, or a funding gap; the venture always needs more money than anticipated.
  - Lack of financial data. A financial history, street wise knowledge, on which to base forecasts and the absence of audited financial data was a problem.

Venture capital investors prefer larger and later stage investments, whilst the angel investors supply the funding for the smaller and early stage investments. The angel investors are normally wealthy individuals who used to be involved in entrepreneurial companies and now want to invest not only their own money, but also their knowledge and skills in newly formed companies. Venture capital investors are normally wary of becoming involved with newly formed companies and prefer later stage companies because they are typically fund managers with little or no experience as entrepreneurs. The role of angel investors is only officially recognised in the USA. The lack of recognition of angel investors in the United Kingdom and South Africa creates an investment gap in the market leading to an increasingly high risk of new venture investment.

The transfer of skills and knowledge is important to the investees and they rate marketing, management recruitment, help with contracts, financial advice and strategic direction as the most important contributing factors. Angel investors normally dispose of a sizeable amount of practical knowledge, whilst the typical venture capitalist is in almost all the events a fund manager with virtually no experience and knowledge of practically managing and developing a business. The venture success rate can vary between 90%, where knowledgeable angel investors and venture capitalists are involved, to as low as 20% in the absence of the above knowledge and skills and the presence of vulture capitalists. Vulture capitalists are those investors that are only interested in maximising their return and acquiring control of the venture, through their financial muscle. They get involved in and will always aim to outwit the entrepreneur.

Many factors may contribute to the success rate of an investment of which the most telling factors are a proper due diligence, sufficient funding and invesment in an industry known to the investor.

Knowledge and skills pertaining to a specific industry may help the investor to give the investee a competitive edge over other role players in the same industry and to ensure that the new venture would have sufficient funds available for funding. The lessons learned during the 2000/2001 market burst, given the contributing factors to the burst, provide a clear indication that angel investors are a critical part in the investment process where knowledge and skills are transferred to the new venture. The involvement of the investor with the investee, proper due diligences, industry related investment knowledge and sufficient funding are important requirements that became apparent. The lessons learned were implemented. Most venture investments in the USA are now subject to the following according to Sohl and Rosenberg, 2003:18;

1) Realistic projections and deal prices are thoroughly analysed.
2) Angel investors' core values are now implemented.
3) Angel investors began to assert their role as value added patient investors in entrepreneurial ventures.
4) Angel investors continue to invest close to home in order to be close enough to render an input.
5) Both entrepreneurs and investors are striving to build companies with real value and sustainable growth.
6) Investors concentrate on an excellent management team and not such excellent ideas, rather than the reverse.
7) Investments are used to develop high risk technologies with a reasonable chance of success.
8) Cash flow is now the key to success.
9) The role of government in the private equity market is now as important as ever.

The Survey Results

The questionnaires were sent electronically to 54 registered members of SAVCA (South African Venture Capital and Private Equity Association) of which three indicated that they are neither private equity nor venture capital companies. One company was under liquidation and was excluded from the survey. Out of the 50 potential respondents, 31 (62%), completed and submitted the questionnaire successfully. This represents more than 60% of the value of the investments made in South Africa. One of the respondents, Business Partners, contributed 69% of the total number of investments made in 2007 (Watkins and Fourie, 2008: 27). The SA private equity and venture capital investors concentrate mainly on later stage investments whilst the seed and start-up companies are only addressed by a few investors.

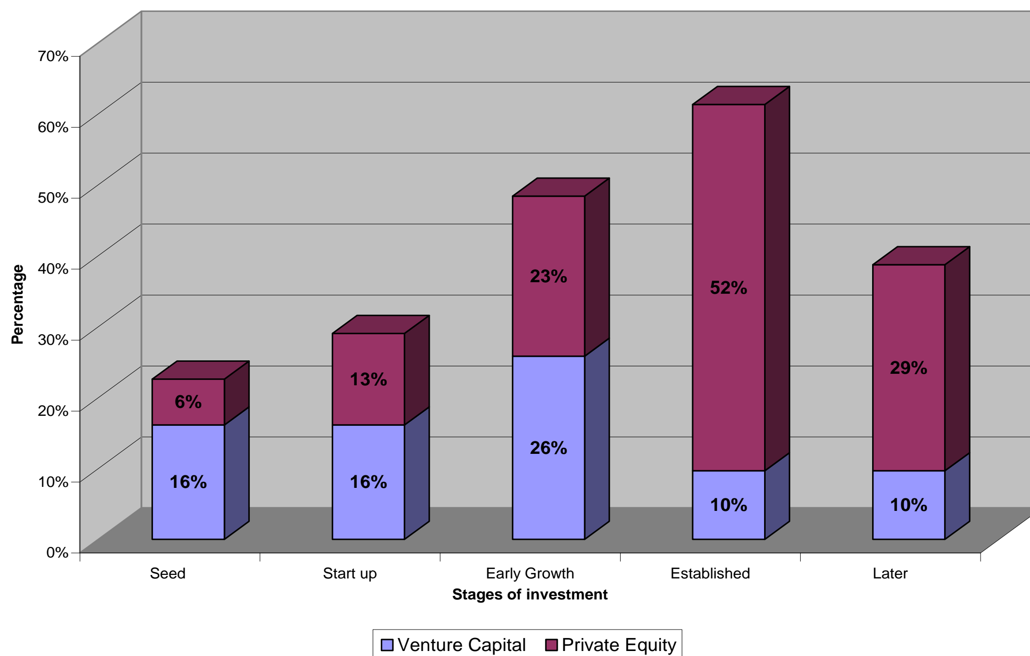
Investments made in South Africa are large amounts in well-established ventures with complete management teams where the investor’s involvement is restricted to control and ensuring that the venture complies with the expectation of the providers of the funds. Most of the investors prefer to take control of the venture through shareholding and directorships with the main intention to maximise their return. The SA market concentrates much more on control and monitoring compared to their counterparts in the USA. The USA market is a matured market where the investors will not be as involved in the day to day management of the venture as is the case in South Africa. The USA investors concentrate much more on the strategic management and assistance of a venture than the direct control thereof.

Venture capital investment is defined by Benjamin and Margus (2001: 7) as the business of building business, an aspect that is neglected in South Africa. The investors are mainly later stage investors that are not too interested in the seed, start-up and early stage development of ventures. The creation of new ventures and the financing of such ventures is neglected and in most cases ignored. Economic growth and job creation are neglected in the process.

The respondents to the questionnaire are divided into venture capital and private equity investors, where 29% of the respondents were venture capitalists and 71% private equity investors. Angel investors is not a formalised investment group is South Africa and could not be surveyed. The distinction between the two categories are made mainly because it is expected that the venture capitalist will concentrate on earlier and later stage ventures whilst the private equity investors will concentrate on later stage ventures. The areas that the private equity investors normally concentrate on are management buy-outs, mergers and acquisitions and leveraged buy-outs. Value that can be added by the investor through the transfer of knowledge and skills to the venture and its management team depends on the investors own knowledge and skills gathered due to involvement in previous ventures (tacit knowledge). Many venture capitalists and private equity investors have previous entrepreneurial experience. About 48% of the investors have no previous entrepreneurial experience. The possible transfer of knowledge and skills becomes restricted in these cases and depend on explicit and not tacit knowledge. Entrepreneurial experience is gathered through practical experience where valuable tacit knowledge and skills are added to the skills pool of the investor.

The investor’s involvement in the different investment stages namely seed, start-up, early growth, established and later stage are determined by the type of investor, that is, an angel, venture capitalist or private equity investor. The investor’s choice of investment stage is determined by the perceived risk, complimented with the knowledge and skills of the investor, that the investor is prepared to absorb. The respondent’s distribution can be seen in figure 2.

Figure 2. Distribution of Funds over Different Investment Stages



The respondents who consist mainly of private equity investors and which make up 71% of the population prefer to invest in later stage ventures.

Venture capitalists prefer to invest in the early growth and the later stages of a venture's development whilst private equity investors prefer established and later stage involvement. Angel investors tend to concentrate on the seed and early stages, the venture capitalist on the start-up to early growth stages and the private equity investors on the established to later stages of a ventures development. Each one of these investor groups has a specific role to play in the development of the venture and contributes to the success of the venture. The angel investors group is not formalised in South Africa whilst they are well established in the USA. The absence of the angel investors as a formalised investment group gives rise to the slower, development of new ventures in South Africa. The development of new ventures depend totally on own funding and funding from family and friends that believe in the entrepreneur and his new venture.

Investors are involved in the portfolio companies with different aspects in the company depending on their expertise and the role they are willing to play. In figure 3 it is clear that not all the investors are actively involved as a shareholder, only as investors. The investors are mostly fund managers and operate similar to commercial banks where their involvement is purely as the provider of finance and not the development of their portfolio companies. Investors also prefer to be involved as non-executive directors as opposed to directors which allow the investor to have an active knowledge of the venture without being involved in the day to day activities of the venture. The differences between the venture capitalist and the private equity investor involvement are mainly at shareholder level, non-executive director and involvement as CEO of the company. The venture capitalists tend to be more involved as CEO of the venture as opposed to private equity investors, while the private equity investors tend to be more involved as investor/shareholder and non executive directors.

The appointment of a non-executive director is always considered to a certain extent when an investor invests in a venture. Investors reduce their risk through their involvement in the selection of the board of directors, CEO and the management team as can be seen in figure 4. Ensuring that the management team, the jockey (entrepreneur), has the skills, knowledge, track record and the experience to run a venture effectively and consequently reduce the investor's risk. Neither the venture capitalist nor the private equity investor will invest in a company with an incomplete management team. A later stage venture with an incomplete management team entails a high risk, especially in cases where investors lack experience in those fields.

Figure 3. Venture Capital versus Private Equity Investor Involvement

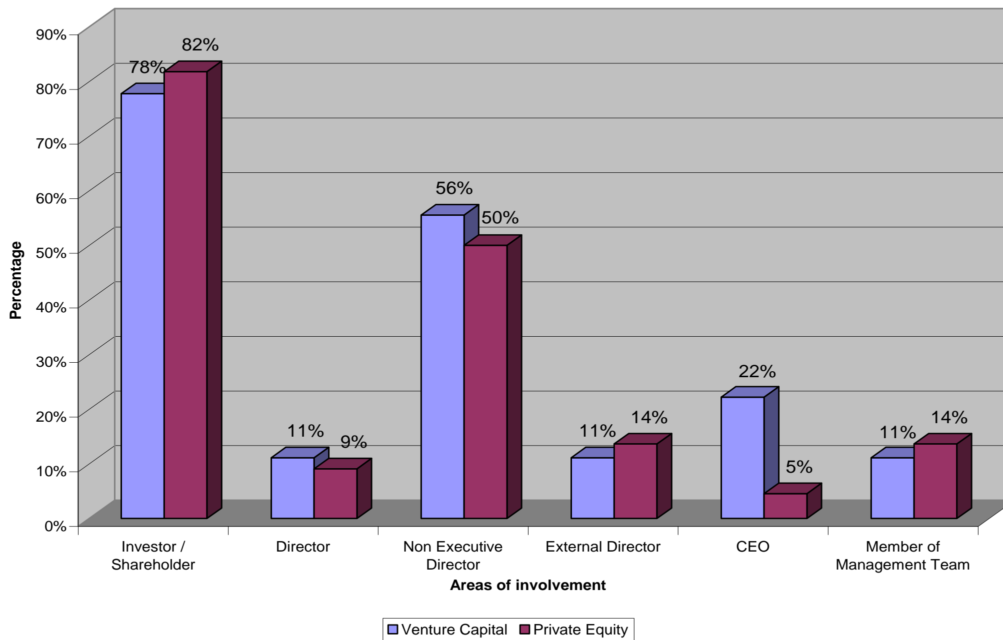
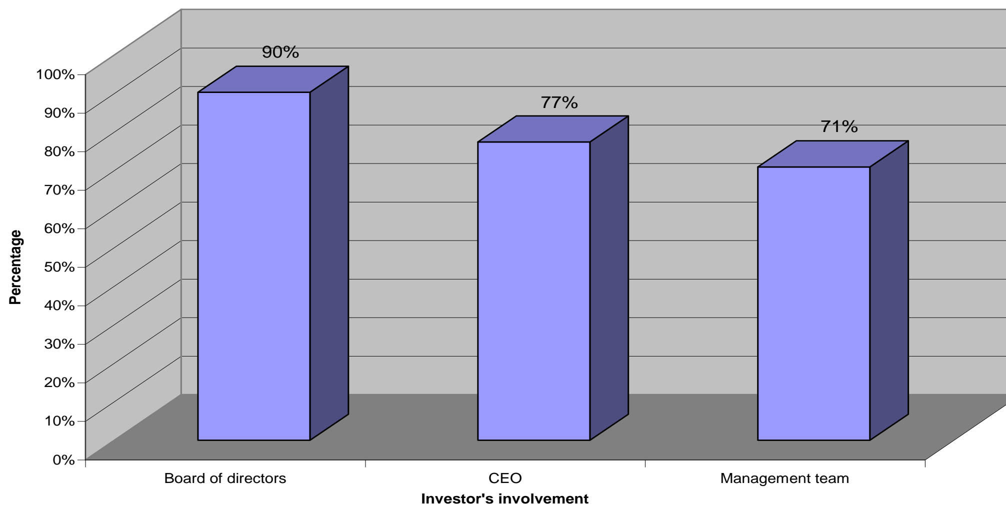


Figure 4. Investor's Involvement in Selections and Appointments of the Board of Directors, CEO and the Management team



The investor's involvement differs from the one investment stage to the next as can be seen in figures 5 to 8. Investors are quite actively involved in the day to day and monthly activities of a venture in the seed and start up phases. The investor's involvement regarding the operational and management level tend to shift from actively involved on a daily and monthly basis to quarterly, six monthly and annual involvements mainly on directors' level and shareholder meetings as can be seen in figure 5 to 8. The investor's risk is much higher in early phases of venture development that explain the investor's involvement in the day to day management of the ventures. As the venture further develops the investor's involvement becomes less frequent.

Figure 5. Investor's Involvement in the Seed Phase

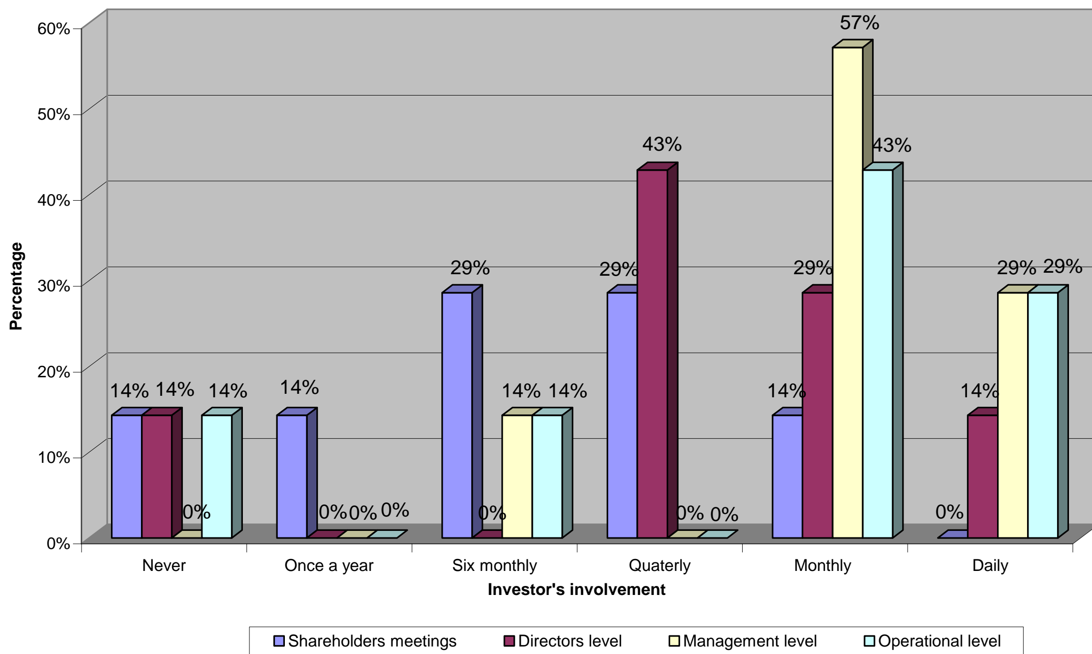


Figure 6. Investor's Involvement in the Start-Up Phase

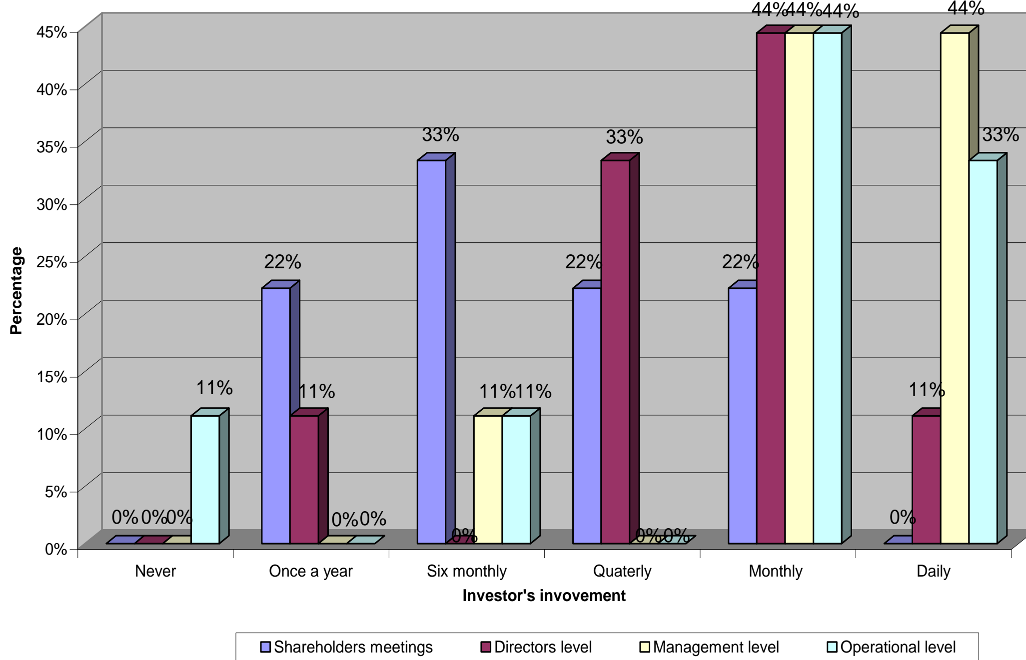


Figure 7. Investor's Involvement in the Early Growth Phase

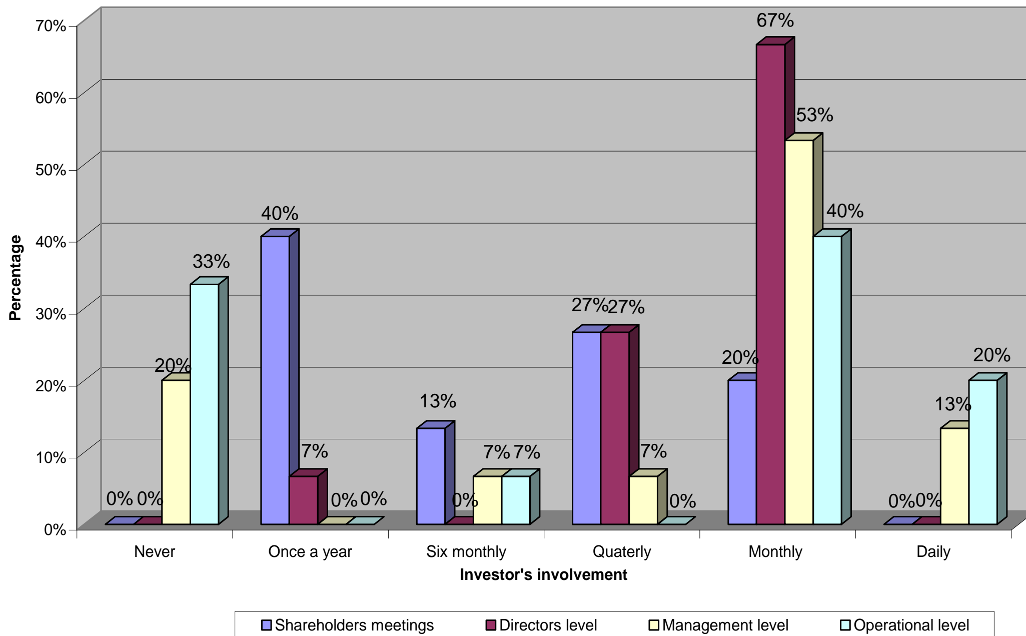
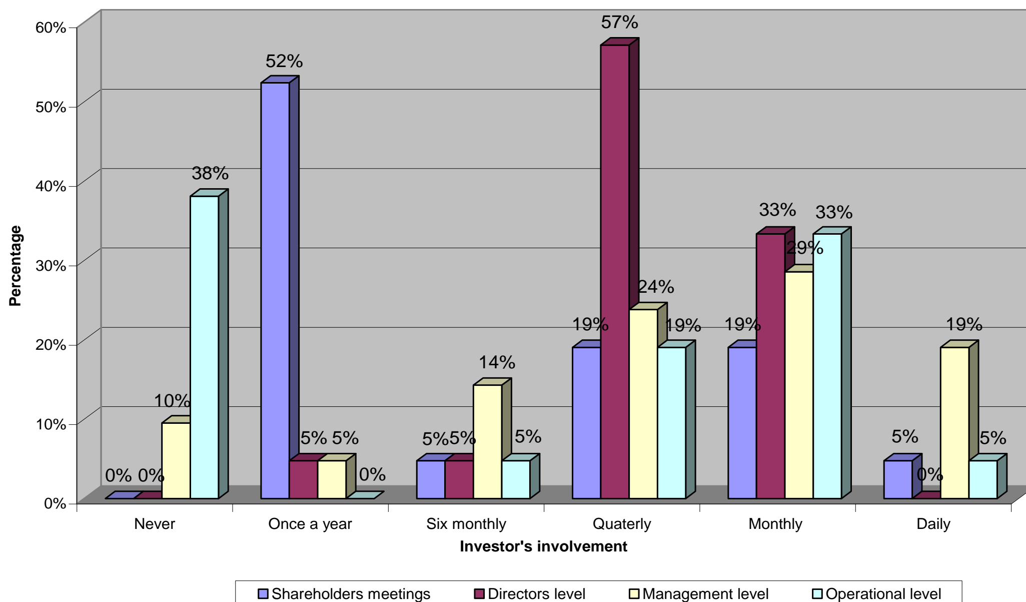


Figure 8. Investor's Involvement in the Later Stage Phase



The role of the board of directors is seen by 68% of the respondents as a service role, where advice and expertise are provided to the management team. The investor becomes part of the venture and becomes the mentor of the venture's management team. In 29% of the instances, investors take control of the venture's management team on behalf of the investors, especially in larger ventures where an established management team exists and the control is needed to serve the best interest of the investors. Only 3% of the investors tend to be passively involved and allow the venture's management team to proceed as it did before the investment was made. The involvement of these investors is merely to fulfil the legal requirements with no input at board level and at the management level.

Investors prefer to invest in a venture with a complete management team although some investors

will invest in a venture with an excellent idea and an incomplete management team as can be seen in figure 9. Fund managers will always prefer to invest in a venture with a complete management team while the venture capitalist and the angel investor are prepared to get involved in an incomplete management team (Hill and Power, 2001: 224, Camp, 2002: 33 as well as Gladstone and Gladstone, 2004: 64). The findings agree with the findings of the research in the USA and Europe, that the risk of an incomplete management team poses just too much risk for the later stage investor to accept. The angel investor's role is crucial in the venture development, (including management development), of a venture to the level where it will be acceptable for the venture capital, private equity and later stage investors.

Figure 9. Investment in an Excellent Idea and an Incomplete Management Team

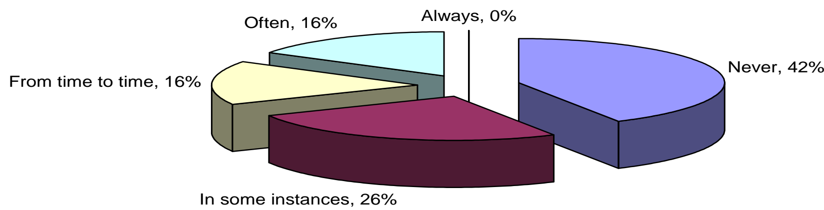
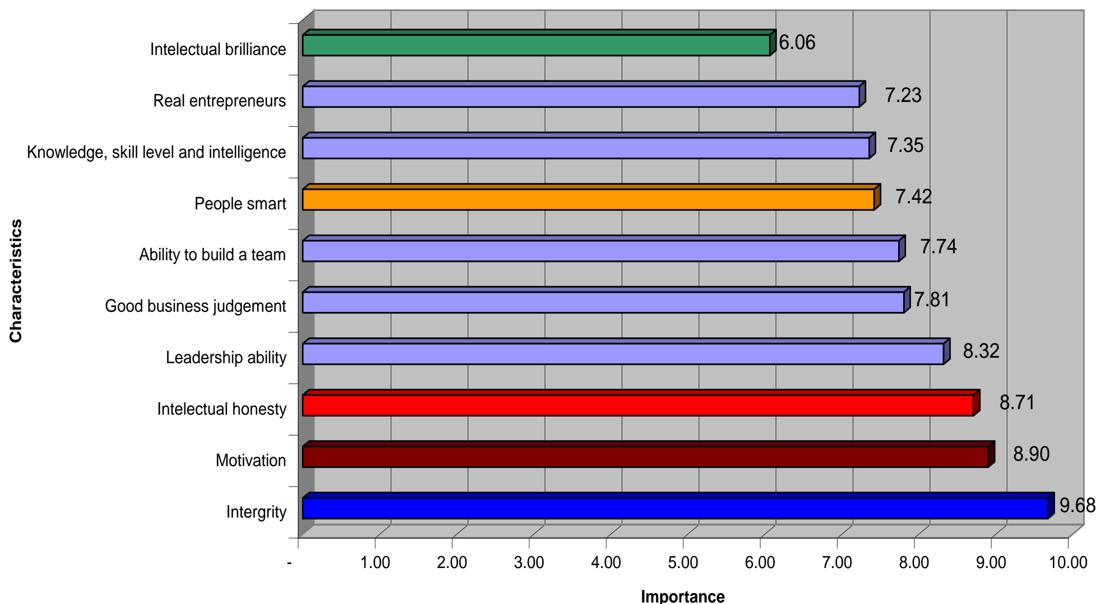


Figure 10. Important Characteristics of a Management Team



A complete management team is not sufficient if the management team does not have the required characteristics. In figure 10 the most important characteristic that a management team must have is seen to be integrity, followed by motivation, intellectual honesty and leadership ability. The management team must be trustworthy without any hidden agendas with the main purpose to ensure the new venture is successful. Table 2 compares the importance of the different characteristics as researched by Hill and Power (2001: 118) and the results of this study.

A clear correlation exists between the findings of Hill and Power (2001: 118) and this study as indicated in Table 2. The importance of the knowledge and skills level deviate the most and is not seen to be that important in South Africa. The respondents do not rate personality compatibility and ensuring that the right management team are appointed through brain preference tests.

Table 2. Important Characteristics of a Management Team

MANAGEMENT CHARACTERISTICS	IMPORTANCE (Hill and Power)	IMPORTANCE (this study)
Integrity	2	1
Dedication, commitment, passion and energy	3	2
Intellectual honesty	Not researched	3
Leadership ability	7	4
Vision and ability to articulate vision	4	5
Ability to build a team	7	6
People smart	Not researched	7
Knowledge, skill level, intelligence	5	8

Figure 11. Importance of Personality Compatibility

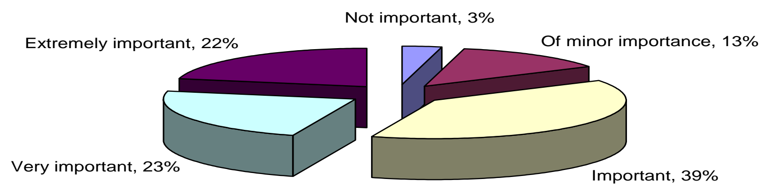
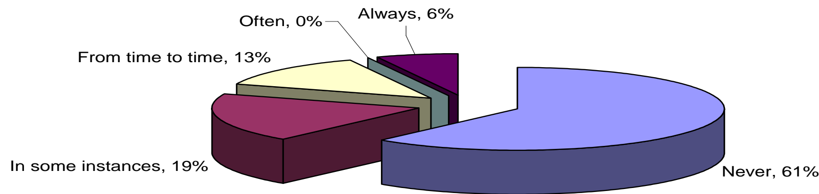


Figure 12. Importance of Psychometric and Brain Preference Tests



The cohesiveness between members of the management team can further be enhanced by the use of a mediator. The respondents do not agree with this statement and only 3% use mediators on a regular basis while a further 26% use it from time to time as can be seen in figure 13. The mediator's role is to ensure that all the parties in the venture will be able to work cohesively as a team. Unsolved differences between team members will hinder the venture's development. The respondents appreciate the role that a mentor can sometimes play in a venture to enhance cohesiveness and capacitate the management team with the transfer of knowledge and skills (see figure 14). The respondents are mainly investors in later stage ventures as can be seen in figure 2, with complete management teams, where the need for mediators and mentors are not that eminent.

Figure 13. Need for a Mediator

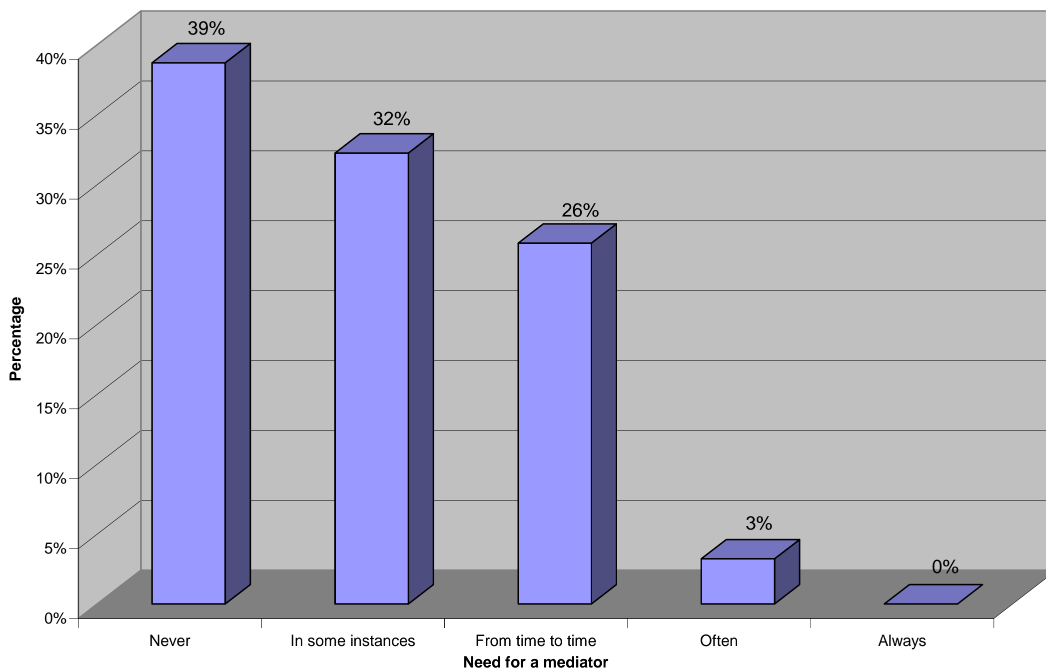
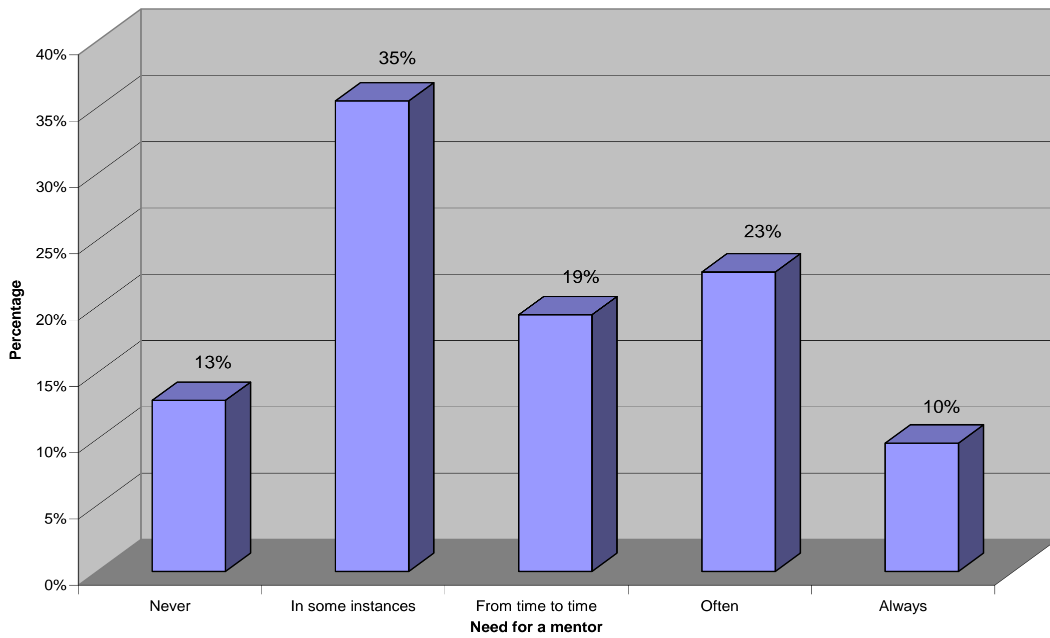


Figure 14. Need for a Mentor



The investment process does not only consist out of the provision of funding but involve important value adding activities which determine the success of the venture. The ranking of the findings in the SA research differs from the research done by De Noble, Ehrlich and Moore (1994:75). Monitoring financial performance, acting as a sounding board and monitoring operating performances are the most important activities in the SA research (see figure 15). Obtaining alternative equity finance is seen as the least important value adding activity in South Africa. The SA investors market concentrate much more on the control and monitoring activities than their counterparts in the USA.

Figure 15. Importance of Value Adding Activities

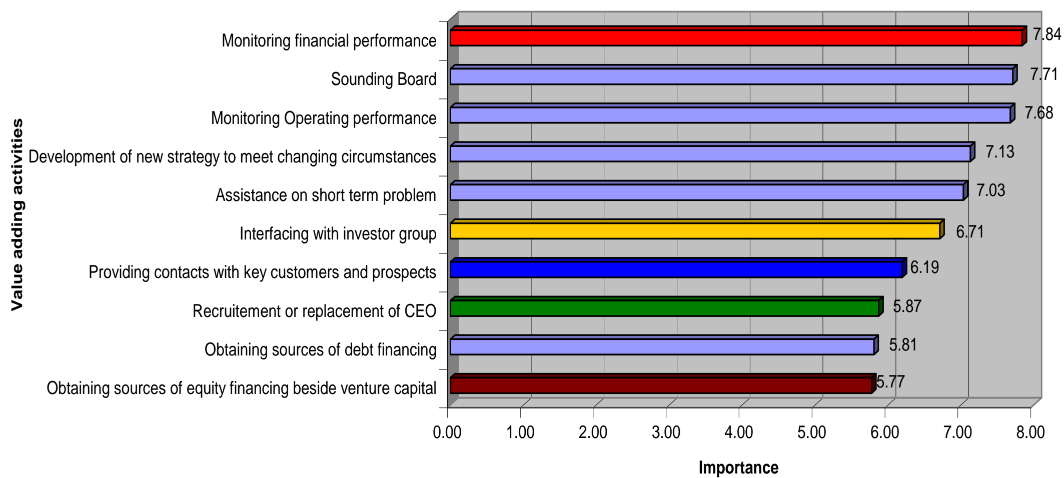


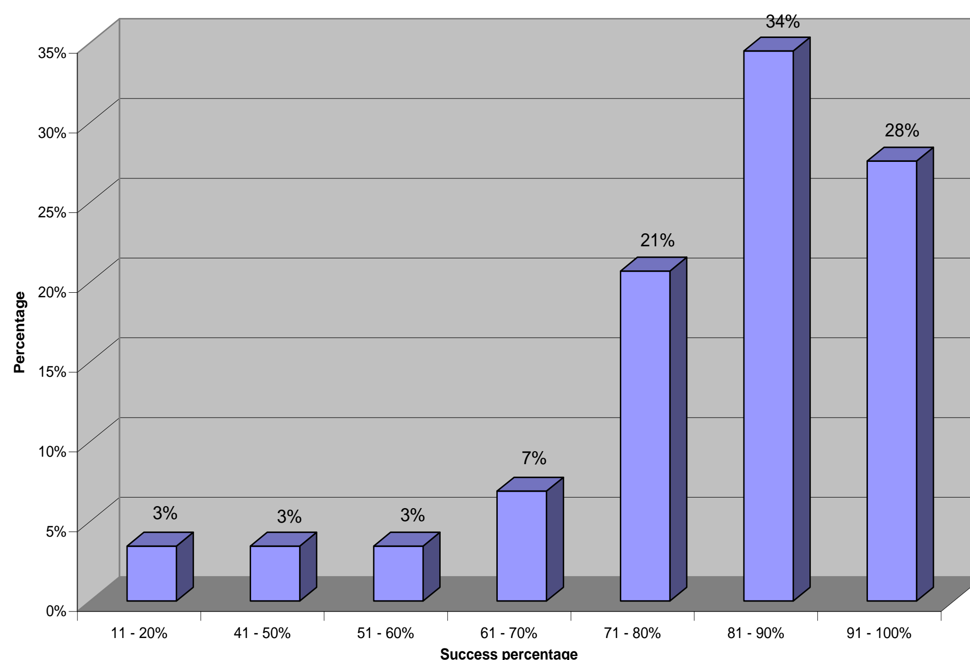
Table 3. Importance of Value Adding Activities

	Ranking of value adding activities (1 = most important, 7 = least important)		
Value adding activities	Venture capital funded entrepreneurs - USA	Angel investment funded entrepreneurs - USA	Value adding activities in South Africa
Monitor financial performance	3	2	1
Sounding board	4	3	2
Monitor operating performance	5	5	3
Formulate business strategy	6	4	4
Assistance in short term problems	Not researched	Not researched	5
Interface with investor groups	1	1	6
Providing contacts with key customers and prospects	Not researched	Not researched	7

The importance of the monitoring and controlling activities is a clear indication that the investors in South Africa are later stage investors and not the creators of new ventures. The majority of the investments made are large investments exceeding R10 million while only 19% of the investments made are less than R2 million.

A very high rate of successful ventures is maintained in South Africa. More than 60% of the investments made have an 80% and above success rate, as can be seen in figure 16. The high success rate is a function of good control, see Table 3 that indicates that control and monitoring are the most important value adding activity, and the preference of investors to invest in the industry known to them. Investment in the industry known to the investor enhances the returns that can be achieved as investors are more able to transfer knowledge and skills to the management team. The high SA success rate is due to the nature of investment and investment stages. The high SA success rate is not a true reflection of the total venture capital market due to the fact that the investors are mainly later stage investors where success is almost guaranteed. New venture investment rarely happens whilst the investors cover their risk through tangible securities taken. The true success rate is therefore difficult to observe.

Figure 16. Success Rate per Investment Made



Conclusion

The venture capital and private equity market is a very young investment market in South Africa while the angel investors market, although it exists, is not formalised. Internationally and especially in the USA these markets are well developed and clearly illustrates the success rate of new ventures in this country. The rest of the world followed in the footsteps of the venture capital markets in the USA, with the USA being the leader in this field. Venture capital is not a new way of the investment, not even in South Africa seeing that companies like ABSA Bank, Sanlam and Liberty Life was formed and funded in a true venture capital manner. Research done determining the reason for success of investments in new ventures normally concentrate on financial aspects, product related aspects and marketing as opposed to the qualitative aspects that are equally important. The non-financial aspects determining the success of the ventures are seen by the investors to be important but are normally left to the management team to resolve, although detrimental to the success of the new venture if not managed correctly. This research confirms that the success of a venture is achieved through non-financial aspects that can be achieved by the transfer of knowledge and skills during the investment process. The literature research indicated that the investor's role entails much more than just providing funding where the transfer of knowledge and skills, "streetwise" knowledge, is determined in the success of any venture.

Later stage investments give the investor the opportunity to be involved as a shareholder/investor and as a non-executive director without being directly involved in other matters of the venture. The venture capitalist in the USA concentrates more on the support of the venture through their interface with the investment group, obtaining of equity finance, monitoring of financial performances acting as a sounding board, monitoring operating performances and formulation of the business strategy, while the SA investors concentrate more on the control of the venture than on the support functions. The high emphasis on control is a clear indication that most of the SA respondents are fund managers and not seasoned entrepreneurs. The investment risk increases as some of the important role players are omitted from the investment process. The attractiveness of an investment is then based purely on the availability of an opportunity. The absence of the different role players creates a lack of knowledge and skills in the venture which could be detrimental to its success. The ability of investors to transfer knowledge and skills is enhanced through the preference to invest in industries known to the investors. Previous knowledge of the industry helps the investor to make prompt, correct decisions and add value to the venture's management team.

A complete management team is preferred by all investors although many opportunities will go astray if the investor ignores the opportunity and only concentrates on the management team. The investor's ability to identify shortcomings in the management structure is an important value adding activity. The quality and ability of the management team can further be enhanced by ensuring that the management's personalities are compatible. Strong leadership and a mediator will enhance cohesiveness and the implementation of psychometric/brain preference tests in order to use the managers in the correct portfolios. The tendency in South Africa to get control of the venture leans towards vulture capitalism. The investors take control of the venture, the entrepreneur's shareholding, eventually controlling the venture which may lead to the entrepreneur losing interest and initiative. Shareholding should be divided according to equitable expectations and fairness.

The investor's role is not only one of funding, but also one of providing knowledge and skills to the venture and its management team. The marginalisation of the investor's role enhances the risk of investment in new ventures which may have detrimental economical consequences effecting growth in any country in the world. Especially for South Africa as an emerging economy, successful ventures are a prerequisite for sustainable long term economic growth and job creation.

References

Books

1. Bartlett J.W., (1988). Venture capital law, business strategies, and investment planning. John Wiley: New York.
2. Bartlett J.W., (1999). Fundamentals of venture capital. Madison Books: Maryland.
3. Benjamin G.A. and Margulis, J., (2001). The angel investor's handbook. Bloomberg: Princeton
4. Camp J.J., (2002). Venture capital due diligence. John Wiley: New York.
5. Echarri J. and Coller J., (2007). EVCA yearbook 2007. EVCA, Brussels.
6. Gladstone D. and Gladstone L., (2004). Venture capital investing. The complete handbook for investing in private businesses for outstanding profits. Prentice Hall: New Jersey.
7. Hill E. and Power D., (2001).Inside secrets to venture capital. John Wiley: New York.
8. Hill B.E. and Power D., (2002). Attracting capital from angels: How their money – and their experience – can help you build a successful company. John Wiley: New York.
9. Schetler A., (2006). The venture capital industry in Europe. Palgrave Mcmillan: New York.
10. Van Osnabrugge M. and Robinson R.J., (2000). Angel investing. Matching start-up funds with start-up companies. Jossey-Bass: San Francisco.
11. Wilmerding A., (2003). Deal terms. United States of America: Aspatore: Boston.

Journals

1. Dana L., Korot L. and Tovstiga G., (2005). A cross-national comparison of knowledge management practices. International Journal of Manpower, 26(1) (p10 – 22).
2. De Noble A.F., Ehrlich S.B. and Moore T., (1994). After the cash arrives: A comparative study of venture capital and private investor involvement in entrepreneurial firms. Journal of Business Venturing, 9 (p67 – 82).
3. Franke N., Grober M., Harhoff D. and Henkel J., (2005). What you are is what you like – similarity biases in venture capitalists' evaluation of start-up teams. Journal of Business Venturing. Article in press.
4. Macmillan I.C. and Kulow D.M., (1989). Venture capitalists' involvement in their investments: Extent and performance. Journal of Business Venturing, 4 (p27 – 47).
5. Maier J.B. and Walker D.A., (1987). The role of venture capital in financing small business. Journal of Business Venturing, 2 (p207 – 214).
6. Rosenstein J. and Bruno A.V., (1993). The CEO, Venture capitalist and the board. Journal of Business Venturing, 8 (p99 – 113).
7. Sohl E and Rosenberg W., (2003). The US angel and venture capital market: Recent trends and developments. Journal of Private Equity, 6(2) (p7 – 17).
8. Sorhiem R., (2005). Business angels as facilitators for further finance: an exploratory study. Journal of Small Business and Enterprise Development, 12(2) (p178 – 191).
9. Watkins W. and Fourie J.P., (2008). KPMG and SAVCA. Venture capital and private equity industry performance survey of South Africa covering the 2007 calendar year: Johannesburg.

World Wide Web

1. Anonymous D., (2004). VC in Asia: An Angel in Singapore. Redherring. The Business of Technology. [ONLINE], Available http://www.redherring.com. Accessed 20 April 2004.
2. Carmichael E., (2006). Teaming up to make business dreams come true. American venture magazine. [ONLINE], Available http://www.americanventuremagazine.com. Accessed, 24 October 2006.