

ANGEL INVESTMENT AND COLLECTIVE AGRICULTURAL MARKETING: THE CASE OF THE MINNESOTA FOOD NETWORK

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The Minnesota Food Network is a limited liability company comprised of 52 farmers producing a variety of high-quality, sustainably produced agricultural products in southern Minnesota. The network's goal is to develop a regional food system to provide locally grown food at a price that "is fair" to both consumers and producers. This case outlines the challenges that the network faces in their efforts to expand to take advantage of a market opportunity. One of their biggest challenges is that they face high operating costs because of their disaggregated distribution system and need to purchase a distribution and storage facility and two vehicles. They will fund the purchase of a building through an angel investor. An angel investor is necessary because the network cannot sustain traditional loan payments in its current form. Students are asked to consider a number of questions pertaining to the decisions in this case outlined in the final section of the case study.

JEL codes: A22, Q13, Q18.

It is June 2013, and Peter has to make a decision soon. Peter cares about the economy of his rural community and is seeking local investment opportunities, but he is also a shrewd businessman, unwilling to make an unprofitable investment. The previous afternoon, he had met with Deborah Smith, the chair of the Minnesota Food Network. Deborah gave him information about the network and an investment proposal for him to consider. The network's mission statement is "to create a regional food system in which local producers who use environmentally sustainable farming methods can market their products at a price that accurately reflects both their input and labor costs to local consumers who understand the economic, environmental, and social benefits of purchasing food directly from the producers."

As Deborah explained, the network's outlook is very promising: sales are increasing rapidly, and the customer base now includes twenty-two restaurants, four retail stores, four buying clubs, and one institution, in addition to retail customers. She further explained that the network is standing at a crossroads

and needs to make several major investments to expand and meet the rising demand. The network is approaching Peter as an "angel investor" to provide the capital needed to purchase and refurbish a building to serve as a storage, distribution, processing, and retail facility. An angel investor is necessary because thus far the network has relied on grants from local extension and rural development agencies to sustain its growth. It is unlikely to qualify for a conventional bank loan at this time because of the relatively modest revenue and high costs. To grow, this network needs a jumpstart, namely a building, to facilitate its projected growth. An angel investor can provide this capital and in this case is willing to wait until 2018 to begin receiving payments on this loan. This five-year period will give the network enough time to grow to be able to sustain such payments.

Peter likes the idea of investing in an organization that could help local farmers, but he also knows that investing in this type of organization is very different than traditional investment opportunities. There are many considerations before he jumps into this investment, and he knows that he will have to answer questions from his equally business-minded wife when he gets home. She will ask

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him about the return on his investment, how long they will have to wait to see this return, how sound the network is in terms of both their supply chain and product demand, and how much say they will have in management decisions. Peter and his wife are both tolerant of risk and must carefully consider the proposed investment of \$199,000.

Angel Investing

Angel investors are generally wealthy individuals who invest in start-up businesses or other ventures. They are different than venture capitalists because they typically invest their own private capital as opposed to a pool of money that is often professionally managed. Angel investors typically receive an equity share or management role. In this case, Peter will be a member of the board if he decides to make the investment.

To provide some background, Peter did some research on angel investing. He found that there is little comprehensive research on angel investing because this type of investment is somewhat disaggregated and operates largely in obscurity. In one of the few studies, [Sohl](#) found that total angel investments in 2012 equaled \$22.9 billion. The top three industries that received angel investment were software, healthcare, and retail. The average angel investment in 2012 was \$314,800, representing an average equity of 12.7%. [Mason and Harrison](#) found that in the United Kingdom the returns on angel investing were highly volatile. They interviewed 128 angel investors who had exited the investments and found that 34% exited with a total loss and 13% realized a partial loss or broke even, but 23% percent of these investors showed an internal rate of return greater than 50%. These results demonstrate the wide variability in angel investment outcomes and indicate that angel investors are more tolerant of risk than average investors.

One of the distinguishing characteristics of angel investors is that they are often motivated by outcomes beyond financial return. [Sullivan](#); [Freear](#), [Sohl and Wetzel](#); and [Linde and Prasad](#)¹ found that angel investors invest in projects that are consistent with

their social values and for the excitement of being part of a start-up company. These investors are generally willing to accept a lower return on their investment because of the dual motivation of both financial return as well as some “psychological” return. For a more complete profile of angel investors, see [Morrisette](#).

History and Current Position of the Network

In February 2010, a local rural development nongovernmental organization invited representatives from community organizations, as well as producers, processors, food retailers, restaurant owners, financiers, educators, and community organizers, to a meeting in rural Minnesota to discuss the formation of a regional food network. It became apparent that the production of high-quality food products was well underway in the region, but a system for efficiently marketing and distributing the food was lacking.

Within months of the initial meeting, a group of attendees wrote a plan and funding proposal for the development of a network to meet the marketing and distribution needs of the Minnesota agricultural producers. Initial funding was provided by two local nongovernmental organizations. A steering committee with expertise in food production, business management, ecology, and community organizing was assembled to guide the initial development of the network. By May 2011, the first products were sold to several buying clubs and restaurants in the Twin Cities.

The network wants to be a successful business, but it has an important social and environmental agenda as well. In addition to providing marketing, sales, and promotional services to its members and assisting with distribution, transportation, storage, and feed procurement, the network wants to supply socially responsible food through the use of sustainable agriculture practices to local and regional consumers. As a member organization, members benefit from the collective marketing and retain 90% of the value of the produce that is sold through the network. The network retains 10% of the revenue to cover marketing expenses.

The network is an attractive marketing alternative for many local farmers. When the network first started, a majority of the members were already involved in direct

¹ Linde, L., and A. Prasad. 2000. Venture Support Systems Project: Angel Investors. Unpublished, Massachusetts Institute of Technology.

marketing but sent less than 40% of their product through the network. As the network has grown, new members, many of whom have never been involved in direct marketing, have joined the network. These new members use the network as their primary direct-marketing channel, typically selling about 80% of their product through the network. This trend indicates further stabilization of the network's product supply. One of the primary challenges to growth is the current supply chain logistics. The existing storage facilities are in scattered locations, primarily in members' houses, and the available storage is not adequate for the product volumes that will be required for anticipated growth. This inefficient system increases transportation costs and time to producers and staff and is the main bottleneck to growth.

The network currently includes 52 farmers and coordinates marketing, sales, and distribution of members' agricultural products to buyers located in two urban areas in Minnesota. Members produce a variety of vegetables, meats, poultry, fruits, and dairy products. In addition to the network's challenges of ensuring a steady supply to consumers, food safety concerns are increasingly important as more dairy and meat products are sold through the network. The network is committed to acquiring all products from network members, requiring a high level of cooperation and coordination.

Membership in the network is restricted to producers farming in eight Minnesota counties in the region. Members pay an initial, one-time membership fee of \$250. After the initial payment, they pay a 10% usage fee on all products sold through the network, and they are also charged for transportation costs at \$0.90 per mile, which includes the driver. Products are delivered currently with a rental truck. The network is strictly a marketing service for its members, meaning that the network never assumes ownership of the product, nor does it currently store inventory. These functions are performed by individual producers.

Market for Local Foods in Minnesota

The market for so-called local foods in Minnesota, as in many parts of the United States, is a growing and dynamic market. Both direct marketing and institutional marketing of local foods has grown substantially in recent

years and promises continued growth opportunities. The number of farmers' markets, for example, has tripled in the last fifteen years (King et al.). Federal and state efforts have encouraged this growth through programs such as the Statewide Health Improvement Program in Minnesota. This program encourages efforts to improve community health, such as including local food purchasing for seniors and local school districts and the creation of farmers' markets in certain communities (Goodspeed).

The demonstrable growth in the market for local foods is observed in both institutional sales and direct marketing. In 2006, only twenty school districts in Minnesota were involved in the Farm-to-School program, a program that matches local producers with school lunch programs. This program saw enormous growth in four years, increasing to 145 schools by 2011 (IATP). This represents nearly 900 public schools and 558,000 students or 58% of Minnesota's K-12 population. Similar growth and growth potential is seen in servicing other types of institutions such as restaurants, retirement communities, and hospitals. Institutional customers are particularly important for the network because of the competitive advantage the network has over individual farmers in this market. One issue with servicing institutions is their need to process and procure larger volumes of product. Working with a network of farmers will reduce the risk of fluctuations in supply for these institutions and represents an important opportunity for the network.

Growth and Revenue Projections for the Network

The network is still a small player in the total regional food marketing system. There is no other organization in this region of Minnesota that provides collective direct marketing of agricultural products. The main competitors in this portion of the food market are individual producers in the region. However, given the variety and consistency of supply available through the network, the network has a competitive advantage over individual producers. This advantage could be threatened by the fact that some food service companies, such as SYSCO, are starting to explore systems to distribute local food products as well. Potential changes in the future

competitive landscape should be considered in the network's projected growth potential.

Reflecting consumer preference trends, the network's customer base has expanded substantially since its start. Sales for 2012 totaled \$83,877, as seen in table 1. The network projects sales of \$268,406 for 2013, and sales through the end of May 2013 were more than three times what they had been for the first five months of 2012. The network has a goal of continuing rapid growth to reach \$671,016 in sales in 2014. Note that the first column in table 1 is realized sales, whereas the remaining columns are projections.

Sources of revenue for the network change over the projection period considerably. During the first three years of the projection period, a significant amount of the revenue is derived from grants. However, starting in 2014, cash sales and on-term sales² comprise a much larger portion of the revenue stream.

Network Challenges

Several important changes are needed to facilitate further expansion. To efficiently handle the volume of product required to meet its expansion goal, the network needs a single location where products can be stored and assembled for distribution. Further, the business has thus far depended heavily on grants from the two local nongovernmental organizations to be financially viable. This grant money will no longer be available after the end of 2014. The network must be financially independent by this time. This can only happen through growth and expansion, coupled with an aggressive effort to reduce costs through streamlining the marketing system both from producers to the storage facility and from storage to the consumer. This expansion in sales will decrease the fixed cost as a percentage of each sales dollar.

Strategy: Purchase of a Storage Facility and Vehicles

The network's highest priority is to purchase a building that the network has identified to act as a central hub for distribution and storage. Acquisition of this facility could

reduce operating costs significantly. Increased sales volume, facilitated by the purchase of this facility, will bring down average costs in human resource expenses, marketing expenses, and insurance costs. The building has income potential, including two apartments, which each rent for \$450 per month. The annual cost of operating the building is approximately \$7,633, which includes insurance, utilities, property tax, and maintenance.

To make this expansion possible, the network is looking for an angel investor to invest \$199,000 to purchase and renovate the building. The price of the building is \$129,000, and it requires a \$70,000 investment for upgrades to provide a usable space for the network. The network would rent the building for a nominal fee (\$1.00 per year) for four years, after which time the network would purchase the building for \$260,848 from the angel investor. The angel investor would facilitate the repurchase for the network by offering a fifteen-year contract for deed beginning in 2018, with a fixed annual interest rate of 7%. The network's annual payment would be \$28,640.

It is also important that the network purchase two vehicles to make deliveries. Currently, the network rents a truck from a member two times per week to make deliveries. The purchase of a van and then a truck is important to ensure timely and consistent delivery of product to customers. As the business grows and product distribution becomes more centralized with the purchase of storage and processing facility, the availability of a delivery van and truck at full disposal of the network is critical.

The financing for the vehicles will be provided by the network. The van will cost \$20,000 and will be financed after a 20% down payment at 7% yearly (0.583% monthly) for five years. The truck will be purchased for \$45,000 at the same interest rate with a term of five years. The total van and truck payments are reflected in the cash flow statement in table 2. Van and truck depreciation and interest payments are also reflected in the income statement in table 1.

Financial Projections

The income statement (table 1) and cash flow statement (table 2) give an account of the projected financial situation for the business

² On-term sales are generally sales that have been established through a medium-term agreement with an institution.

Table 1. Income Statement

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<i>Yearly Sales Growth Assumptions</i>		220%	150%	65%	40%	25%	15%	10%	10%	10%	10%
REVENUES											
Cash sales	50,326	161,044	402,610	664,306	930,028	1,162,535	1,336,916	1,470,607	1,617,668	1,779,435	1,957,378
On-term sales	33,551	107,363	268,406	442,871	620,019	775,023	891,277	980,405	1,078,445	1,186,290	1,304,919
TOTAL SALES	83,877	268,406	671,016	1,107,176	1,550,047	1,937,559	2,228,193	2,451,012	2,696,113	2,965,724	3,262,297
COST OF GOODS SOLD (0.9 × total sales)	75,489	241,566	603,914	996,459	1,395,042	1,743,803	2,005,373	2,205,911	2,426,502	2,669,152	2,936,067
GROSS PROFIT FROM FOOD	8,388	26,841	67,102	110,718	155,005	193,756	222,819	245,101	269,611	296,572	326,230
Other Revenue											
Grant money	49,989	50,000	10,000	0	0	0	0	0	0	0	0
Members' fee	1,750	3,750	5,000	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500
Label box sales	697	696	1,204	3,322	4,650	5,813	6,685	7,353	8,088	8,897	9,787
Rent of apartment		1,800	11,016	11,236	11,461	11,690	11,924	12,163	12,406	12,654	12,907
Income from truck/van truck/van		0	34,423	56,798	39,759	49,698	57,153	62,868	69,155	76,071	83,678
<i>Total Other Revenue</i>	<i>52,436</i>	<i>56,246</i>	<i>61,643</i>	<i>73,856</i>	<i>58,370</i>	<i>69,701</i>	<i>78,262</i>	<i>84,884</i>	<i>92,149</i>	<i>100,122</i>	<i>108,872</i>
TOTAL REVENUE	60,824	83,087	128,745	184,574	213,375	263,457	301,081	329,985	361,761	396,694	435,101
Operating Expenses											
Storage		900	805	1,329	1,860	2,325	2,674	2,941	3,235	3,559	3,915
Distribution		1,200	1,200	0	0	0	0	0	0	0	0
Building interest expense		0	0	0	0	0	18,259	17,533	16,755	15,923	15,033
Van interest expense		0	1,120	925	717	494	255	18	0	0	0
Truck interest expense			0	0	2,520	2,082	1,613	1,111	574	40	3
TOTAL OPERATING EXPENSES		2,100	3,125	2,254	5,097	4,901	22,801	21,603	20,565	19,522	18,951

continued.

Table 1. continued

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
General & Administrative Expenses											
Salary, wages, & fringe		52,414	81,732	84,679	87,353	90,160	93,108	96,204	99,454	102,866	106,450
Development and marketing		6,100	10,771	11,922	13,250	14,413	15,285	15,953	16,688	17,497	18,387
Utilities		7,050	7,060	7,100	7,142	7,185	7,230	7,277	7,325	7,376	7,429
Insurance		375	3,100	3,100	3,100	3,100	3,100	3,100	3,100	3,100	3,100
Building maintenance and depreciation		1,106	7,633	7,633	7,633	7,633	7,633	7,633	7,633	7,633	7,633
Van maintenance and depreciation		0	2,700	2,700	2,700	2,700	2,700	2,700	2,700	2,700	2,700
Truck maintenance and depreciation		0	0	0	5,500	5,500	5,500	5,500	5,500	5,500	5,500
Other expenses		2,647	5,183	5,390	5,592	5,793	5,986	6,177	6,378	6,592	6,818
TOTAL GENERAL & ADMINISTRATIVE EXPENSES		69,692	118,180	122,523	132,270	136,484	140,542	144,543	148,779	153,265	158,017
TOTAL EXPENSES		71,792	121,305	124,777	137,367	141,385	163,343	166,146	169,344	172,787	176,968
NET INCOME		11,295	7,440	59,796	76,008	122,073	137,738	163,839	192,417	223,907	258,134

Source: Authors' calculation.

Note: The growth scenario also assumes that the network will add ten new members per year, will continue to rent the apartments in the building, and will increase the rent by 2% per year. The difference between "total sales" and "cost of goods sold" is gross profit from food. In 2012, there were no wages paid because all employees were member volunteers. On-term sales are sales that have been established through a medium term agreement with an institution.

Table 2. Cash Flow Statement

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Sources										
Beginning cash balance	\$2,340	\$13,635	\$11,673	\$62,067	\$127,912	\$239,384	\$355,928	\$501,847	\$682,935	\$894,165
Cash income from food	\$(44,951)	\$(59,703)	\$(19,560)	\$20,158	\$54,453	\$79,348	\$97,599	\$117,597	\$139,749	\$164,298
Cash grant money	\$50,000	\$10,000	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$—
New members fee	\$3,750	\$5,000	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500
Cash from label box sales	\$696	\$1,204	\$3,322	\$4,650	\$5,813	\$6,685	\$7,353	\$8,088	\$8,897	\$9,787
Apartment rent	\$1,800	\$11,016	\$11,236	\$11,461	\$11,690	\$11,924	\$12,163	\$12,406	\$12,654	\$12,907
Revenue from truck/van	\$—	\$34,423	\$56,798	\$39,759	\$49,698	\$57,153	\$62,868	\$69,155	\$76,071	\$83,678
Total Sources	\$13,635	\$15,575	\$65,969	\$140,595	\$252,067	\$396,994	\$538,410	\$711,593	\$922,806	\$1,167,335
Uses										
Cash withdrawals	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$—
Cash Difference	\$13,635	\$15,575	\$65,969	\$140,595	\$252,067	\$396,994	\$538,410	\$711,593	\$922,806	\$1,167,335
Total building payment	\$—	\$—	\$—	\$—	\$—	\$28,640	\$28,640	\$28,640	\$28,640	\$28,640
Total van payment		\$3,902	\$3,902	\$3,902	\$3,902	\$3,647	\$255	\$18	\$1	\$0
Total truck payment	\$—	\$—	\$—	\$8,780	\$8,780	\$8,780	\$7,669	\$—	\$—	\$—
Total Mortgages Payment	\$—	\$3,902	\$3,902	\$12,682	\$12,682	\$41,067	\$36,564	\$28,658	\$28,641	\$28,640
Ending Cash Balance	\$13,635	\$11,673	\$62,067	\$127,912	\$239,384	\$355,928	\$501,847	\$682,935	\$894,165	\$1,138,695

Note: This cash flow statement implicitly includes all costs included in the income statement. This is reflected in the “cash income from food,” which is a net figure of all costs included in the income statement.

over the next 10 years. With an investment from an angel investor for the purchase of the building, the company has a positive cash balance for all 10 years. Based on the projections, it is impossible for the network to buy the building in 2013 and maintain a positive cash balance using a traditional mortgage plan.³ The primary advantage of an angel investor is that (s)he is a patient investor and is allowing a deferred payment until 2018. If the network were to take on a traditional mortgage right away, this would leave them with a negative net income and cash balance for at least the first two years.

The income statement assumes that the network will grow substantially over the next 10 years. Based on past growth of the network and sales projections from the network's sales representative, sales growth is projected at 220% for 2013 and 150% for 2014. Lines 1 and 2 in the income statement under "revenue" reflect this growth assumption. In addition, the growth scenario assumes that the network will add ten new members per year, will continue to rent the apartments in the building, and will increase the rent of the apartments by 2% per year. Network sales records indicate that they are on target or exceeding their monthly sales goals for 2013, giving some credence to these seemingly optimistic sales projections. Sales projections moderate by the year 2019, when the network projects a more stable growth pattern of 10% per year. Under the total sales figures, the cost of goods sold is the amount paid back to the farmer. The difference between "total sales" and "cost of goods sold" is gross profit from food, which increases from \$8,388 in 2012 to \$326,320 over ten years (as seen in table 1).

The network will realize income from other sources as well. In addition to membership fees and income from the apartment rental, the network will earn income from the van and truck. (Details of these purchases can be seen in the cash flow statement.) Transportation fees charged to member farmers for the transportation of their products are reported in the income statement in the "other revenue" section. Income from the truck and van represents approximately 20% of the

total revenue each year. Currently, transportation costs are covered by the flat fee charged to members. The largest operating expense is the labor costs for salaried and wage workers.

The cash flow statement (table 2) shows a positive ending cash balance for all ten years. It should be noted that this cash flow statement implicitly includes all costs included in the income statement. This is reflected in the "cash income from food," which is a net figure of all costs included in the income statement.⁴ This positive balance is made possible by the angel investor, which allows the network to have a building to facilitate expansion but also to defer mortgage payments until 2018, when revenue from sales and transportation has increased. The yearly payments for the van and truck are outlined in the cash flow statement. Cash from grant money is zero as of 2015.

Decision Faced by the Angel Investor

One major difference between a traditional investor and an angel investor in our case is that the angel investor provides a grace period before payback is required, representing an opportunity cost to the investor. In this case, the motivation of the angel investor is to encourage the development of a sustainable local food system and support small and medium growers in the area.

But the angel investor faces significant risk. The risks stem from uncertainty of growth projections; potential inability of the network to manage the transition to being a larger, more formally run business; and whether the Minnesota market for locally produced food is just a fad or a long-term structural shift in food preferences.

One mitigating factor is that the investment would be secured by the building, which would not appear on the network's balance sheet for five years, decreasing the risk of such an investment considerably. Given that the building will remain in the angel investor's name until that time, the building could not be taken by creditors if the network should go bankrupt. However, the real estate market in the small Minnesota town is

³ An interactive spreadsheet is available in the online supplementary materials. It can be used to change the financing options to examine the financial analysis under different loan scenarios and growth options.

⁴ In 2012, there were no wages paid because all employees were member volunteers.

far from robust, and the purchase and renovation of a building is a risk in and of itself. Additionally, with his angel investment, the angel investor would automatically become a voting member of the network's advisory board, allowing him to have a say in future decisions and directions of the network.

The 7% proposed return is slightly above average for the market, but Peter is assuming a large amount of risk with this investment and could likely see a comparable return with lower risk outside of the food industry. The angel investor is familiar with the financial needs of the network and strongly supports its mission because he is committed to the economic viability of the region.

The Problem

Students are asked to make a decision from the point of view of the angel investor. As the angel investor, students answer the following questions:

1. Based on the information given in the case study and an analysis of the financial tables given, should Peter invest \$199,000 in the food network?
2. If Peter decides to invest, what should he advise the network to do to realize its growth projections?
3. Does it make sense for the network to buy the building? How would this analysis change if the network decided to rent the building for \$1,200 per month? What are the advantages/disadvantages of this strategy?
4. Using the interactive spreadsheet (available in the online supplementary materials), what lending terms would be required for the network to be able to pursue the purchase of a building in a way that leaves them equally well-off as in the angel investor scenario? Identify collateral requirements, interest rate, terms of payment, and so on.
5. Do you think that "social motivations" should be used as a rationale for investing? In this case, Peter is accepting an opportunity cost (how much?) because he is interested in seeing this kind of business flourish in his town. Is this wise?

Supplementary material is available at http://oxfordjournals.org/our_journals/ajae/online.

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