The evolution of Chinese angels; social ties and institutional development

Abstract

Informed by Mike Wright's insight on entrepreneurial finance research problems, we examine how Chinese angel finance has evolved with institutional changes over two decades. Our longitudinal cases explore the changing roles of personal ties within strengthening regulatory institutions. Rather than the diminishing role anticipated, we found personal ties remained vital for investment decisions. Although the improved regulatory environment influenced the extent and volume of investment, encouraging greater and longer investments, personal ties still informed decisions. We conclude angel finance practice has evolved to match the changing Chinese environment. Social ties no longer comprehensively determine investment decisions. Instead, personal ties complement the improving environment. The trust embodied in ties continues to facilitate deal making by quick decisions and simple contracts. Importantly, we noted how trust reshaped moral hazards and agency problems through the moral obligations of ties. Thus, trust in the individual took more account of the business, but remained centred on personal integrity.

We also found how ties with government officials, historically vital in uncertain environments, had become much less important as confidence in the regulatory regime improved. The paper contributes to our understanding of institutions and practices. It highlights culture's continuing role by addressing Mike Wright's concerns and by using his guidance.

Key words: Personal network ties, entrepreneurial finance, angel finance evolution, institutional theory, China

Introduction

Mike Wright laid much of the groundwork for venture capital enquiry in 1988 (Wright and Robbie, 1998) by identifying what was distinctive about equity risk finance, especially the problem of asymmetrical information. Wright et al (1998) argued for the critical role of angel finance as 'informal' venture capital, not least for stimulating a country's entrepreneurial base (De Clercq et al, 2012; Jiang et al 2014). Venture Capital is an increasingly important phenomenon, but geographically diverse (Wright et al, 2005). Zahra and Wright thus argued 'research should address the heterogeneity of the contexts in which entrepreneurial activities take place' (2011:72). Theories developed in one context may offer a poor explanation in other institutional settings (Bruton et al, 2010); research needs to be locally contextualised, but loosely coupled to global debates (Wright, 2007). Our study is set in the context of China's remarkable growth and institutional changes (Ge et al, 2017) and engages with debates about entrepreneurial practices and institutions (Estrin et al, 2019).

Mike's interest in Chinese VC (Lockett and Wright, 2002) highlighted the economic importance of China and the unique context of business practices, culture and legal systems. He signalled a need to understand the vagaries of the investment process (Cumming et al., 2019), especially as China becomes a mid-range economy (Hoskisson et al, 2013). Moreover, Jiang et al (2014) noting VC growth, commented that VC research in China remained limited. Nonetheless, Mike noted how venture capitalists' decisions were less dependent on market, product, and strategy (Wright et al, 1997) and more influenced by personality and experience. Indeed, when institutions are not well developed, VCs may rely on informal institutions in relationships (Wright et al, 2005a). Similarly, Batjargal and Liu (2004) recognised the importance of relationships for Chinese venture capital. They emphasised the significance of existing relationships or referrals. Wright (2007) observed that in a weak institutional environment such as China's, enforcing contingent contracts may be problematical, hence relationships involving trust may be a substitute.

Zahra and Wright (2014) explain that although the role of informal institutions is well recognised, their cultural foundations are often overlooked. Moreover, Bruton et al (2009) suggest that economies such as China provide a natural laboratory for institutional change. Sun et al (2010) note how three decades of transition in China are characterized by gradual experimentation using a variety of pre-reform institutional legacies. Accordingly, 'A greater contribution to our understanding the development of VC markets is provided by papers that have used some dimension of an institutional perspective' (Wright et al, 2005a:146). Mike also pointed out 'an under-researched area concerns the influence of institutional contexts, especially the role of social networks and cultures' (2005:135).

Our research problem

Put simply, some scholars thought that as China's formal institutions developed, the use of informal institutions (e.g. social ties) for economic exchanges would diminish (Peng, 2003; Autio and Fu, 2015). However, others (Wank, 2002; Gambetta, 2000; Kim et al, 2016; Fredström et al, 2020) challenge this. This debate however pays little attention to how network tie practices may also develop in a changing environment. A recurring feature of networks is how they change and develop to cope with new circumstances (Anderson et al, 2010; Jack et al, 2008) including adapting to institutional changes (Anderson and Yiu-Chung Lee, 2008). The relationships between changing institutions and practices are likely to be dynamic (Hoskisson et al, 2013; Wright et al, 2005) and nuanced, rather than a simple transition from informality. To understand these changes, we developed longitudinal case studies examining business angels' practices over time, arguing their close engagement with their investment (Bruton et al., 2010b) enables a sharp personal, rather than corporate, focus on culturally informed practices (Huang, 2018). Our research problem was to establish how ties were used.

Institutional transition research proposes that informal institutions substitute for weak and inefficient formal institutions (Ahlstrom and Bruton, 2006; Bruton et al., 2010a; Batjargal et al., 2013). Informal institutions are relational and their ties (e.g. entrepreneur-investor ties and government connections) function within cultural environments (Ding et al., 2014); whereas, formal institutions form the regulatory environment within which informal institutions operate. Moreover, angel investors typically rely more on relational governance (Fiet, 1995; Drover et al., 2017; Xiao and Steier, 2020). Xu and Meyer (2013) argued that Wright and colleagues focus on institutional theory is a major foundation for studying transition economies. Building on this theory and the entrepreneurial finance literature (Hoskisson et al., 2013), our longitudinal case studies capture changes in the role of personal network ties. Between 1990 and 2016, we followed three investment programmes. This period saw major institutional change and improvement, so we were able to establish the dynamics of personal ties and institutional change.

China offers an interesting case. Institutional environments for the private economy and informal financial market have steadily improved from the constitutional amendments protecting the legal right to private property to granting legal status to private investors. As figure 1 shows, these move from permitting to promoting the private sector. We see how private finance has not only been formally recognised, but encouraged. Over time, legislative uncertainties have reduced (Xiao, 2011; Xiao and North, 2012; Smallbone et al., 2020). Moreover, the Chinese angel finance market is maturing, playing an increasingly critical role in venture creation processes (Batjargal, 2010; Batjargal et al., 2013). China has seen a remarkable expansion of the private equity industry (Xiao, 2020). Indeed, China is now the largest private equity industry in the world (Zero2ipo, 2016). In 2015, the Chinese risk capital fund pool reached CNY[1] 5 trillion (including CNY 2.2 trillion government backed pool), overtaking the US. Moreover, the number of risk capital firms actively investing in new and young firms reached 10,000 in 2015. This remarkable expansion and maturing situation offers a dynamic context for examining process and change in angels' practices.

In fact, we found persistent and continuing importance of entrepreneur-investor ties, but decreasing use of government connections. We saw how strong ties reduced the complexity of contracts and enabled fast deals. Moreover, the agency problem, where funded firms might pursue their own, rather than investors' interests, was subsumed within the perceived moral obligations of ties. Put simply, investors trusted individuals to safeguard their interests. Moral hazard around investment loss was diverted into the integrity of the individual, almost regardless of how the new venture was operated. For government ties, the key issue had been about gaining access. However, the better regulated regime reduced the need for personalised access.

[1] Exchange rate: 1CNY =£ 0.11 on 2nd March 2020

Theoretically, we contribute by demonstrating that treating informal relationships as a substitute for formal obligations and contracts is misleading. The culturally embedded obligations of strong tie relationships is too powerful and too useful to jettison for a transactional, legal agreement. Nonetheless, more robust regulatory environment helped to create confidence in the context, whilst network ties enabled investment processes within that context. As Puffer et al. (2010) described, stronger regulation improved confidence in perceptions about investment generally, and reduced regularity risk. Conceptually, we propose that improved regulatory environment is structural, creating greater confidence in reduced institutional uncertainty. However, ties and relationships are processual, hence enable and facilitate investment deals. Originally, relationships may well have substituted for legal uncertainty. But in the present, stronger legal environment relationships complement the greater structural certainty by facilitating deals on culturally informed personal obligation. Networks and ties thus simplify deal making and work to complement improved formal institutions.

Metaphorically, in the early stages the institutional environment was a stormy sea, with unpredictable currents and capricious weather. Network ties created a sea anchor to offer some stability in this turbulence; offering some predictability but buffeted by uncertainties. The sea has been calmed and horizons made visible. Ties are now less about weathering storms, the sea anchor has become a sail to propel the deal.

Improving regulatory institutions increased businesses confidence generally by reducing some structural uncertainties (Xiao and North, 2012, Smallbone et al., 2020). However, network ties work at a different level, they relate to individual relationships within the structure. The obligations and responsibilities of personal ties enable decision processes and are profoundly social. Accordingly, we argue business practices remain deeply embedded in Chinese culture, where personal relationships continue to inform commercial transactions. We thus offer theoretical insights into institutional theory addressing the ambiguity about the changing role of personal network ties within improving regulatory institutions (Peng and Zhou, 2005).

Theoretical framework; dynamics of institutional transitions and angel finance

Mike Wright firmly believed that institutions helped explain practice (Estrin et al. 2019; De Clercq et al. 2015). Moreover, in a conversation with Gartner and Welter (Welter et al, 2016), he proposed we also need to look at the interactions of exogenous and endogenous dimensions of contexts. For us, this signals the significance of formal institutions offering structure and informal enabling specific practices within that structure. North (1990) classically defined institutions as constraints that human beings devise to shape human interaction. Institutions take two forms; formal (e.g. laws, regulations, rules) and informal (e.g. social norms, cultures, ethics).

Baumol (1996) formalised the idea that formal institutions structure entrepreneurial practices and there is a wealth of evidence to support this at a macro level (Harbi and Anderson, 2010). The micro dynamics of informal institutions shed light on the agency in entrepreneurial practice (Anderson and Ronteau, 2017). Moreover, cultures endorse specific practices (Anderson and Smith, 2007). Yet Bruton et al. (2010a) draw our attention to risks in attributing too much to culture. Nonetheless, the dynamics of macro-level and micro-level institutions, as well as the relationships between personal network ties and formal contracts are useful in explaining firm behaviours and business practices (Hitt et al., 2004; Lau et al., 2002; Peng et al., 2009). The literature, examining contexts at the early phase of institutional transitions, notes the lack of legal protection for private property and perceived difficulties in enforcing a formal contract (Wright et al., 2005b; Peng and Zhou, 2005; Cumming et al., 2010; Puffer et al., 2010).

Personal network ties exerted some control over economic exchanges at the early phase of transitions (Peng, 2003; Xiao and Ritchie, 2009); a consequence of the weaker and inefficient regulatory institutions (Le and Nguyen, 2009; Li and Zahra, 2012; Scheela and Jittrapanun, 2012). Such network ties are typically embedded in, and formed from social and cultural roots (McKeever et al, 2014). They create a high level of trust, cooperation and dependability (Xin and Pearce, 1996; Huang, 2008). Scholars note how ties encourage entrepreneurs to fulfil their promises, thus managing possible opportunistic behaviours of entrepreneurs (Batjargal and Liu, 2004). Ties also compensate for the absence of reliable accounts and information asymmetry (Bruton and Ahlstrom, 2003; Ahlstrom and Bruton, 2006; Ding et al., 2015). In weaker legal regimes and regulatory institutions, investors relied on ties to solve disputes and enforce agreements (Trester, 1998; Batjargal et al., 2013).

Moreover, legislation-based uncertainties made entrepreneur's network ties with government officials essential for a venture's creation, survival, and growth (Peng and Luo, 2000; Peng, 2003; Anderson and Lee, 2008; Meyer et al., 2009; Bruton et al., 2010a). Government connections offer access and competitive advantage in weaker institutional environments (Li et al., 2008; Zhou, 2013). Furthermore, government connections signalled positive perceptions to suppliers and clients (Wright, 2007). Studies demonstrated such connections acting as a vicarious institution and a kind of 'roof', which works to guarantee the deal in countries experiencing institutional transitions (i.e. Russia - Batjargal, 2006; Meyer et al., 2009). Xiao (2011) found that these connections were included in evaluation criteria that early-stage investors used to make investment decisions. Nonetheless, it might be expected that increasing marketisation of the economy would reduce the importance of these ties (Lee and Anderson, 2007). In summary, we ask if the role of network ties has diminished or merely changed in the new stronger environment.

Research methods

We use longitudinal case studies to explore the evolution of angel finance and ties' role for developing theory. Case studies are particularly useful of developing well grounded theory (Yin, 1981; Eisenhardt, 1989; Langley, 1999) and Koze and Lewin (1999) suggest that longitudinal case studies provide a means of understanding the dynamics of network ties as they adapt to new circumstance. Our longitudinal case study approach enabled us to detect subtle and dynamic changes in investment processes and practices. Our research design examined changes in the use and role of ties in investment decision-making over three periods.

Time and change

We examine three consecutive periods featuring episodic changes in formal institutions (see Figure 1) and collected empirical data during each period.

Period I (late 1990s to 2004) characterised by relatively weak regulatory institutions,

Period II (2005 to 2009) with relatively stronger regulatory institutions,

Period III (2010 to 2016) saw the strongest regulatory institutions.

Figure 1 about here

During period I, the regulatory framework lagged far behind growth of the private sector (Tsai, 2002; Ayyagari et al., 2008). Indeed, the legal rights and interests of private enterprises were not constitutionally protected by the state until 2004 (see Figure 1). There was an absence of a stable rule of law and effective enforcement regime to safeguard investments (Cardis et al., 2001; Lu and Tao, 2013; De Clercq et al., 2013). Under such a weak legal system, individual investors played a limited angel role, typically providing small amounts of capital or credit to meet urgent needs for short-term finance, differing substantially from that in developed market-oriented countries (Hitt et al, 2004). Entrepreneur-investor ties and government connections were much more important than formal contracts in determining investment decisions. A very simple agreement was commonly used to govern exchanges. Nonetheless, local government officials sometimes used their power to help young firms navigate the challenging environment characterised by the weak protection of private property and problematic enforcement of contracts (Butler et al., 2003; Peng, 2003; Tan et al., 2009).

Period II saw strengthening regulatory institutions with the granting of a legal status of private lending companies in 2006. The State continued to issue national level policies further promoting the development of private sector. Provincial and local governments introduced legislation to protect businesses legal rights and interests and offered more support. The institutional infrastructure for angel finance improved (Lundstrom and Stevenson, 2005) so that informal finance became the main source for early and subsequent stages of growth (Tsai, 2017). Individual investors began providing longer-term risk capital; but typically, only to entrepreneurs with whom they had longstanding relationships (Xiao and North, 2012).

Period III saw the establishment of institutional infrastructure for the private economy and informal financial market. New policies and regulations were introduced by the State to further support private investments (see Figure 1). Formal enforceable contracts become possible for investors (Xiao and North, 2018). Broadly, structural uncertainties were progressively reduced. This improved legislative environment matched the continued rapid growth of the venture capital industry. It also supported exits from investments (Batjargal et al., 2013). Consequently, the informal financial market thrived, the volume of financial transactions increased (Tsai, 2017) and became longer term (Xiao, 2020). Accordingly, in this more mature environment for investment, we expected to see an increase in the formality of the investment processes such as due diligence and a reduction in the personalisation of decision making; a shift away from a personal relationship to a focus on the proposal.

Data collection

We held three programmes of face to face interviews (2004, 2009 and 2015-2016) with investors who had provided loans or risk capital. From these data, we developed the three longitudinal cases A, B, and C. These cases are ongoing and involve a multiyear retrospective analysis. Each case included the investor, all the investments made and the entrepreneurs of the funded ventures during the periods. It is worth noting that the early investments included in this study were made in the later 1990s. In total, we held 37 interviews; 30 interviews with individual investors and seven interviews with entrepreneurs of the investee firms.

Case A: Lao Luo (fictitious name) was born in a poor village in 1965. He left home for higher education in 1981. He then earned a Masters' degree in telecommunication technology from a top university in 1988 which led to a lecturing post in another elite university. This promising career was short lived, after four years he quit to start his own business in Shenzhen. This imported and sold high-end batteries to research institutes and universities. This business did really well and quickly made his fortune.

In 1998, he turned his attention to financing other businesses. Initially this involved in supporting his friends running businesses in the same industry by offering small amounts of finance. When we asked about how he made decisions he explained he knew entrepreneurs, their family, and business activities really well. His role was to be an angel in his community.

Table 1 about here

Case A includes five longer-term equity investments and tens of short-term investments that Luo has provided to connected ventures from the late 1990s to 2016. Table 1 summarises the attributes and performance of those equity investments as well as features of social ties.

Case B: Zhu Zi (fictitious name) was born in a poor village in 1963. He became the youngest lecturer of fibre-optic communication at an elite university when he was earning a Master's degree from a top university. He was quickly promoted to a professor. His success in academia did not prevent him from establishing his own business in the late 1990s. He too made a lot of money quickly, dominating the Shanghai and Beijing market for imported scientific batteries.

His remarkable business success made him a target investor for his family and friends' businesses. In 2003, his nephew began a business manufacturing navigation devices, and invited Zi to become a business partner. Zi told us that he felt responsible for helping the new generation of his family in their career. One interesting elements of this social obligation was to accept a high level of risk in the investments. To balance this, he made several investments, hoping that one of his investee ventures would have a successful IPO.

Table 2 about here

Case B offered eight longer-term equity investments and tens of short-term investments to connected ventures during the studied periods. Table 2 shows the attributes and performance of those equity investments as well as features of social ties involved.

Case C: Zhang Hong (fictitious name) had a different career path from the other cases. He was born in a city in 1964. After obtaining a first degree in telecommunication technology in 1985, he joined the Army for a couple of years, but then secured a senior position at a large state-owned telecom company in Shenzhen. This was a period of remarkable transitions in China and the opening of opportunities in the private sector for the brave. Like many friends, he quit 'the iron rice bowl' of the state sector to begin manufacturing producing fibre-related electricity products in the early 2000s. The business developed into becoming a key player in the industry.

Similar to our other respondents, commercial success led to a high profile and many contracts and connections. Hong was active in the community and become well informed about what was going on, including financial needs and investment opportunities. Initially he supported friends by offering modest working capital. This led to becoming an angel investor. His approach was based on a strong belief in building strategic alliances, rather than simply investing. Accordingly, he invested in friends who were his clients and suppliers.

Table 3 about here

Case C had two longer-term equity investments and tens of short-term investments. Table 3 displays the attributes and performance of the equity investments as well as features of social ties.

Longitudinal case study development

Figure 2 describes the case studies, 2004-2016. From previous work, we had a sample of 74 firms from which we selected 6 who had provided finance to other firms. These formed our original cases. We asked them broad exploratory questions; how did you know about the investment opportunity? How did you evaluate the venture and the risk? We also enquired about personal network ties; how did you know the entrepreneur? How did that influence the investment decisions? How did personal network ties work?

Figure 2 about here

The 2009 interviews found that only four of the original sample continued to invest. We revisited the original themes and added the theme of experience; tell me about the investment performance and why was this? Did your investment performance impact on new investment decisions and practices?

Preliminary analysis of the 2004 and 2009 interviews suggested some changes to the characteristics of offers (e.g. increased amount of capital and term) and subtle changes to the influences of personal network ties for decision-making. After the 2016 interviews conducted, the three longitudinal cases were successfully developed. It is worth noting that one case without interviews with entrepreneurs of the investee ventures was excluded.

Data analysis

Given our interest in practice and change (Figure 3), we analysed the 2004 data employing thematic analysis (Jack et al, 2015). The interviewees had actively talked about network ties with either themselves or a third party and where those ties originated. Analytical constructs of long-standing relations, high level of trust and dependability emerged from the data. Analysing the role of personal network ties in decision-making, process constructs (i.e. helping gather faithful and less biased information, confidence about reduced relational risk, ability to help deal with legislation-related uncertainties, helping win contacts and gaining access to resources) helped us distinguish the role of entrepreneur-investor ties from government connections. When examining investment practices, items such as simple agreements, quick decisions and perception of the venture appeared. Analysis of the 2009 interview data was guided by these constructs but looked for changes. We repeated this for the 2016 data.

Figure 3 about here

Our final task transformed these data into our cases charting the evolution of practices in context (Yin, 1981). Distinctive patterns of each case emerged and were compared and synthesised to generate thematic patterns across cases (Eisenhardt, 1989).

Findings

An early, but enduring, finding was the critical role of social connections. This was explained as how culture stressed the importance of personal ties in determining responsibilities and obligations. We saw how the tie was a relationship between people, but operationalised commercially. This, we were told, is how business is done in China. We saw this as an 'informal' cultural institution. The logic was that given the unpredictability of the environment, the investment was in the entrepreneur. Chinese culture imposes responsibility on the entrepreneur to fulfil his promises, regardless of how the new business fares, or how the environment changes. Reliance was placed on the individual, regardless of the formal environment.

Evolution of early stage angel finance and embedded personal network ties

Tables 1, 2 and 3 indicates a remarkable change from offering short-term lending to longer-term risk capital to early-stage ventures as the regulatory institutions improved. Nonetheless, investors clearly preferred to build a business partnership with those embedded in a long-standing network relationship. This remained largely unchanged, regardless of the improving regulatory institutions. As an informant commented about his equity investment of CNY 500,000 for 10% of the manufacturing business shares: "*Making the decision was rather easy for me. We were university classmates and keep in touch on a regular basis".* Looked at from a purely economic logic, this long-standing relationship offers little explanation. Why should a shared academic background provide confidence for an economic transaction? We can recognise similarities to western appreciations of the value of social capital (Anderson and Jack, 2002) and how knowing the 'other' in exchanges eases transactions (Anderson and Hardwick, 2017; Hardwick et al, 2013). But the cases describe a much stronger relationship based on mutual affiliations, a ‘special relationship’ (Zhao et al, 2010; Ding et al., 2014). We propose this is a cultural outcome of, and a social response to China’s traditional hierarchical structure and the ensuing low trust society described by Fukuyama (1995).

Compared to angels in developed countries, our Chinese angel investors employ close social links, associations or shared experiences, typically relating to shared elements of personal identity (see Table 1); (i) school/university (i.e. former classmates), (ii) place of work (i.e. former colleagues, clients, suppliers), (iii) kinship (i.e. family friends), and (iv) home town. Investing in people with shared culturally rooted social identities suggests, regardless of transitioning regulatory institutions, the value placed on trust and dependability within a social and cultural link (Huang & Wang, 2011; Fukuyama, 1995; Ding et al., 2015).

Table 1 about here

Evolution was demonstrated within the deepening patterns of financial involvement. Short-term finance successfully repaid encouraged investors to explore longer-term investments. We attribute this to the similarly deepening experience of the relationship. Trust in, and experience of, the integrity of the people and trust in their capability built a strong personalised foundation for developing the informal financial market. Experienced investors started to provide equity finance to businesses, especially for high growth firms. However, our analysis shows that for investments made before 2010, the returns and performance were not as good as investors had hoped (see Table 1). Informants suggested the major reason was sudden changes in regulatory institutions. For us, this reflection of continuing uncertainties illustrates the practical logic of investing in the relationship rather than the business.

Despite the poorer performance, in the 2010s investors continued to offer equity capital to early-stage ventures, but with a marked change towards investing in early-stage ventures within their area of expertise. Investors A and B invested a total amount of CNY 500,000 of equity capital in a start-up producing CMOS sensors for 8% of the business shares in 2014 respectively. The two investors had previously owned business in the same field in the 1990s and had specific industry expertise. Investor C stated: *“I was delighted to offer US $100,000 for 3% of business shares to my client company producing Z-Chips in 2015.”* (Case C, 2015 interview). These findings demonstrate a relationship built on shared experiences and perceptions, but extended into commercial transactions. We saw this as a trust platform which investors employed to inform decisions.

However, investors A and B were initially less selective about the type of firm and offered funding to firms operating outside their experience. Decisions were entirely based on the long-standing personal relationships 2004 to 2009. Later, advanced industry knowledge was added to the evaluation criteria (Cases A and B). Nonetheless, investor C only provided funding to firms run by his university classmates operating in the same industry (Case C). Clearly, entrepreneur-investor ties continued to be the determining factor even as the evolution was informed by industry experience.

Enduring influence of entrepreneur-investor ties

Our analysis indicates the continuing importance and role of embedded entrepreneur-investor ties. Table 2 demonstrates how investors also employed entrepreneur-investor ties from rooted social links to understand opportunities and gather timely, accurate and useful information, regardless of the improving institutions at both macro and micro-level. Shared views and values, social closeness, provided a basis for discussing and informing the investment opportunity as well as the potential partnership at an early stage of development; even before a venture was created. Investor A commented: "*we knew the business idea before discussing about the investment potential since we chat about our businesses on a regular basis.*" (Case A, 2015 interview). Investor B, analysing his equity investment in a business solution firm founded and run by his former colleague, who is also from the same province, stated: *"the entrepreneur was so excited about the fast growth of his business each time chatting to me. I had learnt about the business before being invited to be a business partner and made my investment decisions quite quickly"* (Case B, 2009 interview). Ties informed investors about the project, but supported by knowledge about an entrepreneur's family, clients, suppliers and ambitions through previous conversations. Investors believed this information gathered through the shared social links was comprehensive, faithful, and less biased for evaluating the quality of the venture and risk (Pollack and Bosse, 2014). Trust and integrity remained key, as investor A commented: *"my investment to the venture was a convertible offer. I believe the entrepreneur would sell his properties to pay me back if things went wrong."* (Case A, 2015). For us, this comment signals belief in the integrity of the individual. It clearly reduces the nature of risk and decreases uncertainty.

Table 2 about here

Shared views and values, as well as shared personal identities worked to improve investors' confidence. The emphasis was trust built through entrepreneur-investor ties and less on commercial elements when making their decisions (Mitteness et al., 2016, 2012). As investor B stated: *"the offer that I made was based entirely on the entrepreneur whom I knew since we were 6 years old, and we always chat about our businesses and life"* (Case B). It reflects how bonded relationships caused investors to rely on a few of key, largely personal and contextual elements rather than a full set of evaluation criteria for funding decisions. Moreover, trust in the individual becomes a heuristic means of mitigating perceived risks.

Changing influence of entrepreneur-investor ties

We note how entrepreneur-investor ties better enabled angel investors to make longer-term investments as legislation-related uncertainties reduced. Thus, we saw how legislative uncertainty had previously led to short term investments. However as regulatory uncertainty declined, a longer-term view became possible. We are able to conceptualise two different forms of uncertainty. First the structural uncertainty and second behavioural or process uncertainty such as moral or performance hazard. Initially, ties addressed the risks manifest in both forms, for structural risks, the investment outcome was short term flexibility, but as legislation became stronger, the perceived riskiness lowered allowing a longer term view. However, the processual social importance of tie obligations and responsibility continued.

Bonded relations between entrepreneurs and investors help reduce relational risk, but over time also developed trust in the capabilities of those entrepreneurs to grow the venture and achieve long-term business success. Furthermore, the nature of investment involvement extends beyond the provision of capital as a one-off event and demonstrates the faith in the individual. Investor B explained, *"If this investment fails, I believe the entrepreneur would succeed in the future in which a chance of me playing a role in his business increases."* (Case B). It reflects a network-based investment strategy used by investors, strengthening the bonded relations in anticipation of future collaborations. The perceived benefit of embedded personal ties lies not only the current deal, but also in future collaborations. Mutual obligations form in this network-based strategy that is demonstrably long term and processual. Entrepreneurs are not only socially accountable for single event funding, but also address investor's longer aspirations. These responsibilities are reciprocated, leading to a robust but flexible commercial platform.

Investor B commented, *"we (my university classmates and former colleagues) meet quite often, and chat about our businesses and life."* (Case B). This represents a robust and enduring social platform, created from shared social and cultural links, that enables informed interaction. Such socially embedded interactions can motivate all the stakeholders to share resources (Uzzi, 1999), even allowing investors to detect any potential problems and provide relevant advice or assistance at a very early stage.

Decreased value of government connections

Under a weak regulatory framework, government connections can assist a firm by helping win contracts, obtain grants, gain approval for doing business, solve disputes and provide information (Li and Zhang, 2007; Li et al., 2008; Walder & Zhao, 2006; Zhou, 2013). Moreover, well connected early-stage ventures were perceived by investors to have a competitive advantage (Batjargal, 2010). This example shows the importance of these connections, *“I frequently offer project-based equity finance to an entrepreneur who was my former employee. He has a better chance of winning contracts from one of my previous clients than myself, since the current senior manager of the client company is his classmate”* (Case A, angel A, 2004 interview).

Government officials hold considerable power in interpreting relatively unclear policies and for providing approval for businesses. Previously, even the protection of property rights needed a government official’s support (Ahlstrom & Bruton, 2006). With stronger regulation this power diminished. Investor B had an equity investment in a residential property development in 2007, “*I had initially considered several local officials holding a proportion of business shares as a security for my investment in the business. However, they later failed to gain approval for the real estate development on time, leading to a trapped investment.”* (Case B, 2015 interview). It appears this poor equity performance resulted from the reduced power of the government connections.

As local authority control weakened, the benefits and competitive advantages of ties to officials also decreased. Investors A and B stated how sales of their high-quality batteries fell year by year because several of their university classmates moved to new positions and no longer helped win contracts (Cases A and B, 2009 and 2015). Investor B, (2015); *Central government tightened the legislation that strictly restrict the* *use of farmland for residential property development in 2009, and local government officials could not approve the documents that they had promised."* Investor A's experience was worse: "*The founder's arrest caused my investee company to go completely wrong. He was accused of wrongdoing at his previous job as a local government official"* (Case A, 2015 interview). We see this diminishing competitive advantage from government ties resulting from the stronger regulatory regime.

Interestingly, entrepreneurs of early-stage ventures continue to network with some local government officials on the basis of shared personal identities. These entrepreneurs were the first to gain information about changes to the business environment (Xin & Pearce, 1996; Zhou, 2013). Critical structural information included policy changes, amendments to legislation and government support. *"I was encouraged by my hometown fellow who works in local government to apply for a government grant and got it"* (Entrepreneur 1 from Case A, 2015). Entrepreneurs maintained connections but put less effort into maintaining and strengthening relationships. Investor B commented: *"in order to maintain a close friendship, I now offer small gifts to my classmates who work in the public sector"* (Case B, 2015 interview).

Social processes and a simple contract

Despite the availability of complex legally enforceable contracts, all our informants repeatedly told us about their simple contracts. We saw this as continuing reliance on the social obligations of network ties and the special relationships. We were told how regular events such as dinner, family visits, site visits, and members gathering maintained the bond. Such links also enable to investors socialise and connect with a third party (i.e. customer or supplier). This embedded personal networking process is profoundly social. The interaction processes build strong and enduring relationships which are much more flexible than a legal contract (Wang and Gordon, 2011). They also function as a powerful control mechanism over an investee venture (Ahlstrom and Bruton, 2006; Welter and Smallbone, 2008). The adaptability and flexibility helps with rectifying mistakes or misunderstandings, resolve conflicts of interest and minimise any negative impacts. This socially embedded mechanism appears very effective in conditions of remaining uncertainty. Of course, the problems associated with strong ties and over-embedding remain. It becomes difficult to avoid obligations when these become commercially problematic. More significantly, over-embedding closes off the arrangements for outsiders. The clique becomes a powerful clan that can shut out useful new members.

Nonetheless, the simplicity of the contract with its implied obligations facilitated fast payments and deal flows. Our informants repeatedly commented: *"I do not think it is necessary to produce a contract with a long list of covenants, and I always made a transfer of the full amount of capital agreed days after a simple contract has been signed"* (2009 and 2015 interviews). This is also illustrated here: *"I received the full amount of the investment capital from three business partners in a week after a simple contract signed"* (Case A, entrepreneur A, 2009 and 2015 interview). The embedded network ties make a complex contract unnecessary, avoiding delays. Indeed, legal complexity might even damage the trust between entrepreneurs and investors (Batjargal and Liu, 2004; Ahlstrom and Bruton, 2006).

Nevertheless, there is also an awareness of shortcomings of these simple trust-based contracts. Investor B assessing the performance of his equity investment: "*I could have received dividends by now if the entrepreneur had better managed the cash flow. I wish I had added more details about stock control to the contract"* (Case B, 2015 interview). Investor A grumbled, *"I have not received any dividends from the firm run by my best friend, although the business has been doing well."* (Case A, 2016 interview). Opinions about complex contracts did vary depending on a business partner. Investor C commenting on his 2014 investment: *"I had a lawyer look at the contract drafted by the investee firm that is owned by Americans and operated in the US. It was new to me, but I am happy with the experience"* (Case C, 2015 interview). It indicates that a subtle change in investors' views over time, towards using a more detailed contracts when appropriate.

This social situating of Chinese business suggests that practices may continue to differ from the US and Europe (De Clercq et al., 2006; and Fairchild, 2011; Ding et al., 2014). Although new regulations open possibilities for more market driven decision making, we found a continuing reliance on personal ties. Mike Wright had suggested we look closely at the interplay of institutions, formal and informal (Wright et al., 2005). We did this and found these nuanced relationships. We argue these are not solely market driven practices but seem almost determined by the cultural obligations that characterise the social ties of our investors. There are obvious advantages, but considerable problems for those lacking social connections.

One of our reviewers astutely pointed out the processes of unfolding legitimacy in our processual data. He noted how increased structural legitimacy related to change, balances, in cognitive legitimacy (Zimmerman and Zeitz, 2002). Tsang (1996) had pointed out the importance of legitimacy for entrepreneurs in China's uncertain environment. Webb et al (2008) describe how formal institutions confer legal legitimacy on what may have been informally cognitively legitimate in terms of values and beliefs. They propose that entrepreneurial activities taking place in the informal economy fall within informal institutional boundaries (i.e., norms, values, and beliefs). De Clercq and Vornov (2009) discuss the social construction of legitimacy (cognitive) which Anderson and Smith (2007) described as the moral space of entrepreneurship. This serves as a useful conceptual contrast to political, formal institutional legitimacy in the dynamics of China's move to a market economy.

Discussion, future direction and conclusion

Using Mike Wright's insights, we identify, chart and theorise the roles and practices of business angels' network ties in changing formal institutional environments. We found strong evidence of how profoundly social relationships shaped investors' decision making and how they monitored the processes. The attitudes of Chinese people towards entrepreneurship became more positive as the institutional environments improved (Smallbone et al., 2020). The enhanced confidence encouraged much longer term financing and investment. This contrasts with the short term and flexible lending of the less regulated regime. We theorised the evolution of angel investment practice is a response to structure, the uncertainty of what governments might do. We showed how social ties provided an effective mechanism to overcome the structural uncertainty in dysfunctional institutional environments. The obligations associated with strong ties acted as a risk control mechanism through which the opportunistic uncertainty is reduced. Investment decisions were made in the relationship, rather than in the business.

As regulatory uncertainty reduced, tie role and work shifted to prioritise the impact on processes rather than structure. The changing role of ties focused on opportunistic risk rather than legislation-related uncertainty. We offered evidence from the much-diminished importance of ties to government to support this analysis. This was not to say the influence and importance of ties reduced, it merely changed. We saw more sophisticated and longer-term investments shaped by strong social ties. In evolutionary terms, the role of ties moved to more general management of the investment processes. Knowledge and experience evolved too and played a greater role. We noted how regular social exchanges such as meetings and family involvement- socialising- maintained obligations. What did not change was the source of the tie, links were always formed from historical affiliations; classmates or shared home towns. We criticised this as over-embedding, because it seriously restricts the range of connections.

Our overview was that these transactions demonstrate the socially embedded nature of business in China. It could be argued that ours were extreme cases of operating in conditions of uncertainty. The new ventures had no track records and the entrepreneurs were largely new to the game. The products often had novelty and markets were unclear and the angels lacked investment experience. Yet even as extreme cases, they shed light on how business processes are embedded in social relations. In such a potent mix of risk and ambiguity with obscure outcomes, this falling back on well-established cultural norms makes good sense. Nonetheless, we saw that even when some uncertainty was removed, the socialised system of network ties and socially defined obligations moved ties from control mechanisms to being used to fasciate better, larger and longer deals. It appears use of the system evolved to meet the changed circumstances. This seems to us to confirm our view of Chinese business practices as socially embedded and socially enacted.

Future research, implications and directions

We noted how the extent of uncertainty made ours an extreme case. It would be helpful to examine the roles of ties in less extreme conditions. Moreover, we asserted that culture created the usefulness of these social ties. Hence it could be useful to examine finance and credit practices in different Asian contexts. This could establish the uniqueness of Chinese culture. Ours were strong ties, yet the literature suggests that weak ties bridge structural holes. Consequently, a future focus on weak tie development would be interesting. Finally, we will continue to monitor these angels in the increasing marketization and maturity of the Chinese economy. Evolution may take personal ties and networking in interesting new directions.

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