Informal Venture Capital in Emerging Economies: A Case of Pakistan

Abstract

Venture capital in emerging economies is part of shadow economy and consequently under-explored. The paper attempts to disentangle the hidden operations of informal venture capital (IVCs) in emerging economy such as Pakistan. Moreover, the study examines the impact and consequences of the un-documented economy, the role of IVCs and networks that give rise to the shadow economic systems. Using 21 semi-structured interviews, (1) we developed a conceptual framework to study the presence of IVCs; (2) the analysis suggests that IVCs fil the finance gap where formal financial institutions and government funding schemes failed to meet the needs of high-growth entrepreneurs; (3) IVCs have a significant presence in case of Pakistan and serve a vital role in promoting economic well-being; (4) the findings suggest that government-sponsored schemes give rise to favouritism and malpractices in the distribution of funds give rise to “Hybrid” IVCs operation; (5) finally, our results suggest rationalisation of IVCs promote sustainability and agenda for entrepreneurial growth. The findings have implications for policymakers to develop venture capital market and facilitate the transition of IVCs to formal capital market.

Keywords: Informal venture capital, sustainability, shadow economy, emerging market

1. Introduction

In a world where environmental challenges have gained momentum, sustainability issues are now an integral part of evaluation for an investment projects. Informal finance in developing economies has gained importance for environmental innovation (Guo et al. 2021; Tonoyan et al. 2010). In the current environment, informal finance providers perform a vital role in fostering a sustainable path to economic growth. Mason & Harrison (1993) defined informal venture capital as business angels who provide risk capital to entrepreneurial businesses. However, in the case of Pakistan, we found there exists a category that is more than business angle and lesser than formal venture capitalist. Therefore, the established category fails to capture the operations of informal venture capital (IVCs). For this reason, we defines IVCs as a group or individuals who invest in undocumented viable enterprises in return for equity without legal status/protection in Pakistan. Access to finance from formal or informal institutions is a prerequisite for the development of a progressive and goal-orientated entrepreneurial ecosystem to stimulate innovation and economic growth (Bustamante, Mingo, and Matusik 2021). Informal venture capital, through equity finance, catalyses the advancement of innovative green solutions (Niu et al., 2023) . IVCs in emerging countries have extensive networks, both at formal and informal levels, to organise finance for large-scale investment in green technologies and sustainable projects. Although formal financial institutions have extensive networks and expertise in identifying companies suitable for VCs, but they are exposed to stringent regulatory compliance and bureaucratic burdensome that increase their cost of doing business. Whereas IVCs have low compliance costs due to their invisibility from regulatory authorities (Niu et al., 2023).

Informal venture capitals are independent in decision-making and less exposed to bureaucratic intricacies; allowing them to experiment, take on risks and manoeuvring strategies as required by circumstances (Atahau et al. 2021). Memduh Eren et al. (2022) report that IVCs are not without challenges such as regulatory, operational and technological advancement. Informal venture capital carries limited expertise to handle the complexities of the evolving green industry; informal businesses have limited access to formal financial markets to access cheap finance that often are at the mercy of IVCs and the cost to access finance may be higher. Furthermore, the absence of regulatory oversight, weak operational structure, and limited expertise in risk assessment practices expose the IVCs to potential fraud, mismanagement of resources and volatile returns (Chu, 2021), forcing them to seek higher returns. Therefore, balancing the benefits of IVCs with a stable source of finance to address the environmental complexities remains a challenge for emerging economies.

It has been suggested by Memon et al. (2022) that IVC positively influences environmental sustainability through investing in renewable energy-efficient technologies. Although several studies (Bakry et al. 2023; Chen et al. 2023; El Khoury, Nasrallah, and Alareeni 2023; Khan et al. 2021) have reported the beneficial impact of collaboration between formal and informal venture capital investment in green technologies. However, there is still limited research that explores IVCs' presence and impact in emerging economies such as Pakistan.

The growth of venture capitalists in the Western developed countries suggests that small innovative companies benefit from access to venture capital markets (Bustamante, Mingo, and Matusik 2021). This has attracted policymakers to pursue policies to encourage the growth of VCs in the emerging economies too. However, the success of venture capitalists must be viewed in the national context of each country as they are at different stages of maturity and regulation (Bustamante, Mingo, and Matusik 2021; Foo, Vissa, and Wu 2020). Developing countries are characterised by lax formal regulations that negatively impact confidence to do business and the poor legal frameworks are deterrent. There is an array of emerging markets, ranging from complete institutional voids to moderately regulated markets (Khanna, Palepu, and Sinha 2015). Such a range of financial market regulations and environment suggest that emerging markets cannot be considered homogenous entities (Grilli, Latifi, and Mrkajic 2019; Moore, Dau, and Mingo 2021) and venture capital operations practices vary. Therefore, venture capital markets, especially operating within the shadow economic environment are not directly comparable with the developed economies, nor one public policy instrument is directly replicable (Grilli, Latifi, and Mrkajic 2019). This suggests that institutional operations and the environment are fundamental drivers of venture capital market creation. However, in an aspect of emerging markets, the researchers failed to adequately analyse the challenges faced by venture capitalists that operate within the ambit of the shadow economy and their inaccessibility to the researchers.

It has been suggested (Bertoni, Colombo, and Quas 2019; Meuleman et al. 2017) that institutional infrastructure is a motivating factor for access to finance for small enterprises with the potential to innovate and grow. The institutional environment is part of broader formal and informal systems that provide legal as well as political and social norms that regulate participants' behaviour within the society (North 1990). Formal institutional operational practices are regulated by government legislation that regulates transactional, behavioural, and ethical practices within the economic system. Formal venture capitalists are better positioned to publicise their service to potential entrepreneurs and provide finance for projects with considerable risk and high-growth innovative startups and growth-oriented businesses. However, informal venture capitalists’ operatives are not easily accessible nor reachable to entrepreneurs. The nature of their transactions is non-documented, not regulated, therefore such relationships are susceptible to differences and conflicts that do not fall within the ambit of regulations to resolve the business-related conflicts. There have been studies (Gilson and Schizer 2003; Wallmeroth, Wirtz, and Groh 2018) that have examined the presence, functioning and effectiveness of venture capital institutions to support with finance and mentoring of potential innovative enterprises which may not succeed otherwise. The literature review has suggested that there are limited studies (Grilli, Latifi, and Mrkajic 2019; Li and Zahra 2012) that specifically attempt to provide a rigorous analysis of the informal venture capitalist operations within emerging marks such as Pakistan, therefore there is a gap in the literature and a need to analyse and theorise IVCs operation in an emerging economy. This study attempts to fill a gap in the literature by providing a theoretical perspective and complementing this with empirical primary research findings to analyse the operation of IVCs to derive recommendations for policymakers in emerging markets to facilitate the transition of IVCs from the informal to the formal market.

This research is novel in that it explores the existence of IVCs within the emerging market, examines the scope, breath and attempts to demonstrate the benefits of IVCs for an economy such as Pakistan where legislative instruments are barriers to creativity, innovation, and entrepreneur growth. The study, having reviewed the complexities of emerging economies proposes that policymakers in the emerging economy need to examine the interplay between legislative environment, institutional developments and enterprise culture when considering promotion of venture capital. It is suggested by (Bustamante, Mingo, and Matusik 2021) that informal institutions such as IVCs are associated with culture, values and norms that need to be analysed to promote the VCs activities. Universally but more so in emerging economies financial and social institutions are heterogenous, therefore there is no one policy prescription to promote VCs. However, what pathway precedes before IVCs could help transition to the formal economy is a question, that requires a robust theoretical framework followed by a rigorous empirical study to examine the interaction between IVCs, and the broader economic and legislative environment.

This research was carried out in Pakistan in the provinces of Punjab – the largest province of Pakistan and Khyber Pakhtunkhwa. Using informal networks within the entrepreneurial communities, we carried out twenty-one (16) face-to-face interviews and twelve (16) using online technologies. However, the research objective was to reach IVCs to explore their operational approaches and the size of their portfolios. Furthermore, we explored with the participants the process of identifying suitable ventures which may benefit from the sizeable funding, and support to harness their full potential. The researchers being part of the regions were able to tap into informal, and formal networks, technocrats, and government officials. Therefore, this novel study, to the best of our knowledge, is the first of the kind that provides insight into the operation of IVCs within Pakistan. This study's findings will provide impetus for further studies into IVCs in emerging economies and the findings lend themselves to replication for other economies.

Pakistan has experienced a turbulent journey over the last seventy-seven years in terms of political and economic events, that have negatively impacted the legislative and institutional environment leading to the growth of a shadow economy and IVCs. Therefore, Pakistan is an interesting economy to consider. Pakistan has been governed by democratic, technocratic, and military. The punctuating history of the country and unstable institutional and legal developments have hampered the country’s progress; which has negatively impacted the growth of public policies to promote a formal economy and robust institutional framework. Therefore, financial institutional development in Pakistan is lagging. Consequently, the venture capital market remains underdeveloped, and invisible, and has emerged in the form of IVCs.

Pakistan is characterised by duality in that the corporate sector, well-funded by financial institutions, is documented with the strong presence of subsidised public sector ownership. Whereas there is a large swath of non-documented enterprises that have the potential for innovation and high growth but are negatively impacted by the lack of supply-side finance. Therefore, this opens opportunities to the informal lenders at the lower end to provide finance at a higher cost. Wealthy individuals and cartels also operate in this non-regulated informal domain; these operatives could be classified as IVCs who seek innovative, growth-oriented and progressive enterprises which may benefit from capital injection. Furthermore, the IVCs are better positioned to access preferential treatment, given their influence derived from their networks, from the government sector to divert resources from formal to informal sectors. Thus, Pakistan provides an intriguing scenario where informal operations dominate the formal sector (Mughal and Schneider 2020). Wallmeroth, Wirtz, and Groh (2018) reported venture capital operations are profitable compared to conventional investment, this suggests the same should be the case with the IVCs. However, the IVCs market is invisible and prefers anonymity (Harrison and Mason 1996). In the case of Pakistan, due to the large presence of the shadow economy, fewer taxpayer base and the higher incidence of informal practices lends itself to IVCs operations. Therefore, this research is novel in that it offers a new perspective to understand the role of IVCs within Pakistan. We expect this study to open new avenues for research and empirical studies that explore how IVCs operate and support sustainable projects within emerging economies. The following questions are investigated: firstly, we investigate the presence of informal venture capital operations within the emerging economy such as Pakistan. Secondly, it examines the institutional and regulatory framework. Thirdly, it investigates the cultural, capitalist masculinity and elite collegiality that protects the fungibility of capital invested within the informal sector. Fourthly, whether the institutional infrastructure is a motivating factor for access to finance for small enterprises.

The structure of the paper includes section 2, where we conducted a critical review of the literature; section 3 describes our methodology approach. Onward Section 4 describes the data analysis, section 5 analyses the study results and Section 6 describes the conclusion and further recommendations.

2. Literature review

2.1 Significance of finance, social capital and growth of venture capital

The entrepreneurship literature highlighted the significance of finance and social capital for the creation and growth of new ventures (Zhang, Chen, and Zhou 2020). Informal venture capital (IVCs) operations are heavily reliant on social capital as a resource to connect the supplier of finance with potential entrepreneurs (Nahapiet and Ghoshal 1998). Shane & Venkataraman (2000) advocate due to high asymmetrical information, individuals with high social capital can connect with one another, therefore social capital is an enabler that provides entrepreneurs resources to identify, evaluate and exploit opportunities (Aldrich and Zimmer 1986). In the context of Pakistan through literature review and interviews with IVCs, we found informal market exists that draws on social, reputational, and cultural capital and operates outside the legal framework. Therefore, this study offers a more nuanced view of the role of the IVCs market that helps to disentangle the relationship, operations and invisible operating practices that are not norms in western economies.

The venture capital market and institutions have a long history of operations in the Western economies, and it gained traction in the USA during post post-Second World War (Kaplan and Lerner 2016). The term venture capital suggests risk capital supplied by individuals or institutions to promote high growth and innovative technological growth-orientated enterprises. The concept of venture capital was popular amongst policymakers interested in economic growth (Grilli, Latifi, and Mrkajic 2019; Pistoresi and Venturelli 2015; Pradhan et al. 2017). There is considerable literature that reports the finance gap for small and medium-sized enterprises (Deakins and Hussain 1994; J. Hussain, Millman, and Matlay 2006; Vasilescu 2010). The finance gap is attributable to reluctance on the part of formal institutions to provide risk capital to viable enterprises (Yao et al. 2024); giving rise to type 1 (viable enterprises fail to secure adequate finance) and type 2 error (supplying finance to firms which are most likely to fail) (Deakins and Hussain 1994). A-prior reasoning would be that developed countries have superior finance markets, that can meet the adequate needs of growth-oriented innovative enterprises. However, developing markets which are characterized by imperfect capital markets, lack sophisticated technologies and financial literacy to assess the financial risk to make lending decisions. The emerging finance gap is addressed by informal venture capital in developing countries and formal venture capital institutions in developed countries, such as the UK and, USA. There is now considerable literature that has examined, in the US, the role of formal venture capital (Gompers and Lerner 2001; Van Stel, Storey, and Thurik 2007). Formal venture capital (FVCs) invests in small and young startup companies that require large amounts of money and can benefit from support mentoring and close involvement from an experienced team of VCs. In the US, VCs fund sizes are more than USD 100 - 218 million (Cumming and Dai 2024).

However, there is limited literature that explores the presence of informal venture capital, more specifically in developing countries that lack regulated financial markets and legal institutions such as Pakistan. Formal capital markets have promoted the presence of venture capital markets. Venture capital institutions often are aligned with the equity market (Lerner 2010). Formal VCs presence is linked with the progressive legal institutions, taxation instruments (Da Rin, Nicodano, and Sembenelli 2006) and the regulatory system Mingo et al. (2018) operating within the country. Lack of formal venture capital has a negative impact on the supply side of finance, therefore informal VCs are the main supplier of finance for enterprises which have growth potential but are unable to raise an adequate large amount of capital to exploit their potentials. Informal venture capital is therefore a new phenomenon observed in developing countries, to meet the needs of progressive, potentially high-net-worth firms.

The review of literature suggests there is a gap in scholarship that adequately examines and analyses the challenges for the venture capital operating within informal markets and their market dynamics to promote sustainability agenda as well as supporting employment creation and domestic economic growth. The IVCs operating within developing countries lack visibility and recognition within the documented/regulated economies (Ahlstrom and Bruton 2006). There is a dearth of empirical evidence that examined the impact of IVCs within developing countries but there are few studies (Eesley et al. 2018; Grilli, Latifi, and Mrkajic 2019) that examined the combined effect of formal and informal VC markets on the supply side of finance for high growth firms. There is a strong correlation between formal VCs, governance, and the growth of viable high-risk enterprises (Li and Zahra 2012). However, it is contended that economies with developed financial institutions and governance have better access to finance for enterprises, VCs have greater visibility and deep embeddedness. Whereas IVCs presence is often associated with economies that are characterised by archaic legal frameworks and underperforming financial markets.

Sustainability is defined by the World Commission on Environment and Development (1987) as "the commitment of business to contribute to sustainable economic development…." implying working with all stakeholders to improve their quality of life through job creation and access to high earnings. To understand the interplay between financing and sustainability is essential to develop strategies to mitigate the negative impact of environmental degradation. Financing methods have implications for the adoption of sustainable practices in the economies (Guo et al. 2021). Formal VCs have access to vast capital resources, risk evaluation expertise, when investing in sustainable technologies and innovations (Niu et al. 2023) and to foster practices to share knowledge and mitigate the environment risk (Guo et al. 2021). However, emerging economies are characterised by low financial deepening and underdeveloped markets where formal VCs presence is lacking due to considerable risk, therefore, IVCs fill the gap (Sohail et al. 2020).

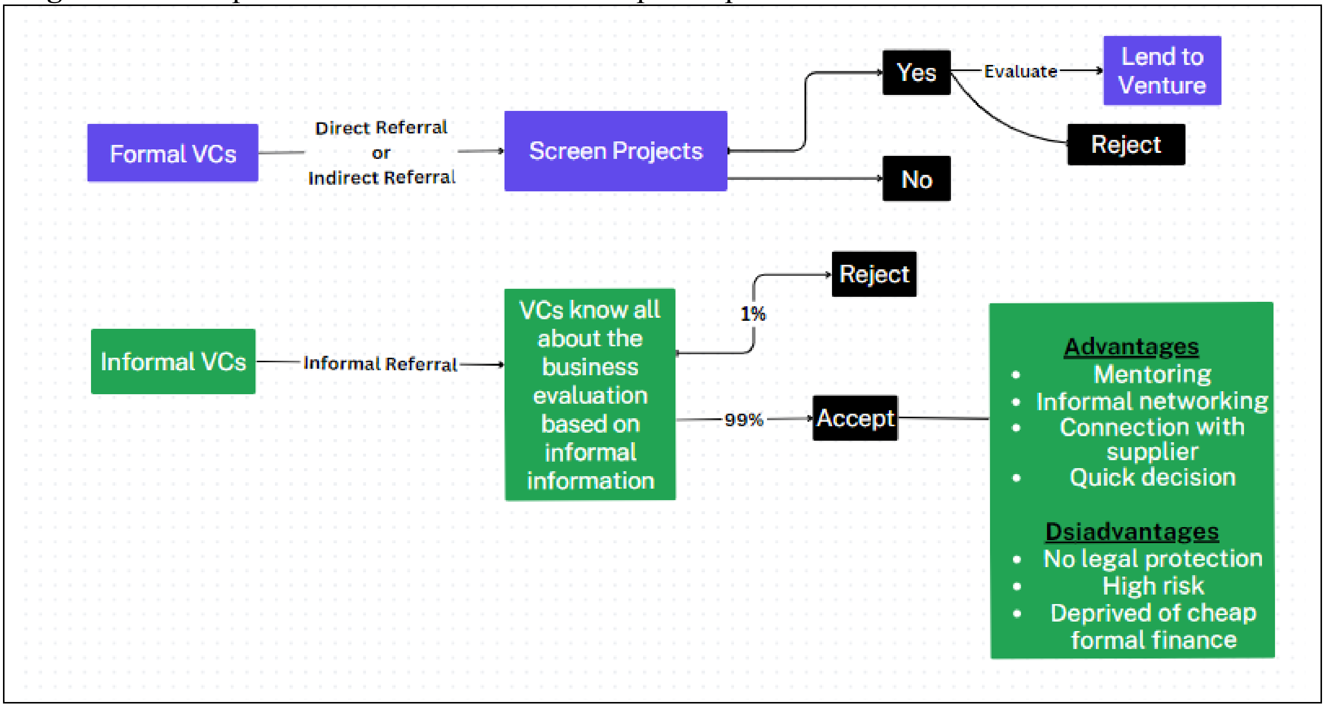
Lian et al. (2023) reported a positive impact of informal financing on green innovation in line with the findings of (Feng et al. 2022), who associate informal financing with the growth of entrepreneurship innovations. This suggests IVCs strategically select sustainable projects which require large capital but are not supported by formal financial institutions. IVCs use local knowledge and informal groups, familiar with the local complexities and environment (Yu, Wang, and Feng 2023). IVCs are flexible in decision-making, less bureaucratic, make timely investment decisions to support environmentally friendly projects (Lian et al. 2023). IVCs tend to be invisible, and the nature of investment does not require regulatory approval, their market knowledge enables them to assess risk, therefore do not require collaterals to finance the project (Yin et al. 2022). The above literature is built on the stakeholder theory (Freeman, 1984); it links the key stakeholders (government, enterprises as well as financial institutions) and provides rationale for linkages between the shadow economy and IVCs in the context of Pakistan.

However, the existing literature is silent on the presence and operations of IVC in emerging economies Therefore, this study is novel in that it explores the presence of IVCs within emerging economies, their invisible operations, their contribution towards sustainable agenda and support for economic growth in the case of Pakistan.

2.2. Conceptual framework

Figure 1, firstly, presents the conceptual framework for formal venture capital that has legal existence. Entrepreneurs approach formal VCs directly or through their financial intermediaries such as Banks and financial advisors. However, the size of investment sought tends to be more than one million (USD) in Western economies. But in the case of Pakistan, such values of investment are rare due to its economic differential compared with the West. Entrepreneurs' funding applications are screened to evaluate their viability. Successful projects are vetted for their operations, management structure and a decision to invest is arrived at. The VCs offer not only finance but also take positions at the board level and provide technical strategic and emotional support.

Figure 1: Conceptual Framework of Venture Capital Operation



Source: Authors

Informal venture capital (IVCs) also depicted in Figure 1 is distinct from formal venture capital (FVCs) and business angels in the context of Pakistan. The IVCs is a hybrid model that sits between FVCs and business angels. IVCs are informal, yet of significant importance and size in Pakistan; they operate in the shadow of a formal economic environment, tax evasion is common as businesses supported are also often unregistered and do not seek legal protection as they use their malpractices to evade taxation and regulations. Their referral systems mirror FVCs but from the responses of the sample of the study it is reported that IVCs economic and social networks are used to identify more investment. The IVCs have full access to information about the business and information asymmetry tends to be low. The proposal evaluations, often unwritten, are informal and the exchange of information is person to person which minimises the need for formal written documentation. IVCs operational practice is “friendly” with potentially high-growth entrepreneurs. There is continuous mentoring, informal networking and a high level of collaborative decision-making approach. The decision-making is rapid and where necessary the IVCs intervene to mitigate any potential risk. Given the selective nature of investment and screening based on networks and relationships, 99% of the projects are approved for funding; the decision-making is flexible and quick as IVCs are individual or family-owned businesses.

3. Methodology

To collect empirically rigorous data from Pakistan is a challenge, yet to gain an in-depth understanding of such an approach is valuable. Pakistan is a special case within South Asia that is characterised by economic and political turbulence, yet financial institutions have remained functional for over seventy years. The country is characterised by a poor regulatory environment and a significant presence of the shadow economy (Mughal and Schneider 2020). Due to formal financial institutions" imperfections, the formal venture capital market remains significant yet invisible although IVCs' exists (Love and Zicchino 2006). Pakistan represents an extreme case of an economic model that can provide interesting insight into IVCs phenomena and assist in generating new theoretical insight. Eisenhardt and Graebner (2007) suggest that unusual or extreme cases provide ideal instances of theoretical sampling to build a theoretical framework to analyse the occurrence of unusual events. Finally, the unique nature of the country, where financial markets operate parallel to the shadow economy limits the operation and growth of entrepreneurial activities.

To analyse the presence of IVCs in Pakistan and to examine their evolution and presence, we collected primary data from two states, Punjab and Khyber Pakhtunkhwa (KP). The authors analysed the countries' legal, financial, and political environment and designed a semi-structured questionnaire, translated into Urdu, local language, piloted and administered using the language suitable to interview IVCs owners and managers. The participants of IVCs were fluent in English language yet there was a tendency to dip into Urdu language and English language.

The questionnaire was implemented to twenty-one respondents to gather qualitative and quantitative information about their financial status, educational attainment, business portfolio and the number of businesses supported. First, five pilot interviews were conducted to develop a deep understanding of the IVCs operations in Pakistan. These interviews examined how the IVCs are structured, operate, and their motivations to invest in the targeted businesses yet formal documentation remains absent. We also attempted to analyse the interplay between IVCs and the state. The aim of semi-structured questionnaires and prolonged interviews, lasting under two hours, was to gather additional data to triangulate issues which are not documented in formal government statistics.

The use of a semi-structured questionnaire approach with extended in-depth questions provided access to analytical techniques to examine multiple operative methods used by IVCs to identify potential investment opportunities and analyse risk-return before making their investment. Following the completion and evaluation of the pilot study, a further sixteen IVCs were identified, six in KP and ten in the state of Punjab. We acknowledge that the participating IVCs were selected through networks which were associated with the elite segment of the population in Pakistan. The questionnaire was implemented by one researcher who had extensive experience of living, working, and teaching in Pakistan. Pilot questionnaires were conducted in December 2022 and the remainder were completed in January-February 2023. Given the hidden and privileged nature of IVCs in Pakistan, their operations are difficult to identify as the business' status is opaque. Therefore, this study does not claim to use a representative sample due to the nature of the IVCs operation, cost and time involved in carrying out comprehensive research of all IVCs in Pakistan.

4. Data Analysis

4.1. Age

Out of 15 IVCs identified from two states, Punjab and KP in Pakistan depicts that majority of IVCs owners' ages are above 30. The most frequent respondent category was positioned, in the range of 50-59 (47%) and 40-49 (27%). Similarly, the highest number of businesses invested by IVCs owner aged between 50-59 who own 31 businesses, followed by 40-49 who own 23 businesses, and above 60 who own 14 businesses. The respondent's classification of social status was inquired and 12 of them classified themselves amongst the top 5% of the social demographics category and one of them said *"Obviously if you are not rich you would not be in this business"*. IVCs living standards reflect the richness, and everyone knows about their wealth, yet they are invisible in the government accounts, operations are anonymised, and they do not rely on legal remedies for the protection of their wealth.

4.2. Gender

Pakistan being a male-dominated society is reflected in IVCs operations as 94%, 14 IVCs were male and in Punjab only 1 female. Whereas in the state of KP, despite extensive exploration no female IVCs were identified. This is reflective of the conservative nature of the population in KP and in general, the female participation in the economic domain remains insignificant but in one region, Kalash valley of district Chitral was observed to be an outlier. Kalashi people being a minority, approximately 4100 (Hussain and Mielke 2020), exhibit higher entrepreneurial traits.

Table 1. Sample Characteristics

Variables	Punjab (IVCs)	No of Businesses Invested by each IVC (total)	Khyber Pakhtunkhwa (IVCs)	No of Businesses Invested in by each IVC (total)
Age				
Under 30	Nil	-	-	-
Between 30-39	1 (7%)	2 (2)	-	-
Between 40-49	4 (27%)	6, 4, 8 and 5 (23)	2 (33%)	2, 5 (7)
Between 50-59	7 (47%)	2, 8, 5, 4, 3, 5, 4 (31)	3 (50%)	3, 2, 5 (10)
Above 60	3 (20%)	7,3, and 4 (14)	1 (17%)	7
Total	15	70	6	24
Gender				
Male	14 (94%)		6 (100%)	
Female	1 (6%)		NIL	
Qualification				
Higher Secondary	10 (67%)		5 (83%)	
Undergraduate	4 (27%)		1 (17%)	
Postgraduate	1 (7%)		0	
Sectors				
Manufacturing	5 (33%)		1 (17%)	
Retail	4 (27%)		2 (33%)	
Services (Real Estate, Personal and Financial)	6 (40%)		3 (50%)	
Total	15		6	
Amount Invested (USD Avg.)				
30K to 99K		60 Businesses		20 Businesses
100K to 250K		10 Businesses		4 Businesses
Duration of Investment (Years)				
30K to 99K	5-10 years		2-5 years	
100K to 250K	10 plus years		5-7 years	
IVCs Net Worth (USD)				
1 to 10m	3 (20%)		2 (33%)	
10 to 20m	8 (53%)		1 (17%)	
20m to above	4 (27%)		3 (50%)	

Source: Authors

4.3. Sector, amount invested and duration

Economic sector analysis of the two states showed that the majority of respondents operate in similar sectors, Punjab 40% and KP 50% respectively operated within the services sector. Retail and manufacturing sectors are not heavily invested in. The amount of capital invested is reflective of the lower cost of operations within the country, hence the capital invested range is from USD 30-90k in 60 ventures in Punjab and 20 in KP: reflective of low capital-intensive requirements. A similar trend is observed for the investment requirement of large ventures.

Most of the investments were in the range of 30-99k, with a duration period of 5-10 years in the state of Punjab but in the case of KP, the duration was significantly lower 2-5 years. This variation may be attributed to the socioeconomic growth stages and political and investment risks of the regions.

4.4. Qualifications and net worth

The prevalence of secondary school education is remarkably higher for IVCs operating in the state of Punjab (67%) and KP (83%). To analyse this finding, we examined the educational achievement within their families; it showed that the heads of IVCs were supported by their immediate family members and more striking the wealth acquisition was due to large asset inheritance and their political affluence. Further informal exploration suggested the owner of IVCs had deep-rooted connectivity with the bureaucratic set-up that ensures their invisible status was protected and furthered. The reported net worth by IVCs owners is of a significant amount for Punjab is USD 10-20m (53%) and in KP is USD 20m and above (50%). The reported figures are approximate, though all the participating IVCs owners were reluctant to place a value on their personal net worth due to their secretive business operation.

The striking finding from the IVCs discussions was that they did not classify themselves under the term venture capitalist nor did their knowledge extend to the VCs" westerner operations. However, the practice of investing in viable businesses within the region extended to their forefathers, that suggested they have tacit knowledge of investing in potentially profitable ventures. Furthermore, from the discussion, the respondents have in-depth sectoral knowledge due to their local peer-to-peer connections and reputation which enables them to exploit information asymmetry. Moreso, the respondents had a high level of liquid assets, a common trait of developing economies, which aids them to operate freely and make quick decisions without going through financial or legal institutions.

Given the small sample size for explorative research, the high presence of non-documented business operations in Pakistan, the authors would suggest caution needs to be exercised in the interpretation of the findings of this research. The research sample was selective, non-random and access was gained through privilege networks with personal assurances of the authors for non-disclosure of personal or business-related information. Further research on the larger and representative cohort of IVCs would be informative and helpful to contextualise the depth and presence of the functioning of IVCs and their contribution to the shadow economy in creating employment and economic growth (Mughal and Schneider 2020).

5. Results and discussion

The primarily results for IVCs operating in Pakistan have highlighted several themes. The main emerging findings are discussed and evaluated in this section.

5.1. IVCs Investment Strategies

Informal venture capital investment strategies are informed through their informal network. In the case of Pakistan, such networks have existed over time and their visibility in the public domain remains limited. On the other hand, the participants in our sample suggest that IVCs numbers are large. IVCs support the growth of innovative, emerging enterprises. The owners of IVCs rely on their experiential journeys with their families to gain business-specific knowledge in selecting businesses to invest in. As gleaned from Table 4.1, educational attainment is not necessary to inform investment strategies. One respondent reported:

> *Instead of following investment strategies from academic books we rely on our local knowledge and networks to invest.*

Another three respondents were supportive of this view. Their first consideration was the informal relationship with the potential business owners, second the reputation of the recipient amongst the wider community and their approach to financing their enterprise. IVCs valuations are based on their own unwritten assessment criteria that give rise to high risk yet potentially high reward.

To evaluate the investment strategies and to gain a deeper insight, the researcher sought the view of IVCs through semi-structured interviews. The respondents in Punjab (85%) reported a deep-rooted presence within the region and communities that provided them with information from informal networks. Respondents no 8 suggested:

> *Our ancestors have been operating for over two generations, we know all about the key retailers and new fashion designers. We keep an eye on potential winning stars who have ideas, but limited access to capital and networks to trade within the sector. That is where we make money.*

At prima facie, there exists a common belief in IVCs in Pakistan to exploit the information asymmetry that gives rise to imperfection in capital markets, and turbulence in the economic and political system to benefit from the innovative entrepreneurs. This also implied that the IVCs have acquired opportunistic traits. However, they are the intermediaries which meet an unmet financial demand. Access to adequate finance assists employment generation, and growth of economic activities and eventually the enterprise is transformed into well-established formal businesses that contribute to tax revenue. The respondents, 12 out of 21, acknowledged their involvement has had a transformative impact on local, regional, and national economic activity. All 21 respondents suggested that IVCs operations within Pakistan are undocumented, yet they are the most important non-traditional investors for emerging ventures who require large sums of finance for expansion or startups.

The majority of respondents (80%) suggested that they fund businesses which would not be supported by formal financial institutions due to high risk, lack of collateral, and financial history. Therefore, findings from IVCs owners imply that they invest their capital in those businesses which have growth potential as well as the ability to repay. However, unlike Western VCs, the IVCs operating in Pakistan did not appear to invest in technology or innovative ventures, they still are investing in traditional businesses; this may be attributed to their lack of exposure to the contemporary trends and practices in entrepreneurial education. This finding corroborates literature cited in section two of the paper.

5.2. Sustainability

In terms of the sustainability agenda emerging due to global climate change, the question regarding IVCs' responsibility towards investing in sustainable projects to mitigate negative climate effects was explored. All the respondents (21) were acutely aware of the impact of climate change, yet they did not see how their actions could alleviate the worsening climate events. The researchers quizzed IVCs further by suggesting when IVCs invest in businesses, should they not be asking questions about the environmental impact of the ventures and what strategies are in place to mitigate such impacts. Of the respondents in the study, 11 out of 21, had little knowledge or the desire to consider sustainability issues. Whilst only 6 respondents with university degrees showed concerns about sustainability issues and only 2 out of 6 reported, whilst screening the venture for potential investment they consider sustainability issues. Respondents 3, 7, 14 and 18 were of the view that sustainability issues do not concern them or their investment decisions.

The findings suggest that there is a lack of awareness and commitment amongst IVCs to consider sustainability issues. This may be explained due to the informal sector within which IVCs invest, thus there is no responsibility on the part of the recipient of funds to comply with environmental or other regulations, until they grow and formalise their businesses. One of the respondents, number 19, suggested:

IVCs sector is small in numbers, operates informally to avoid regulatory oversight as well as benefit from high returns; should they consider sustainability and environmental issues they may not be able to invest in the ventures. The consequence of this would be to prevent entrepreneurs from securing funding for their businesses, negatively impacting employment creation and transition of informal to formal enterprises.

The issue of sustainability is important as it is the case in the growing literature (Ref..) the evidence prsented from teh respondents.

5.3. Factors driving investment

From the evaluation of the interview data, we proposed that the main factor deriving IVCs' investment decision is the financial gap that is a consequence of the failure of formal financial markets' inefficient operations; coupled with their reluctance to fund high-risk entrepreneurs. The data analysis suggests high growth innovative entrepreneurs" finance demands are unmet. In the case of Pakistan, one other factor that promotes IVCs presence is the size of the shadow economy that enables businesses to operate outside the regulatory framework. Consistent with this view, the analysis of responses suggested IVCs are essential to support potential entrepreneurs to innovate and to create employment opportunities. However, lack of transparency and registration hamper their access to government protection under relevant legal and regulatory provisions. Moreover, the recipient of IVCs is deprived of access to government-subsidised financial support, education, and training.

The findings of this research are consistent with the findings of (Baumol 1996). Pakistan like other countries has entrepreneurs but they experience a finance gap. However, responses from IVCs interviews repeatedly suggested that their presence in the market is due to the historical deficit in the supply of risk capital and the failure of the legal framework. Consequently, entrepreneurs heavily depend on informal sources of finance. The findings of this research suggest that financial market failure impedes the survival and high growth of entrepreneurs in Pakistan. Trust was another recurring theme that was commented upon by IVCs; they suggested their long-standing presence in the market and reputation has enabled them to gain the trust amongst the entrepreneurial community, thus entrepreneurs seek finance from IVCs despite their informal operating practices. Our findings suggest that IVCs in the context of Pakistan remain significant enablers for high-growth entrepreneurs to realise their full potential. Thus, IVCs perform an augmented role that supports high-risk, high-return, and progressive businesses in Pakistan. Therefore, we propose based on the responses from IVCs, that strengthening the legal framework will assist the transition of IVCs and informal businesses to *mainstream.*

5.4. Withdrawal Strategies

Given the informal nature of the relationship between IVCs and businesses, there is an absence of literature that reviews their conduct and practice. To investigate how the relationships are disentangled, either at the successful conclusion of the business or in circumstances where a business has failed, researchers also quizzed IVCs. The responses from 9 out of 15 IVCs suggested, given their in-depth insight of the sector as well as the expertise they have acquired over generations, enables them to invest in businesses with high levels of successful outcomes. Secondly, the IVCs reported that not only they provide finance but also act as intermediaries and provide connectivity between supply and demand from potential customers. Furthermore, interviews with IVCs suggest that at the screening stage, there is reluctance amongst the IVCs to invest in new startups unless they believe the modern technology or innovation has a high chance of success. The IVCs responses suggest there may exist an early-stage finance gap for new startups which may call for government intervention.

IVCs interviewees were asked to discuss their investment decision-making approaches. From the responses, it was observed that investment decisions were made on subjective personal views; objective criteria were non-existent. However, all respondents indicated that they collated the financial and personal information of the recipient to test the financial viability, quality of entrepreneurs, their motivations, and the potential scalability of the project. As one of them pointed out:

> *Existing businesses have a history, financial and more importantly personal specific information. Such information is tested through social networks that enable them to make informed investment decisions. We know how to transform entrepreneurs into heroes to maximise profit.*

Given the informal relationship, IVCs suggested they have written agreements, yet these are not enforceable in a court of law to exit from the investment. In circumstances where a conflict arises the social network serves the mediatory role, something which is agreed at the start of a formal relationship. One IVCs suggested:

> *Not every investment has a favourable ending. Investment is inherently risky, but experience suggest we make good money from investing despite the fact at times there are some failures. When we see a business might fail, we actively involve ourselves with the operations of the business and supervise technical, social and financial support to turn the business around, if possible.*

6. Conclusion and recommendations

Most of the venture capital (VC) literature is focused on the role and importance of formal venture capital, growth, operation and regulation (Kaplan and Lerner 2016). The importance of the VC market is recognised. Currently, there is a considerable body of research (Eesley et al. 2018; Stenholm, Acs, and Wuebker 2013) that documents the vital role VCs perform.

Literature in the West often interchangeably uses informal venture capital (IVCs) with business angels. In the case of Pakistan, this classification does not capture the "hybrid" nature of the IVCs market. We proposed, for Pakistan, a specific purpose definition is employed that captures sizable IVCs that operate beyond regulatory oversight.

This study contributes to the literature by capturing and analysing the role of IVCs —social networking, family affluence, shadow economy, and trust— in providing access to finance for high-growth entrepreneurs. From the analysis of interviews, we conclude that IVCs in the context of developing countries such as Pakistan serve a vital role in fil the finance gap where formal financial institutions and government funding schemes failed to meet the needs of high-growth entrepreneurs. There have been some studies (Eesley et al. 2018; Li and Zahra 2012) that have evaluated the combined contribution of formal and informal institutions for the Western economies but in the case of emerging economies that is not the case. Therefore, not examining the importance of IVCs operating in emerging economies is an omission in literature, yet such institutions have a significant presence in developing countries and serve a vital role in promoting economic well-being as well as creating employment and contributing towards gross domestic product.

The analysis of this study proposes VCs in emerging economies will only develop formally where space for shadow economy is shrinking and financial institutions are developed to support the financing needs of the high growth businesses. Secondly, it has been suggested in the literature (Minniti 2008; Woldemichael, Kim, and Kim 2024) that government intervention is important to make finance accessible to entrepreneurs through encouraging banks to lend and set up government venture funds, education, and training. However, the analysis of the responses from IVCs suggests that government-sponsored schemes in countries such as Pakistan give rise to favouritism and malpractices in the distribution of funds. It is proposed that enhanced legislation and public policy may improve the functioning of formal financial markets, and effective taxation regimes and regulations may lead to changes in the functioning of IVCs and the businesses they serve. We observe that in the case of Pakistan, the legitimisation of high-growth enterprises is the result of the IVCs conduit. This study contributes to knowledge by identifying a "Hybrid" IVCs operation in Pakistan which may also exist in other emerging economies. This unique finding of the study, in addition to the fascinating analysis of the IVCs operation in Pakistan, offers a new perspective to understand a niche segment of the VCs market.

In emerging economies, this research suggests sustainability is an important issue due to global warming and ensuing adverse climate events. Therefore, it is suggested that institutional development as well as enterprise policy must be aligned to mitigate adverse environmental impacts. Thus, this study makes a case to rationalise the operation of IVCs and enterprises supported by them to ensure sustainability policy and agenda adhere to; penalties or incentives are embedded within the policy and practice framework as depicted within the conceptual framework

Our analysis offers a more nuanced view of the role of IVCs; disentangles the complexities and the mechanism that assist in the growth and expansion of enterprises in Pakistan and identifies areas for further research to enhance the access to finance for entrepreneurs in emerging economies. However, this study is also punctuated with limitations such as the demand side recipients' views are omitted, and we hope future researchers will empirically test our propositions to explore the reasons for seeking finance from "Hybrid" IVCs rather than formal institutions. Despite the limitations, the study offers an intriguing insight to the operation of IVCs and their role in supporting the high-growth but capital-deprived enterprises in Pakistan. Another aspect that will benefit from future studies is how to facilitate the legitimisation of informal businesses and IVCs and transition them to the formal sector of the economy.

This study is especially useful for policymakers in emerging economies such as Pakistan that aspire to improve the functioning of the financial markets and grow their VCs market. However, we suggest emerging economies should evaluate the distinct features of their economy such as informal network, culture, values, regulatory and financial structure to promote institutional strengthening and to support the development of venture capital.

The authors would suggest care should be exercised in the interpretation and application of the results, as only 21 IVCs are included, therefore the sample size is relatively small and highly selective; we used the purposive sample to access individuals with high net worth. Therefore, the authors do not claim that the sample was meant to represent a random for statistically significant IVCs operating in two states of Pakistan. As suggested earlier further research should recruit a large more representative sample to conceptualise and contextualise the functioning, attitudes, operational practices, and their objectives whilst operating in Pakistan or other countries under consideration.

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