



European Commission



Enterprise Directorate-General

Benchmarking business angels

Final report

4 November 2002

EXECUTIVE SUMMARY.....	3
1. INTRODUCTION.....	4
1.1. AIM OF THE REPORT	4
1.2. STRUCTURE OF THE REPORT	5
2. POLICY CONTEXT.....	5
2.1 EFFICIENT AND INTEGRATED CAPITAL MARKETS.....	5
2.2 ROLE OF BUSINESS ANGELS.....	7
2.2.1. <i>Definitions and operating model</i>	7
2.2.2. <i>Business angel financing</i>	8
2.2.3. <i>Types of business angels</i>	10
2.3 BUSINESS ANGELS IN EUROPE.....	11
2.3.1. <i>Business angel investments</i>	11
2.3.2. <i>Business angel networks</i>	12
2.3.3. <i>Number of networks</i>	14
2.4 EUROPEAN POLICY CONTEXT	14
2.4.1. <i>Risk Capital Action Plan</i>	14
2.4.2. <i>Results of the pilot action on business angels</i>	15
2.4.3. <i>Helping innovative companies</i>	17
3. BENCHMARKING FRAMEWORK.....	17
3.1. MODEL OF INTERACTION	17
3.2. BENCHMARKING APPROACH FOR BUSINESS ANGELS.....	18
4. PUBLIC POLICY AND THE OPERATING ENVIRONMENT	19
4.1. ENTREPRENEURIAL CULTURE	19
4.2. TAXATION	20
4.2.1 <i>Introduction</i>	20
4.2.2 <i>Capital gains taxes in the Member States</i>	20
4.3. REGULATORY ENVIRONMENT	23
4.3.1 <i>Administrative hurdles</i>	23
4.3.2 <i>Policy development</i>	24
5. PARTNERSHIP WITH BUSINESS ANGEL NETWORKS	24
5.1. RAISING AWARENESS	24
5.2. TRAINING OF ANGELS AND ENTREPRENEURS	25
5.3. INVESTMENT READINESS	27
5.4. QUALITY AND INTEGRITY OF NETWORKS.....	28
5.4.1 <i>Codes of conduct</i>	28
5.4.2 <i>Setting up and operating angel networks</i>	30
5.4.3 <i>Inclusiveness</i>	30
5.5 FINANCING ANGEL NETWORKS.....	31
6. MATCHING ANGELS WITH ENTREPRENEURS.....	32
6.1. MATCHING PROCESS.....	32
6.1.1. <i>Network practices</i>	32
6.1.2. <i>National matching services</i>	33
6.2. LEVERAGING EFFECTS THROUGH COOPERATION.....	34
6.2.1 <i>Cooperation with other types of investors</i>	34
6.2.2 <i>Integrated approach</i>	36
6.3. CROSS-BORDER ACTIVITIES.....	37
7. CONCLUSION AND RECOMMENDATIONS	38
7.1. CONCLUSIONS OF THE ANALYSIS.....	38
7.2. RECOMMENDATIONS.....	39

EXECUTIVE SUMMARY

The supply of start-up and **early-stage equity finance is becoming more dependent on business angels**, wealthy individual investors. The reasons for this include changes in the banking sector, which have made lending to small enterprises unattractive for banks due to low margins and high overhead costs. In addition, venture capital funds are often not able to accommodate the large number of small deals with heavy due diligence requirements. Particularly in current difficult market environment the capability of business angels to continue investing is a valuable feature.

Business angels provide both financing and managerial experience, which increase the likelihood of start-up enterprises to survive. Business angel networks bring together angels and increase the efficiency of matching angels and entrepreneurs by making it likelier that angels find suitable entrepreneurs.

The fundamental nature of the business angel market is informal. Most angels share a desire for anonymity, and are unwilling to divulge information about their investment activities. Thus all inferences about the true and potential size of the angel investment market are based on guesswork, and there is no way of knowing whether a sample of angels is representative or not. The absence of data precludes statistics-based benchmarking and **caution is needed when drawing conclusions concerning the whole angel market**. More data is needed from the angel investment market in order to make rational and well-grounded policy decisions.

Capital gains tax has a direct effect on the return of investments. A tax environment that encourages risky investments can be favoured by either with low capital gains tax for business angel investment, or by introducing tax breaks for eligible investments that make business angel investments attractive.

Raising awareness about the benefits and services of business angels and angel networks is the first step in increasing business angels' investments. Informing potential angels and entrepreneurs about the advantages of business angel networks takes time and concentrated efforts of networks and the public sector.

The entrepreneurs' prospects of success in attracting business angel investment can be improved through increasing the **investment readiness** of entrepreneurs. This is important because entrepreneurs need to understand the differences between sources of finance and the specific concerns of business angels.

Business angel networks need to protect their **integrity and reputation**. One way of doing so is to introduce a code of conduct, which, although it can not guarantee behaviour, can act as a reminder of critical issues to be addressed. In the end it is the real integrity of the angels, entrepreneurs and networks that determines whether the market operates according to high ethical standards.

Business angel networks often have difficulties in **securing funding** for their operating expenses. As their services are essential in a functioning business angel market, many networks receive public support from local, regional or Member State authorities.

As a conclusion, **the report recommends the following**.

- **Sustained awareness raising campaigns** are needed in many Member States and in the candidate countries to present the benefits of the business angel market for potential angels and entrepreneurs.

- **More data should be collected from** the business angel marketplace to increase the ability to make informed decisions.
- At European level, **a business angel panel should be created** to discuss topical issues affecting the angel community.
- The Member States should **pay attention to the effects of taxation** on business angel activity.
- Business angel **network operations should receive support** from local and regional authorities.
- Business angel networks should promote high ethical standards through transparency and by adopting a code of conduct.

1 INTRODUCTION

1.1 Aim of the report

Informal individual investors, business angels, finance and advise a large number of start-up companies. By sharing their experiences and expanding the financing opportunities of entrepreneurs they contribute to growth and employment, and make European culture more entrepreneurial.

The supply of start-up and early-stage equity finance has become more and more dependent on business angels, as venture capital funds are not able to accommodate a large number of small deals with heavy due diligence requirements. The traditional European source of start-up and early-stage financing has been bank lending, but it has become unattractive for banks due to its high overhead costs.

Recognition of the importance of business angels and angel networks at public policy level is needed to create an environment favouring their investments. The focus of this Benchmarking business angels project report is in the possibilities of public sector to stimulate the activities of business angels and business angel networks.

The project has been carried out by an expert group that was set up by the Enterprise Directorate-General of the European Commission. The expert group was composed of experts nominated by governments and private sector experts. This combination provided to be a very fruitful basis for the work of the group.

The project was anchored on the observation in several forums that the potential investment capacity of business angels in Europe had not been fully utilised. In many Member States the activities of business angel networks had not developed enough so that they could effectively facilitate the matching of investors and projects. The benchmarking project aimed to find the best practices and set up benchmarks so that the situation could be improved.

The objective of the benchmarking exercise was originally worded *“Improve SMEs’ access to seed and early stage capital by increasing awareness in the Member States of the potential of business angels to provide such capital, which banks are reluctant to do.”*

The starting point for the benchmarking project was provided particularly by the Multiannual Programme for Enterprises and Entrepreneurship (2001-2005)¹. In it the Council emphasised the importance of business angels for an entrepreneurial economy: *“In response to the conclusions of the Lisbon European Council of 23 and 24 March 2000, this programme will foster in particular [...] measures to encourage proximity financing, and in particular to develop*

¹ 2000/819/EC

networks of Business Angels[...]". Other relevant background documents include the Risk Capital Action Plan of 1998 and its yearly follow-up reports², and the BEST Report of 2000³. The feasibility study on the potential of business angels networks in Europe (1998)⁴ led to a pilot action to support the setting up of business angel networks. This pilot action was conducted under the third Multiannual Programme for Enterprises (1997-2000)⁵. The problems of the angel market were highlighted in the Commission Communication "Sustaining the commitments, increasing the pace" in November 2001⁶.

1.2 Structure of the report

The final report has been written by the Commission services based on the outcome of the expert group meetings⁷. The Commission services also prepared two documents outlining the purpose and the elements of the project for the expert group to discuss and comment. The members of the group contributed documents on Member State policies, on the experiences of angel networks, and key statistics. The aim was to create a common understanding of the problem, to define key areas of public action, and to establish the benchmarking elements. The expert group met six times from October 2001 to September 2002.

This report is structured as follows:

- Chapter 2 outlines the policy context of this exercise.
- Chapter 3 sets out the benchmarking framework.
- Chapter 4 looks at public policies on the operating environment of business angels.
- Chapter 5 reviews the possibilities of partnering with angel networks.
- Chapter 6 looks at improving the matching of angels and entrepreneurs.
- Chapter 7 contains the conclusions and recommendations of the report.

The target audiences of this report are all those responsible for or working with SME finance issues in the Member States and in the candidate countries.

2 POLICY CONTEXT

2.1 Efficient and integrated capital markets

The Commission's programme for developing the European risk capital markets has been outlined in the Risk Capital Action Plan with the overall goal of removing regulatory and administrative barriers. Such markets support the development of an entrepreneurial culture that is essential for economic growth and job creation. Over the last 20 years there have been 35 million jobs created in Europe, compared to 68 million in the US. In relation to the GDP, the number of start-up companies in Europe is only half of that in the US.

The goal of the Risk Capital Action Plan is that European entrepreneurs should be able to access the right financing, at the right price, at the right place and at the right time to develop their enterprises. There is a recognised market failure in financing the beginnings of a new enterprise, the seed and

² SEC(1998)552 final, COM(2000)653 final, COM(2001)605 final, and COM(2002) 563 final..

³ SEC(2000)1825.

⁴ Dissemination Report on the Potential for Business Angels Investment and Networks in Europe, 1998.

⁵ 97/15/EC

⁶ COM(2001)641 final.

⁷ For members of the expert group, see the annex.

early stages. This is commonly called the equity gap. It is often viewed as a supply problem, but in reality it is a problem of both supply and demand. Besides the need for the supply of seed, start-up and expansion capital, entrepreneurs need to be willing to accept, and be active in seeking the participation of private and institutional equity investors.

A strong equity culture helps the financing of start-up enterprises. There are several elements in an equity culture. First, a widespread and consistent demand for equities for investment purposes requires that institutional and individual investors have the will and the means to accept the risks and the rewards of equity investments. The investment policies and regulations of investment and pension funds are important in allowing this. Second, large and liquid stock markets and low-cost brokerage services promote equity investments. Efficiency and transparency in the stock markets increase trust and low broker margins encourage entry and exit. Third, a vibrant risk capital market where business angels and venture capital funds provide capital for rapidly growing companies, and successful companies issue stock through initial and secondary public offerings provide the stock markets with a constant supply of new equity issues. The prospect of a successful initial public offering of shares as an exit route for an investor is an essential incentive encouraging investment in very risky start-up companies.

The emergence of such an equity culture can effectively be promoted through public policies. The European-level Risk Capital Action Plan is increasing the liquidity and efficiency of the European market through liberalisation, removal of barriers, harmonising legislation and favouring competition. At national level, many Member States are using tax incentives to encourage risk capital investments. The common aim is to provide the necessary conditions for the creation of wealth and jobs through entrepreneurship. Combined with regulations that enhance transparency, increase confidence and protect investors, these measures form the basis for developing a more entrepreneurial culture.

Europe lags behind the United States in the development of a risk capital market. The US has systematically used tax incentives to favour equity investments. It promotes individual share ownership through tax advantages granted to the 401(k) private pension schemes. Employees can invest up to 9% of their income into tax-deferred savings accounts (taxes are paid when the funds are drawn), and the funds invest largely in the stock market. The risk capital markets also benefit from investments by these pension plans. In addition, many investors like universities (which invest their endowments) are not taxed. For individuals the capital gains tax usually only goes up to 20%. Further investments are provided by the developed corporate venturing sector.

The development of the US risk capital markets has been helped by the Small Business Investment Companies Program (SBIC) initiative. It supports privately owned and managed investment firms, which use their own capital and funds borrowed at favourable rates with Small Business Administration (SBA) guarantee. The investment firms provide equity capital, long-term loans, debt-equity investments and management assistance to qualifying small businesses. The total SBIC financing in fiscal year 2001 was \$4.5 billion.

In conclusion, liquid and well-functioning capital markets are essential in creating an entrepreneurial culture. Public policy initiatives can contribute to the development of a well-functioning capital market, including the informal risk capital market where business angels operate. An entrepreneurial culture and efficient financial markets feed each other, as successful entrepreneurs contribute funds to the further development of an investment market supporting more start-up businesses.

2.2 Role of business angels

2.2.1 Definitions and operating model

Business angels are individuals who invest capital in, and bring entrepreneurial know-how and experience to enterprises with growth potential. Business angels can overcome the information problem plaguing banks and venture capital funds. They can make investment decisions using their knowledge of the field, and their appreciation of the potential of the company they are investing in. Business angels' investments can be both early stage and expansion, and they can have a leveraging effect for other sources of funding, including bank loans and formal venture capital. Thus, business angels are a key link in the financing and business development chain from start-ups to listed companies.

Business angels are often viewed as preferring local projects because they want to be in regular contact with the manager of the enterprise. The enterprises into which the angels invest have often been within two or three-hour drive from the base of the business angel, and although some of this might be attributed to difficulties gathering information, it is also related to risk management. The business angels can exert closer control over the activities of a company when they are geographically close.

However, this model is changing. Particularly in sectors like high-tech, where the number of companies in a given niche market can be very small in the whole world, business angels do not see the geographic location of the company as a limiting factor. On the contrary, they are willing to invest in relevant companies all over the world.

Informal investment has been around in Europe for a long time, but business angel networks are a newer phenomenon. Business angel networks are organisations that are set up primarily to facilitate the matching of angels and entrepreneurs. The reason for matching services is that the angel investment market is characterised by an information gap on both sides. The entrepreneurs are not finding angels that would be interested in them, and the angels are not able to find enterprises that would fulfil their criteria. These problems can be alleviated by business angel networks that make the matching process more efficient.

A study⁸ made for the Commission in 1998 estimated the potential for business angel investments to be between €10 billion and €20 billion a year. Compared to the investments of the whole European venture capital industry, which made €4.1 billion worth of seed and start-up investments in 2001⁹, the potential is considerable. The number of active business angels in Europe was estimated to be about 125 000, and the number of potential investors was estimated to be one million.

Although business angels often invest individually, other forms of investing are possible, including investing as a group. This group can be an informal syndicate or a formalised company. Individual angels can also invest through a company for taxation or other reasons. Particularly in the US, business angels invest mostly by using syndicates, and formal business angel networks are much less important than in Europe.

The multiplicity of approaches and the low profile of business angels make the collection of statistics on angel activities difficult. Currently data is only available about business angels affiliated with

⁸ European Business Angels Network (1998) Dissemination Report on the Potential for Business Angels Investment and Networks in Europe.

⁹ EVCA Yearbook 2001.

networks, which cover only a small part of the total angel activity. However, due to the informal nature of the market, there will always be limits to the statistical information available.

The underlying assumption of this paper is that the matching services of business angel networks increase the likelihood of angels finding suitable entrepreneurs and vice versa. The transparency and information provided by the angel networks should translate into a greater number of financing deals than would otherwise have been the case. Unfortunately the lack of deal data makes this assumption hard to prove. One conclusion has therefore to be that there is an urgent need to gather more data from the angel investment market in order to make rational and well-grounded policy decisions.

2.2.2 Business angel financing

Enterprises consider access to finance as a long-term constraint to growth. The latest survey¹⁰ notes that 18 % of European SMEs regard the cost of finance, and 19 % the availability of long-term finance, as a constraint for expansion. This problem is worse for start-up companies without collateral, credit history, or track record. It is also particularly acute in countries where loan finance has traditionally been prevalent. Only 2 % of UK companies consider lack of equity finance as a major obstacle in their long-term expansion plans, whereas 19 % of German companies do. However, the problem with such surveys is that they might suffer from success bias as firms which are not able to start, or fail quickly, because lack of finance, are not represented in them.

The changes in the banking sector are making banks more reluctant to continue their low-margin activities, of which SME lending is one. The expert group viewed increasing business angel investments as one way to counteract the withdrawal of some banks from SME financing. This could be the case particularly in financing innovation, which requires equity investments because of its inherent riskiness and because companies are often unable to provide collateral for bank loans. Consequently, banks are unwilling to lend to innovative start-ups, and risk capital is the best source of financing for them. The core problems of riskiness and large overhead costs also deter venture capital funds from investing small amounts, whereas business angels can overcome these constraints.

As a consequence of the changing banking sector, development of the financial markets, and the increased sophistication of entrepreneurs, Europe's small and medium-sized enterprises are increasingly looking at alternatives to loan finance. The alternatives include equity, debt-equity combinations, leasing, and guaranteed loans and equity.

The European risk capital market has developed considerably over the last five years, and the availability of risk capital has increased. However, supply and demand do not necessarily meet, as it still is difficult for start-ups to get enough capital for their early needs. Many institutional venture capital investors claim that there is no shortage of venture capital, only a shortage of good projects. However, this claim has to be seen in the context of the venture capital market, which is focused on larger projects at the later stage of enterprise development. Furthermore, under the prevailing difficult market conditions, venture capital funds are protecting their existing portfolios through additional investments in their existing clients and not investing in new start-ups.

The high due diligence costs for small deals keep formal funds in many cases away from early-stage financing, and European venture capital has been active in financing management buy-outs and the later stages of firm development. Only 17 % of formal European venture capital in 2001 went to seed and start-up investments – although measured by the number of companies, the 3 300 companies receiving seed and start-up finance were 40 % of the total. An additional 3 700

¹⁰ Grant Thornton European Business Survey 2002.

companies got expansion capital. By its nature the venture capital market is very selective and funds tend to concentrate on large investments. The average size of an investment in companies under 200 employees was €1.15 million in 2001. This figure has shown a rising trend following the increase of funds flowing to the venture capital industry¹¹. The European averages hide big differences between Member States, and in some of them the venture capital situation is considerably worse.

In the United States' equity culture the venture capital industry is more mature and the size of average venture capital investment has increased rapidly to over \$10 million¹². This is despite the fact that roughly 25 % of new enterprises start with an investment of less than \$5 000. Furthermore, 50 % had less than \$25 000 and 75 % less than \$100 000. The US angels have historically financed ten times more start-ups than venture capital funds, and there are an estimated 400 000 business angels investing \$30 to \$40 billion per year in 50 000 enterprises¹³.

The financing problem is particularly acute during the time the enterprise has not reached the size that most venture capital funds require. Business angels can be a crucial bridge between the initial investments of the entrepreneur, family and friends, and the later involvement of other investors, including venture capital funds and the public sector. There are various forms of cooperation between angels and venture capital funds, including sequential investment, deal referral, and coinvestment. However, cooperation between angels and other investors is only achievable when there is enough trust between them, based on, for example, previous relationship. The different motives, expectations, and the exit horizons of angels and other investors can create difficulties that are sometimes hard to overcome, but cooperation has potential¹⁴. This points to a need for transparency, increased cooperation efforts between investors, and possibly a quality assurance scheme by the networks.

Finance is only part of the contribution of a proper business angel to a company. Arguably the most valuable contribution is experience, both in the operating field of the company, and in general management. Lacking managerial experience is a problem for growing start-up companies, and contributes to their high mortality rate (more than half of European enterprises cease activities within five years of their creation). Furthermore, angels have usually a wide network of contacts that can benefit a start-up company.

Entrepreneurs are constantly emphasising that the experience of the business angels is even more important for them than the actual financing¹⁵. Particularly for technology-oriented start-ups this is crucial, and these have ranked business and strategic advice as the first thing they wanted from their investors, followed by money and contacts¹⁶.

It is widely recognised that a different set of skills is needed in setting up a company, which is an entrepreneurial activity, and in managing the growth phase, where the emphasis is on managerial skills. As business angels are experienced entrepreneurs, they can provide crucial hands-on managerial experience, which reduces the risk of failure. In Germany, the average time spent on an

¹¹ EVCA Yearbook 2002.

¹² According to NVCA Yearbook 2002 the average deal size was \$11.7 million.

¹³ US figures from Sohl J and Sommer B (2002) Angel Investment Activity: Funding High Tech Innovations.

¹⁴ Harrison R and Mason C (2000) "Venture Capital Market Complementarities: The Links Between Business Angels and Venture Capital Funds in the UK", *Venture Capital* 2, 223-242; and a study by A Riding on high-tech firms in Ottawa where 57 % of angel-backed firms got venture capital funding, whereas only 10 % of those without angel support got it.

¹⁵ Lindström G, Olofsson C (2001) "Early Stage Financing of NTBFs: An Analysis of Contributions from Support Actors". *Venture Capital*, 3:2.

¹⁶ Red Herring, June 2002.

investee company was 3.2 hours per week and other estimates include figures of up to 8 hours per week.

In conclusion, business angels are becoming more important as an investor class that is able to bridge the investment gap that exists between the proximity financing of family and friends, and formal venture capital. The angels are also replacing bank lending, as these are reluctant to invest in risky start-ups. Angels provide both financing and managerial experience, which increase the likelihood of start-up enterprises to survive. The effect of angel investments can be increased by public or private sector co-investment, and it can have a signalling effect for venture capital funds at a later stage. For public sector investments, the respect of state aid rules is necessary.

2.2.3 Types of business angels

The fundamental nature of the business angel market is informal. Most angels share a desire for anonymity, and are unwilling to divulge information about their investment activities. Thus all inferences about the true and potential size of the angel investment market are based on guesswork, and there is no way of knowing whether a sample of angels is representative or not. This points to a need for caution when drawing conclusions concerning the market. It also makes a full-fledged statistics-based benchmarking report impossible.

The angel investment market is also heterogeneous. There are very wealthy investors that invest up to €500 000 - €1 000 000, and there are angel syndicates that invest up to €4 to €5 million. Both of these compete with smaller venture capital funds. Particularly the emergence of larger syndicates in the most developed market, the UK, is taking it towards the US model, where syndicates are very common. As the angel market matures in Europe, angel networks might need to pay more attention to benefits of, and support needed for syndication. Business angel networks need to take this complexity of the marketplace into account when devising strategies to activate angels, and the same holds for policy makers when designing policies favouring angel investments.

The challenge is to get potential angels that are interested, but have not yet made investments, and inactive angels, who might already have some experience in investing, to start investing actively. According to a study¹⁷, an important barrier was that the risk of informal investments was perceived to be too high. More information and personal knowledge of the entrepreneur could lower this obstacle. Other studies have found that difficulties in finding good projects and entrepreneurs prevent angels from investing. Business angel networks' matching services can expand the pool of projects and angels available, and in this way increase the likelihood of a match compared to the case where the angels work individually. In addition, awareness-raising campaigns help both angels and entrepreneurs to appreciate the opportunities provided by informal investing.

Taking into account the heterogeneity of the angel market, it would seem that the best way of stimulating it would be to create favourable framework conditions. This would point towards policies promoting an entrepreneurial culture in general, raising awareness about the potential and benefits of an angel market, and formulating policies that support the market.

¹⁷ Mason C. and R. Harrison: Strategies for expanding the informal venture capital market. *International Small Business Journal*, vol II, pp. 23-28.

2.3 Business angels in Europe

2.3.1 Business angel investments

A large majority of business angel deals are done by angels and entrepreneurs not registered with a network, but the networks provide valuable data on deals done through them. In addition, studies and surveys on business angels in various Member States establish the basic features of the marketplace.

Most business angel network activity in Europe is concentrated in the large Member States, as the United Kingdom, Germany and France have between them over 80 % of business angel networks. The estimated number of active angels in the UK is 20 000 to 40 000, who make about 3000 to 6000 investments yearly, investing £0.5 to £1 billion (€0.8-1.6 billion)¹⁸. In Germany, the actual size of the informal market was about half as big as the formal venture capital sector measured in total invested amount, but the informal sector funded more companies¹⁹.

According to the European-level survey made for this report, the sampled business angel networks indicated that their average investment size was €200 000, although it varied between €40 000 and €750 000. In the United Kingdom, about half of angels invested more than £50 000 (€78 000), and in Germany 75 % of investments were less than €500 000²⁰. Around one-third of investments involved two or more business angels in a syndicate. Business angels invest in a very small proportion of investments that they see: for example in the UK typically at least seven out of eight opportunities are rejected.

One in five investments in the UK²¹ had an average annual return of 50 % or more; 33 % of investments involved a total loss; and 13% of investments either generated a partial loss or broke even in nominal terms. The angels' means of exit in the UK are listed in table 1.

Table 1. Business angel divestments in the UK

Written off as a loss	40 %
Trade sale to another company	26 %
Sold to other shareholders	16 %
Sold to a third party	10 %
Floated in the stock markets	8 %

It is in the nature of the market that many investments lose money and lead to business failures. The Mason and Harrison study found that the median holding period was four years for a profitable exit, two years for a failure, and six years from a "living dead" investment.

One key factor that hinders a rapid expansion of business angel financing is the critical mass needed for a real take-off. If angels invest in 5 % to 15 % of the opportunities presented to them, the number of business angels needs to be 7 to 20 times the number of enterprises funded. If the number of

¹⁸ C Mason and R Harrison (2000): "The size of the informal venture capital market in the UK", *Small Business Economics*, 15, 137-148.

¹⁹ European Business School (2000): *Business Angels. Die Bedeutung von Informellem Beteiligungskapital für die Entwicklung von Internet/E-Commerce Gründungen in Deutschland*.

²⁰ The UK figures quoted are from Mason C and Harrison R (2000): "The Size of the Informal Venture Capital Market in the UK". *Small Business Economics*, 15, 137-148. German data from: FH Hannover (2002) *Business Angels in Deutschland*, tbg, Deutsche Ausgleichsbank.

²¹ UK Data from Mason C and Harrison R (2002), "Is It Worth It? The Rates of Return from Informal Venture Capital Investments", *Journal of Business Venturing*, 17, 211-236.

companies that could benefit from business angel funding is about one in twenty, then optimally there should be between 7 and 19 million business angels in the Member States. The task is enormous.

2.3.2 Business angel networks

Business angel networks facilitate the matching of investment demand and supply. Their services can include deal matching, training and investment preparation. The pioneer among European national networks has been the National Business Angels Network (NBAN) in the UK, which has been the model for several other national networks.

The development of business angel networks in Europe has accelerated since the establishment of the European Business Angel Network (EBAN) in 1998. EBAN has been able to raise the profile of business angel investing, to spread experience and good practices between Member States, and to influence public policy in order to support angel network activities.

There are several types of European angel networks, most of which are small. Many regional networks can be more like investment clubs, whereas some of the larger regional networks resemble a national angel network. There are also networks that concentrate on a certain industry or sector, and the frequency of meetings and contact forums of the networks vary greatly.

Usually the networks have few paid employees. The Business Angels Netzwerk Deutschland (BAND) conducted in 2001 a survey of the active business angel networks in Germany²², which noted that on average the German networks employed 1.6 persons. The average number of registered business angels per network in Germany was 25, and there were on average 9 deals per network per year. In France the number of angels per network was usually between 15 and 100, but two commercial networks had 300 and 500 potential investors.

Only some business angels and entrepreneurs operate through networks. According to the survey made for this report, about 19% of potential contacted business angels showed up as registered angels, and about 2% of new entrepreneurs contacted a network.

The legal form of business angel networks vary, but in many cases they are non-profit entities. For example, 47 % of the German networks were formed as an initiative, 38 % were an association (Verein), 17 % had a limited liability structure (GmbH), and the rest had not decided their organisational form. France had both non-profit (16) and commercial (16) angel networks.

The United Kingdom angel market is the most developed in Europe, and annual surveys have been conducted for several years on the market. Based on these surveys, the UK business angel market looks like the following.

- The number of networks is stable, around 50;
- In the financial year 1999/2000, 386 registered business angels invested over £28 million (€44 million) in 215 UK based companies;
- Almost one third of the businesses supported by a business angel attracted other sources of finance as well (from banks, venture capital funds, governments, and other business angels). The additional investment sources increased the invested amount by £51 million (€80 million).
 - Most of the money went into seed, start-up and early stage companies in a wide range of sectors.

²² BAND (2001) Eine empirische Studie des Business Angels Netzwerkes Deutschland.

Best practice case 1: Business angel panel in Germany

The Business Angel Netzwerk Deutschland (BAND) in cooperation with two universities and a media company has launched a business angel panel comprising around 30 business angels that give every quarter information on their activities. The participants have been selected taking into account regional balance.

The data collected includes investment sector, geographical focus, views on the development of the market, and the motivations of the angel. Furthermore, the panel replies to questions about the transfer of know-how, deal flow and invested amounts – in total, 16 regular, mostly multiple choice questions. These are complemented with one or two topical questions every quarter, and the participants are expected to evaluate the mood of other angels.

The results are reported in a specialised magazine and in other media so that the answers of individual angels can not be recognised. Usually the data is complemented with interviews and entrepreneur portraits.

More information: www.ba-panel.de

Best practice case 2: Business angel data collection in the United Kingdom

The annual data collection from UK angel networks has been going on since 1993. It was originally sponsored and published by the British Venture Capital Association (BVCA), but now the funding is shared between BVCA and the National Business Angel Network (NBAN), and NBAN is responsible for the publication. Professor Colin Mason from the University of Strathclyde does the data analysis and writes the yearly report.

Of the NBAN member networks, 22 participate in the survey, and the results are valued more for the trends over time than actual figures, as it is known that the networks only represent a small fraction of the angel investments. The questionnaire details each investment made through the networks, including data on the investee company, invested amounts, syndication, and possible coinvestments.

More information: www.nationalbusangels.com

In Italy, 12 regional networks have been created during the last three years and these have nearly 300 accredited business angels. In 2001, 6 deals were concluded out of more or less 70 business opportunities presented to the BA community.

In Denmark, in addition to the national network, five regional networks were created in the first half of 2002 and these have so far concluded eight deals, all of which were made by a syndicate of at least three business angels. All Danish networks are supported by the public sector. The model in Finland is not built around a formal network, but around the Finnish National Fund for Research and Development, which manages a marketplace for pre-seed technology companies and business angels. It also offers syndication opportunities for the angels.

Some angel networks have been set up – or are in the process of doing so – also in the candidate countries. This could provide the countries with an avenue towards an evolving entrepreneurial culture. A better availability of money can encourage entrepreneurs to come forward with their projects, and at the same time angel investments can increase confidence in the enterprise and in the whole economy.

The lack of comparable data makes it difficult to draw strong conclusions. The data problem can be addressed either by using the UK practice of collecting data through the business angel networks, or

by using the German approach of national business angel panels where a group of selected angels reports regularly on their investment activities.

In conclusion, although the number and activities of business angel networks have grown rapidly, it still has a long way to go before it reaches maturity as measured by a stable and sufficient deal flow.

2.3.3 Number of networks

The number of business angel networks in Europe has grown rapidly in the last few years and most countries have a national network and several regional ones. The sizes and operating methods of the regional networks vary between countries reflecting local conditions, but the rapid increase in the number of networks indicates that there has been a need for them, and that they are serving a purpose.

Table 2. Business angel networks in Europe

	Angel networks		Enterprises		Networks in	
	2002	% of EU total	'000s	% of EU total	2001	1999
Belgium	7	4%	545	3%	6	2
Denmark	6	4%	180	1%	4	0
Germany	40	25%	3 550	18%	36	3
Greece	0	0%	800	4%	0	0
Spain	2	1%	2 700	14%	1	1
France	31	20%	2 490	12%	24	3
Ireland	1	1%	95	0%	1	1
Italy	13	8%	4 125	21%	6	0
Luxembourg	1	1%	20	0%	1	1
Netherlands	2	1%	555	3%	2	1
Austria	1	1%	225	1%	1	1
Portugal	1	1%	685	3%	1	0
Finland	1	1%	210	1%	1	1
Sweden	1	1%	270	1%	1	1
United Kingdom	50	32%	3 490	18%	49	49
European Union	157	100%	19 940	100%	134	64

Source: Enterprise data from the Observatory of European SMEs (2000); Network data from EBAN and the Member States.

2.4 European policy context

2.4.1 Risk Capital Action Plan

The underdeveloped risk capital market in Europe means that entrepreneurs and companies are highly dependent – much more than in the US – on bank loans and overdrafts for early-stage financing. Loan finance is usually a less flexible, more expensive, and less secure alternative than risk capital and frequently available only under favourable economic conditions. The collateral required by banks usually poses a particular problem for SMEs and loan finance is particularly inappropriate for high-tech start-ups where cash flow in the early stage is either negative or very limited.

The Risk Capital Action Plan (RCAP) has identified six categories of barriers that hinder the development of risk capital markets in Europe. These categories are: (1) market fragmentation, (2)

institutions and regulations, (3) taxation, (4) paucity of high-tech SMEs, (5) human resources, and (6) culture. The aim of the RCAP is to remove these barriers to allow the development of a true Europe-wide risk capital market.

The European Council has regularly²³ emphasised the importance of completing the Risk Capital Action Plan by 2003, and considerable progress has been made in achieving this target. Several legislative initiatives are currently waiting for the approval of the Council and the European parliament.

2.4.2 Results of the pilot action on business angels

The Business Angel Network Pilot Action was launched as an answer to the feasibility study of 1998 under the Third Multiannual Programme for SMEs (1997 – 2000)²⁴ to promote business angel networks in order to increase informal private investors' investments in entrepreneurial firms. It sought to address the cultural issues preventing entrepreneurs from seeking finance from the informal sector and to transfer good practices in running angel networks across Europe. The programme funded three types of actions:

- Dissemination actions to heighten awareness and spread good practice.
- Feasibility studies to test the validity of the angel network concept in a particular area.
- Network creation projects setting up and supporting the creation of new networks.

The pilot action was designed to address a number of supply and demand side problems, like information and education, structural problems, the negative perceptions of many entrepreneurs and angels, visibility, and good practice transfer. The pilot action dealt with these problems through promoting the creation of angel networks across Europe and improving the environment for angel investments. In addition to direct project support, the pilot action also gave support to the creation of the European Business Angel Network (EBAN).

The main findings of the programme evaluation were the following.

- **Awareness raising:** In addressing the problems of accessing finance and in response to the continuing informal equity gap, entrepreneurs need to be educated and trained in how to heighten their visibility to, and communicate with, the right type of financier at each stage of enterprise development. At the same time, the potential benefits of risk finance, combined with personal involvement, that business angels can bring, need to be communicated consistently to entrepreneurs as an attractive and appropriate source of early stage funding. There is an opportunity for good practice transfer.
- **Network funding:** Important features of good angel network creation projects are activities that are focussed on facilitating effective person-to-person contacts between well-prepared entrepreneurs and well-motivated angels, supported by appropriate codes of conduct on both sides. The consensus is that public funds are needed to deliver this capability.
- **Network benefits:** The direct impact expected from business angel network creation projects is in terms of increased facilitation capacity leading to a flow of new deals. Wider impacts are likely to be felt in the local and regional angel communities, rather than the in broader constituencies that virtual and cross-border networks set out to deliver. However, ongoing BAN sustainability will need longer than the 2 years given to the pilot projects.

²³ Conclusions of the Lisbon, Stockholm and Barcelona European Councils.

²⁴ 97/15/EC

- **Matching process:** Informal investment is a highly personal process and individual experience suggests an angel prefers to be near to the entrepreneur as part of the conditions necessary for running a successful network. All parties agree that investment events are a suitable medium through which meetings can take place. High visibility of networks through direct targeted marketing creates the greatest awareness among angels and entrepreneurs.
- **Networking in Europe:** The best results of the pilot action as a whole are seen to be in the post-investment stage, particularly in networking and relationship building across Europe. Angel network management experience remains a problem for attaining desired impacts, partly due to a lack of operating tools. Although the programme is expected to have a favourable impact on knowledge about EU based BA activity, there is concern that it is not sufficiently “mainstream” to have a substantial impact.

With regard to the relevance of the pilot action, the report found as follows.

- **Projects selected:** The range of projects was relevant to the problems encountered and to the aims of the business angel network pilot programme. However, some projects were less relevant than others and there could have been a greater variety of themes (e.g. awareness raising projects). More attention could be given to the appropriateness of organisations hosting angel networks to ensure that they are relevant to supporting network goals. The presenting of projects depends on the equity culture, ie the acceptance of external investors, which is less developed in some Member States.
- **Small action:** Although the overall relevance of the pilot programme can be discerned, its lack of visibility and the tiny budget allocated to such a large issue make its overall relevance questionable and it seems likely that any new funding needs to be directed in new ways.
- **Integrated policy:** It is considered relevant to continue to deploy public funds to encourage the speedy delivery of a more widespread angel network capability and capacity across Europe. If such support is to address the continued market failure at European level, integration of business angel related initiatives into mainstream entrepreneurial networking and entrepreneurship policy and programmes is necessary.

The effectiveness of the pilot action on business angel networks was summarised as follows.

- **Limited impact:** The range of projects studied in the report included one or two that have been effective, but overall the contribution to programme objectives has been small. However, it is important to remember that the business angel network community is still in its start-up phase. The main impacts are that awareness has been raised and a European network is in place, and it can be said that the pilot programme has levered a lot out of a small budget.
- **Lack of visibility:** The programme has been severely hampered by its lack of visibility to the main players in the angel and angel network community across the area. Because there has been limited awareness of the existence of a business angel network pilot programme, there has been little effort to ensure that the projects were effective and the lessons from funded feasibility studies and network creation projects were absorbed and disseminated.
- **Follow-up needed:** For the programme to have a longer-term impact, it will need some follow-up on the basis of a new design. An improved impact will be a function of greater visibility, increased leverage on policy and the inclusion of any initiatives in the mainstream of entrepreneurship policy.

The evaluation results make it clear that the scope of the pilot action was limited both in funding terms and in length. However, the evaluation results point out that the benefits of network-building are considerable, and mainstreaming business angel related measures into general policy frameworks could produce better results.

2.4.3 Helping innovative companies

The Commission is facilitating the financing of innovative enterprises through an investor identification and guidance service, Gate2Growth. The service is operated by a team of investment analysts with venture capital or entrepreneurial background, and it has an online database of investment opportunities. Since its start in March 2002, 1300 entrepreneurs and 60 active investors have registered to the database. The initial experiences in terms of the value added the service brings to entrepreneurs' investment readiness have been positive. The first operations also clearly confirm that the current situation in the financial markets is starting to hamper entrepreneurial activity. The database also has 150 registered service providers and innovation professionals who provide entrepreneurs with business planning tools, access to expert advice and business plan diagnostic, a database of appropriate business support services and specialised workshops. To increase the readiness of entrepreneurs, the service will pay particular attention to advising entrepreneurs in preparing a business plan.

The Gate2Growth.com website functions also as a single access point and an operational platform to thematic networks of early stage venture capital investors, incubator managers, managers of industrial liaison offices at universities and research institutes and providers of entrepreneurship training. This makes it easier for innovative entrepreneurs to identify the most appropriate support available locally. Gate2Growth will also establish partnerships with local operators of business plan contests, business angel networks, and investment forums.

3 BENCHMARKING FRAMEWORK

3.1 Model of interaction

Optimally a benchmarking exercise needs a quantifiable set of indicators that can be used to establish the benchmarks and to highlight differences and identify best practices. Establishing the methodology for benchmarking business angels requires a detailed look on the different aspects that might form the basis of a benchmarking exercise, and determining their applicability.

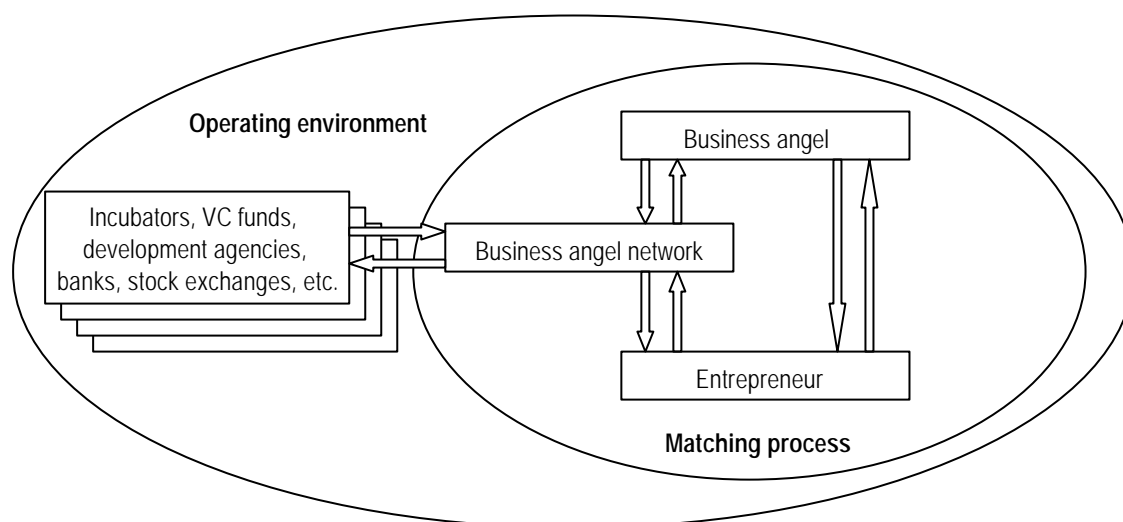
However, applying a full-blown benchmarking model into the business angel investment arena poses problems. Essentially the lack of comprehensive data precludes quantitative analysis and comparisons based on statistics. Although the number of public policies that are specifically aimed at business angels is also limited, the focus of the benchmarking exercise should be on those public policies that are beneficial for the development of a mature business angel investment market.

On the basis of discussions in the expert group the key areas where public policy can have an effect on business angel investments can be grouped as follows:

- Policies developing a favourable operating environment for business angels;
- Policies promoting the sustainability of business angel networks;
- Policies facilitating the matching of entrepreneurs and investors.

The model of interaction viewed in the context of this benchmarking exercise is in figure 1. This benchmarking study is limited to viewing policies that are relevant to business angels and business angel networks. More general policies towards entrepreneurship, and specific policies towards, for example, incubators have been explored elsewhere²⁵. The public policies of the Member States towards business angels and angel networks are usually fairly recent and mostly limited to one or a few aspects of the business angel market. This makes any systematic comparison and evaluation of policy initiatives difficult.

Figure 1. Model of interaction



The difficulty to directly observe the phenomenon of business angel investment has limited the ambition level of this study. Most business angel investments are done privately without the help of a network – and never reported anywhere. Due to the nature of the market, comprehensive statistics are not possible, not even desirable, as an intrusive data collection effort might discourage investments. Even when dealing with angel networks, the number of successful deals is probably understated in cases where a success fee is charged, as this can act as a disincentive to report successful deals.

While keeping in mind that business angel networks capture only a fraction of the deals, they are in a key position to facilitate the matching process and to achieve leverage through cooperating with other actors supporting entrepreneurs, like incubators and development agencies.

3.2 Benchmarking approach for business angels

Benchmarking is a framework for learning from best practices, but the variety of policies to be used in this context is limited. As with other public support policies, those aimed at supporting the business angel community should have clear targets, effective implementation mechanisms, and they should be regularly evaluated. The business angel network industry is still in its infancy and this benchmarking report can only be the first step in developing policies in the Member States.

²⁵ See the Report on the activities of the European Union for SMEs from 1997 to 2000, COM(2001) 98 of 01.03.2001 and the report on Benchmarking the management of incubators. (These are available at http://europa.eu.int/comm/enterprise/entrepreneurship/promoting_entrepreneurship/index.htm and http://europa.eu.int/comm/enterprise/entrepreneurship/support_measures/incubators/index.htm).

The first policy area concerns policies affecting the operating environment of both individual angels and networks. For networks the issues concern mostly the regulatory environment, and for individual angels the key policy factor is taxation, as it influences the expected net return on investment.

Creating a sustainable business angel investment market requires that the business angel networks are successful in creating awareness about the angel market, in upgrading investment readiness of the entrepreneurs, in maintaining their own quality, and in financing their operations. The successful completion of many of these tasks requires a long-term partnership with public sector institutions.

Ultimately the activities of business angel networks should be seen in the successful matching of investors and projects. Business angel networks can increase the quality of their projects by cooperating with other organisations, like incubators, and can provide other investors with quality assurances. By cooperating across borders, networks can increase the likelihood of matches in niche markets like high technology. Carefully aimed public policy measures can provide essential support for these activities.

Although optimally a benchmarking exercise should use quantifiable performance indicators, in the case of the business angel market this is not feasible at this stage. However, in general the best practice policies should fulfil the following criteria:

- **Relevant:** The best practice cases should help business angels and angel networks.
- **Applicable:** In the right context, any best practice should be transferable to a set of different cultures, not only in a single legal or administrative framework.
- **Implementable:** The best practices and indicators identified should be implementable for the Member States.

The best practices under each of the three policy areas are grouped under operating environment, network activities, and matching process.

- **Operating environment:** Taxation and regulatory environment.
- **Network activities:** Raising awareness, investment readiness, training activities, network integrity and quality, and financing of angel networks.
- **Matching process:** Efficiency, leverage and cooperation, integration, and cross-border activities.

4 PUBLIC POLICY AND THE OPERATING ENVIRONMENT

4.1 Entrepreneurial culture

Entrepreneurship is an engine for innovation and growth. Stimulating this engine increases the dynamism of the European economy so that it can better sustain growth, increase wealth and add jobs. Entrepreneurship is needed in all phases of the business life cycle, from small start-ups to big companies. The European Union has set itself the goal to become the most competitive and dynamic knowledge-based economy in the world and it needs a strong entrepreneurial culture to achieve this goal.

Entrepreneurship is a multidimensional attribute, which is conditioned by both the individual's motivation and capacity, and a culture valuing and encouraging such attitudes. Differences in entrepreneurial, cultural and financial traditions mean that entrepreneurs have different attitudes and face different environments also when trying to find financing.

In many Member States entrepreneurs value their personal control over the company more than the growth possibilities that could be achieved by bringing in outside shareholders. This reduces the number of good projects on the demand side of equity finance, at the same time that the supply side (venture capital funds, business angels) has not yet been fully developed. Although educational and information campaigns may be used to overcome this cultural barrier, it has been argued²⁶ that the most effective way of encouraging entrepreneurs to accept equity finance are tax incentives.

4.2 Taxation

4.2.1 Introduction

The taxation of risk capital and equity investments has a direct effect their attractiveness. This matters, both on the demand side (the high growth SMEs seeking finance) and the supply side (the institutional and individual investors). The stability and predictability of the overall tax environment is also important. As can be expected, the tax picture in the European Union is a complex one, varying considerably from one Member State to another.

Capital gains tax (GGT) affects angel investors through two channels. First, CGT applies to the disposal of assets and hence affects the rate of return on investments. It influences decisions by individual investors, financial institutions and venture capitalists to invest in early start-up companies. Second, CGT can affect the remuneration packages that are in the form of assets, usually stock options. The ability of start-ups to offer stock options is often needed to attract qualified personnel and achieving growth. Although stock options have recently fallen into disrepute, particularly when used in larger companies, for many smaller high-growth companies they provide one of the few available remuneration options.

The Commission views company taxation as an important element affecting the functioning of the internal market. Since 1990 the Commission has produced three communications²⁷ and several directives on company taxation. However, the taxation of individual persons has not been part of any of these exercises. Most business angels invest as private persons, and for them the most important tax is the capital gains tax for individuals.

4.2.2 Capital gains taxes in the Member States

Comparing capital gains taxation schemes in the Member States is difficult, as tax rates, rules, exemptions and qualifications abound. The most important features of the capital gains tax regimes in the Member States are in table 3.

Table 3. Capital gains taxation of individuals in the Member States

Member State	Capital gains tax for individuals	Notes
Belgium	No CGT, except for professional investors.	Taxable at 17% (plus local taxes) if a participation of more than 25% in a Belgian company is sold to a foreign company. If the seller is a professional investor, capital gains are always taxable either as ordinary income (when held less than 5 yrs), else at 17% plus local taxes.
Denmark	If held less than 3 yrs, between 38.5% and 59%.	If shares held less than three years, loss is only deductible against capital gains on other shares disposed of within the three-year period.

²⁶Harrison R and Mason C (1995) “Final Review and Evaluation of Five Informal Investment Demonstration Projects”, report to the Small Firms Policy Branch of the DTI.

²⁷SEC(90)601, COM(97)495, and COM(2001)582.

Member State	Capital gains tax for individuals	Notes
	If held at least 3 yrs, 28% up to € 337 and 43% if over. No CGT if total value of quoted stocks during the last three years prior to the sale has been less than €6 817.	Losses on quoted shares held for at least three years is only deductible in gains on quoted shares held for at least three years. Losses on non-quoted shares that are held for at least three years is deductible in share income. The tax value of an exceeding loss is deductible in tax from other income.
Germany	No CGT for shares held over 1 yr, if the participation is less than 1 %.	If shares held under 1 yr or if the participation is substantial (1 % and over), only half of the profits are subject to income tax (2002: 19.9 % to 48.5 %; 2003/4: 17 % to 47 %; 2005 onwards: 15 % to 42 %, with a 5.5 % surcharge of the income tax liability). In this case also half of the losses incurred are deductible. No CGT for shares sold by an incorporated company.
Greece	No CGT for stocks quoted in the Athens stock exchange.	A 5% tax on every share transaction for companies not listed in the stock exchange.
Spain	18%	Progressive rate of up to 48% if held less than one year.
France	26 %	Payable only if total proceeds exceed € 623 / year. Losses are deductible up to €5 200 / year from taxable income. After five years only social charges have to be paid. 25 % of investments in non-quoted SMEs can be deducted from taxable income. The company's turnover must be below €1 million and its balance sheet less than €10 million.
Ireland	20 %	€ 270 / year tax free. For investments of over 5 years in non-quoted stocks, income tax relief of up to €1 750 / year is available. Roll-over relief is available for employees and directors of companies (and trading companies). Losses can be charged against CGT in subsequent years.
Italy	12.5 %	If the participation exceeds 2 % - 5 % in listed companies or 20 % - 25 % in unlisted companies, CGT is 27 %.
Luxembourg	No CGT if held over 6 mths.	If holding is over 25% or held less than 6 mths, progressive income tax.
Netherlands	1.2 % for gains exceeding a threshold (€8 146 to €40 166 depending on tax bracket).	If holding is over 5%, taxed at a rate of 25%. Tax relief available for investments in start-up companies.
Austria	No CGT if held over 1 year, and the investment share is less than 1 %.	If the participation is 1 % of shares or more (in the last five years), investment income is subject to half of the average rate of the total income (up to 50 %) for investments held more than one year.
Portugal	No CGT if shares held over 1 year, otherwise 10 %.	
Finland	29 %	
Sweden	30 %	If an individual sells shares in a company, and the sum of the company's financial assets, liquid recourses and similar assets exceeds half of the payment for the sold shares, the gain on such sale will be deemed as salary for the seller. The tax rate is between 30 and 55 % for private individuals. The individual needs to pay social security charges of 24.26 % on the gain. If the shares are in a privately held company, 50 % of the gain is taxed as salary income and 50 % as capital income. The maximum taxed gain is capped at €18 000.
United Kingdom	10% to 40%	Depends on the tax band, €1 977 / year tax-free. Tax rate tapering to 10% for business assets after 2 years. Deferral of tax charge when reinvesting the profits.

Sources: Member States; Enterprise Directorate-General; EVCA; Finnish Foundation for Share Promotion.

The table shows a wide variety of notional tax rates, of which some have associated incentive schemes that can benefit business angel investments, others have not. Making a meaningful comparison is difficult, but there are clear criteria that can be used to evaluate the approaches. The initial premise is that business angels do not need a specific tax regime, but an overall framework that does not punish risk-taking should be encouraged.

In general, a simple, equitable and readily understandable tax code is a good goal in a democratic society. Furthermore, as investments in start-up companies are an effective way of creating wealth, jobs and growth, capital gains should not be punitively taxed, as they are the reward for investments into risky enterprises. A relatively low level of capital gains tax (for example, below 20 %) would then be the public sector's contribution to leveraging investment in start-up companies. In addition, the system should not penalise investments in unlisted equity as opposed to listed stocks.

Specific tax relief schemes for individual investors can encourage repeated investments. Whether or not tax incentive schemes are desirable in overall economic terms, legally permissible or practically useful within the specific design of a tax system is, however, another matter. The tax relief schemes should not lead to perverse incentives that distort economic calculations. An alternative for incentives is to have a low capital gains tax rate for longer-term investments, whereas shorter ones are taxed at higher rates.

Although the provision of risk capital cannot form the single most important element to take into account while designing the structure of tax systems, care must be taken to avoid unintentional negative effects on this activity. Thus, the structure of any national tax system should not hamper the positive aims of risk capital, innovation and R&D. On the contrary, special tax regimes have been, and should continue to be, used to encourage these activities, provided they meet the requirements of the Code of Conduct on business taxation, EU State Aid rules and other commitments of Member States in the EU tax arena.

According to available research²⁸, CGT can be harmful for the development of a high-quality venture capital market. Raising taxes has a particularly strong effect in reducing the willingness to invest. Conversely, reducing taxes and increasing tax relief increase the willingness of angels to invest. Acceptable levels of taxation are a necessary, though not sufficient, condition for the growth of the angel investment market.

As opposed to individuals, investment and pension funds do not usually pay taxes for their capital gains, but the individual investors to these funds pay taxes either on the dividend they receive or on the capital gains they receive when selling their shares. Here the possible different tax treatment of dividends and capital gains sets different investment vehicles into unequal position, particularly if the rules about the share of ownership in many Member States are taken into account.

Non-resident individuals are in most cases exempt from CGT in the country of the investment under double taxation treaties, but they pay the CGT in their country of residence. There are exceptions in some countries if the ownership exceeds 25%, or if the investments are predominantly in real estate.

As a point of comparison, in the United States capital gains are taxed at 10% to 28% depending on the individual's tax bracket. Half of the gain is excluded if the investment was made to a qualifying small business and held for five years.

²⁸ See Keuschnigg C and Nielsen S (2002) "Start-ups, Venture Capitalists, and the Capital Gains Tax", Universität St. Gallen Discussion paper 2002-05; Mason C and Harrison R (2000) "Influences on the Supply of Informal Venture Capital in the UK: An Exploratory Study of Investor Attitudes", *International Small Business Journal*, 18(4), 11-28; and FH Hannover (2002) *Business Angels in Deutschland*, tbg, Deutsche Ausgleichsbank.

In conclusion it might be noted that there is no one and only good approach to capital gains taxation. The practical possibilities to improve the situation depend on the design of the existing tax system and the political willingness to change it. The simple alternative is the absence of capital gains tax. A more widely used is the introduction of investment breaks that make business angel investments attractive.

Tax advantage can be implemented in different ways, one of which is to have tax deductions up front. Another is to reduce the CGT rate, a third is to allow the rollover of capital gains, and a fourth is the possibility of offset losses against capital gains. In the UK, business angels have indicated a preference for front-end tax relief.

Best practice case 3: Capital gains tax in the United Kingdom and Belgium

The expert group identified the capital gains tax regimes of Belgium and UK as good candidates for best practice in the European Union. Of these the Belgian one exempts most capital gains from tax, and the UK one provides incentives that favour long-term investments in companies.

The UK capital gains tax regime encourages investment in early stages for expanding companies. It has limitations that are designed to discourage investment in speculative ventures like property, and it encourages the investments to be held for periods of over three years.

The first part of the UK system is an income tax relief for investments, which lowers the net cost of the investment made. For example, if an investor makes an investment of 150 000, the up-front tax relief of 30 000 makes the net cost only 120 000.

Furthermore, capital gains tax can be deferred if an investment of similar size is made with the realised profits. The tax is only payable when the shares are finally disposed of. For example, if the capital gain at the end of the investment is 150 000, and a similar investment is made, the net cost of the investment is 90 000 with the saved 60 000 payable only at the final disposal of shares. However, the last component is an exemption system in cases where the investment has been held for at least two years.

The benefits can be combined to lower the effective cost of investment. This approach can effectively increase the supply of funds for investment, particularly if the rollover has to be done within a set time period.

More information: www.inlandrevenue.gov.uk, fiscus.fgov.be

4.3 Regulatory environment

4.3.1 Administrative hurdles

Securities market legislation can have an impact on the activities of business angel networks if it places artificial limitations on them. In addition, uncertainty about the application of capital market rules to business angel networks should be avoided, as such uncertainty could easily destroy any momentum the nascent business angle market might have achieved.

At European level the drive towards a single market means that legislative and other proposals are being adopted in view of completing the Risk Capital Action Plan by 2003, and the Financial Services Action Plan by 2005. It is important that the needs of the developing venture capital market are taken into account in these proposals. The Commission's amended proposal for a Directive on Prospectuses²⁹ includes an exemption where SMEs can raise €2.5 million in a year without having to

²⁹ COM(2002) 460 final.

issue a prospectus. This exemption addresses directly the business angel market and makes possible its unhindered development.

The functioning of the angel networks are sometimes limited by national regulations or their interpretations. Most Member States have concluded that business angel networks do not make investment recommendations and are thus exempted from the legislation concerning investment advisory providers. However, the attitude towards the networks charging fees varies. In Belgium no fees can be asked from entrepreneurs. In the UK the networks can have a success fee but if they were to make profit they would fall under the financial services regulations, which would require additional qualifications. In general, the UK networks needed to be approved by the Financial Services Authority or be part of an economic development initiative.

Although there are minor regulatory issues that concern business angel networks, in general they seem to be able to operate without regulatory obstacles in the Member States. It is important that both the Member States and the European institutions keep the needs of the informal venture capital market in mind when drafting legislation. Due to the informal nature of this market, this task is not always easy.

4.3.2 Policy development

As the number of angel networks has grown, and they have become more visible, the Member States have gradually incorporated business angel friendly measures into their economic policies. Some Member States are experimenting with specific instruments aiming at supporting angel investments. Thus, in Austria the public SME development agency, AWS, can issue guarantees for business angel investments. Belgium is working on policy initiatives favouring angel investments, and the UK has announced a series of pilot projects to promote investment readiness.

However, as opposed to policies creating favourable operating conditions like low taxation and liquid financial markets, specific public investment support schemes must always respect the state aid regulations for SMEs as laid out by the Commission³⁰.

5 PARTNERSHIP WITH BUSINESS ANGEL NETWORKS

5.1 Raising awareness

Raising awareness about the benefits and services of business angels and angel networks is the first step in developing the business angel market. Both potential angels and entrepreneurs need to be aware of the advantages of business angel networks. Raising awareness is an activity where sustained efforts are needed, and where public-private partnerships have shown their usefulness in many countries. Angel networks play an important role in the process, as they spend considerable amounts of time to identify potential business angels and to bring business proposals to their attention.

As business angel networks are a new phenomenon in many places, awareness raising is also needed in the public sector at both national and regional level. Experience shows that achieving media coverage is an effective technique for raising general awareness. In general, such awareness raising would also need to include discussion on the administrative, legal and fiscal environment in which business angels and business angel networks work.

³⁰ 2001/C 235/03, 21.8.2001.

Awareness raising has many aspects. Networks in the Netherlands, Italy, Austria and Belgium have used seminars to inform potential business angels and entrepreneurs about the advantages of the business angel market. Such seminars typically bring together experienced angels and both successful and potential entrepreneurs to share information about the marketplace. In general, awareness raising is a slow process, and specific intensive awareness raising actions can be needed for three to five years before their results can be seen.

Best practice case 4: Awareness raising in Austria

The publicly financed and AWS-linked Austrian i2 angel network has paid particular attention to media coverage. It has actively sought to be presented in various media – newspapers, magazines, and television – throughout the country. It has developed an extensive internet site and it uses local partners in all of the provinces to promote the idea of informal investment, and it has tried to locate archangels to support the recruitment of new angels to the i2 network.

The i2 has also been organising seminars for entrepreneurs that have aimed to enhance their position in negotiations with potential investors. These training sessions carry a participation fee of €100 for members and €150 for non-members. These seminars have served both training and awareness-raising purposes. They have included examples from experienced business angels, presentations from successful entrepreneurs that have received business angel financing, and presentations from bankers and consultants on the investment process. The i2 has also published guidelines for entrepreneurs providing information on the private investment process.

More information: www.innovation.co.at

5.2 Training of angels and entrepreneurs

Training of angels and entrepreneurs in finance is one way of improving the probability of matching. That said, there are aspects in the relationship that are difficult to introduce into formal training programmes. These include the willingness for teamwork of both parties and building trust. In many ways business angel syndicates are a good way of transferring practical knowledge between experienced and less experienced investors. Syndicated investment is common for example in Denmark.

Business angels often need to be encouraged to expand their horizons from the markets and geographical locations they know best. This can be a particular problem if the angels have made their money in the traditional sectors, but the opportunities are mainly in the technological area. These obstacles can be overcome by having the angels join syndicates and helping the angels through independent due diligence services³¹.

Many networks arrange training programmes and seminars for both sides to clarify the expectations concerning power sharing, investment protection, exit, and other relevant issues. Another popular form of experience transfer is the coaching of new network executives by older ones. This holds also at European level, where many recently established networks can benefit from sharing of experience with other networks. To this end EBAN has organised seminars on the management of business angel networks, and has in general raised awareness about network activities.

³¹The obstacles are found in Mason C and Harrison R (2002) “Barriers to Investment in the Informal Venture Capital Sector”, in: Entrepreneurship and Regional Development.

Best practice case 5: Schools of business angels in France and Spain

The French national business angel network France Angels is putting in place a training initiative called *l'Ecole des business angels*, which aims to increase awareness among investors, and to recruit new investors giving them high quality training sessions.

The programme contains issues like profiling typical business angels and their investment horizons, expectations concerning reward and exit, the place of business angels in the financing of an enterprise, the complementarities and conflicts between different financiers, and the steps in angel investments (including legal and taxation aspects). There is information on how to become a business angel and on the aspects of entrepreneur–angel relationship. The relationship is looked at through the expected contribution of the angel in financing and in decision-making, the contractual relationship, the organisation of information-sharing, the access to the angels' network of contacts, and the different exit routes of the angel.

The XIP, private investors' network of Catalonia, and the business school IESE in Barcelona have established a school for business angels that, besides training, seeks to provide a platform to allow the exchange of information and experiences. The programme is managed by an academic team from IESE, and includes presentations from diverse outsiders, including entrepreneurs.

More information: www.franceangels.org, www.cidem.com

In Germany a comprehensive guide³² provides information on all aspects of starting an enterprise. The guide covers the features of the risk capital market in general, and the business angel market in particular. It explores the foundations for cooperation between entrepreneur and angel, the preparation of a detailed business plan and the selection of projects by the angels. The guide also covers the legal aspects of cooperation including avoidable mistakes, the problems of ongoing cooperation, and the ways to terminate the cooperation. The guide also has an extensive section on business angel networks, their operations and tasks, and the rules governing them. The economics ministry of North Rhine–Westphalia has commissioned a detailed study³³ on training of business angels, including pilot seminars, with the view to develop a coherent approach to angel training.

Sweden and Finland have used business plan competitions aimed at fostering entrepreneurial spirit in universities. The Danish Business Angel Network has arranged a skill-developing seminar for 24 of its angels aiming to focus on the relationship between the entrepreneur and the angel, to have the angels networking, and to exchange experiences. The seminar was organised around the social and behavioural aspects of angel-entrepreneur relationship, from the viewpoints of angels, researchers, and entrepreneurs. The seminar concluded that business angels need openness, frankness and humility when dealing with the entrepreneurs. This psychological approach provided the participating angels with new perspectives, although initial resistance towards the concept of training had to be overcome. The group discussions and experience sharing were instrumental in transforming the seminar to a learning event.

Fundamentally the business angel networks are a start-up industry like any other. A long time is needed before their efforts produce visible and lasting results. Only after concentrated efforts of networks and the public sector can we see the emergence of serial angels investing over and over

³² “Ein Beitrag zum Wissenstransfer zwischen Wissenschaft und Unternehmen: Vademecum für Unternehmensgründer, Business Angels und Netzwerke”. Published by the Stiftung Brandenburger Tor der Bankgesellschaft Berlin and available from http://www.stiftung.brandenburger-tor.de/wissenschaft/index_vademecum.html.

³³ BAAR (2002), “Qualifizierung und Zusammenarbeit im Markt des informellen Beteiligungskapitals”.

again, experienced network managers that can sustain networks throughout the business cycle, and a widespread awareness of the benefits of business angel investing.

5.3 Investment readiness

A feature of the whole venture capital market, including the business angel part, is its competitiveness. Only the best projects get financing from angels, and only a few of the financed projects grow rapidly. There is no way to know beforehand which enterprises will be successful, and there will be failures: a large number of projects will not be selected for investments, and a large number of investee companies will fail or will not grow.

The prospects of success in this competitive process can be improved through increasing the investment readiness of entrepreneurs. This is an important element in the matching process, as the entrepreneurs need to understand the differences between sources of finance and the specific concerns of the business angel.

Investment readiness can be defined as the entrepreneur's understanding of and responding to the investor's concerns when presenting the project. The key tool in this respect is business plan. Often entrepreneurs are not able to put themselves in the shoes of the investor, and are unable to fashion their proposals so that the prospective business angels would get the information they want. Areas which usually need to be addressed by the entrepreneur are the valuation of the company, the probable exit strategy, the protection of minority shareholders, the taxation considerations, and the need for due diligence.

According to research³⁴ on the public support policies of several Member States, the most effective ways to stimulate the venture capital market concentrate on the demand side. This means overcoming the uncertainties and resistance of the entrepreneurs, which are heavily cultural issues that depend on the educational system, business climate, administrative traditions and public policy.

The gap in entrepreneurs' understanding of investor requirements can be addressed through various support services. As an example of such services in constructing an attractive business plan in the framework of the European Union's eContent programme was the "aIRe" project in the UK. It provided the entrepreneurs seeking financing, for example, with a self-assessment tool on their investment readiness, with capacity-building services, with information access and with a matching service. The project noted that there are no easy solutions to raising finance, and even with an investment ready proposal, the average time entrepreneurs spent in seeking investors was 12 to 16 weeks.

Another example of an investment readiness service is run by the Finnish National Fund for Research and Development. It gives grants of up to €3 600 to entrepreneurs in the pre-seed stage to prepare a viable business plan and to prepare the management team for business angel funding through its subsequent matching service.

Business angel networks have actively tried to provide training services for the entrepreneurs seeking informal investors. Of German networks, 25 % provide such services, and 58 % plan to do so³⁵. But even though an entrepreneur's proposal might be technically investment ready, in the final analysis it is the "attractiveness" factor that determines whether a business angel decides to invest.

³⁴ Harding R (2001) "Plugging the Knowledge Gap: An International Comparison of the Role for Policy in the Venture Capital market", *Venture Capital*, 4, 59-76.

³⁵ BAND (2001).

“Attractiveness” includes the overall presentation skills of the entrepreneur, the personal chemistry between the investor and the investee, and the overall potential the investor sees in the proposal.

Best practice case 6: Investment readiness pilot projects in the United Kingdom

The UK Small Business Service has launched a series of pilot projects to demonstrate the usefulness of investment readiness education and support. The pilot projects concentrate on SMEs with growth potential and aim to educate the entrepreneurs about the available types and sources of private sector funding. The projects will also groom selected businesses to investment readiness so that they are ready to present their proposals to potential investors.

The six pilot projects will be run by regional and local private and public bodies all over the UK. The first results from the pilot projects should be available towards the end of 2002 and these should contribute towards a national programme of regional investment readiness services.

More information: www.sbs.gov.uk

5.4 Quality and integrity of networks

5.4.1 Codes of conduct

Business angel networks are services based on trust. The business angels trust that the networks have a selection of good projects available for them, and that the networks do not waste their time for low-quality projects. The entrepreneurs trust that the angel network provides them a good opportunity to present their project to serious, interested investors. The entrepreneurs need to be assured that the confidentiality of their information is preserved, as the networks are not subject to legislation on banking secrecy. Thus, the strength of their brand is the key asset in business angel network operations.

For this reason it is not surprising that codes of conduct have become common among business angel networks. Such codes provide one tool to uphold the standards of the network brand through clarifying the principles of behaviour of all stakeholders, enhancing transparency and increasing trust. Codes of conduct have been introduced for both the angel networks and for the business angels themselves.

Best practice case 7: Codes of conduct in Belgium and Denmark

The European Business Angel Network (EBAN) has introduced a model code of conduct for angel networks. Among others, this code has been adopted by the Belgian association of business angel networks (BeBAN). The EBAN code covers the following areas:

- Need for openness in their relations with entrepreneurs, business angels and other networks;
- Maintaining the good standing and reputation of the network;
- Avoiding funds with suspicious provenance;
- Need for contractual relationship between angels and entrepreneurs
- Limiting the spread of company information to inside the network;
- Forbidding networks to invest significantly in the investee companies;
- The networks should preserve their impartiality even if they have introduced a success fee;
- The networks do everything to protect the confidentiality of information.

The Danish Business Angel Network (DBAN) has introduced ethical guidelines for individual business angels containing the following elements:

- Maintaining the good standing and reputation of business angels;
- Maintaining the standard of investments and adhering to the code of conduct;
- Avoiding funds with suspicious provenance;
- Forbidding cash payments to the angels;
- Preserving the confidentiality of information;
- Restraining from defamatory statements against other angels;
- Full disclosure of information in syndicated investments;
- Duty to provide statistical information to the network;
- Forbidding the abuse of information received.

More information: www.beban.be, www.dban.dk

The objective of a code of conduct is to give standard guidelines how a network should operate. The expert group was hesitant to extend the contents of such codes of conduct too far, as the market should indicate the right operating method in various cases.

A code of conduct could be complemented with the exchange of good practices between networks. One example was the growing trend of organising business plan competitions. This was considered a good exercise for the entrepreneur and the winning business plans would have a better chance to find an angel. According to the expert group this kind of cooperation should be encouraged but not written into a code of conduct.

The question whether the business angel networks themselves could invest in the companies listed in their matching services is an interesting one. For example, the Belgian BeBAN code of ethics forbids such practices, except a small share up to 5 % as a compensation for networking services. The LINC in Scotland has introduced such a practice to increase the likelihood of self-financing of the network.

In conclusion it is clear that codes of conduct are only guidelines, pointers towards issues that need to be taken into account when matching investors and entrepreneurs. Codes as such can not guarantee behaviour, it is the real integrity of the angels, entrepreneurs and networks that determines whether the market operates according to the principles listed. Codes of conduct can provide information for public policy purposes about the attention to standards of fairness.

5.4.2 Setting up and operating angel networks

Setting up a business angel network requires often cooperation with banks, regional development agencies, professional service providers, and naturally business angels and potential investee firms. In many cases existing angel networks provide logistical support and expertise for new networks, as do national business development agencies.

Since its inception EBAN has provided a forum for exchanging information, for person-to-person networking, and for establishing best practices among network operators. In large countries with numerous angel networks (United Kingdom, Germany, France), a national network of networks provides a forum for cooperation, and the Nordic countries are looking at the possibilities of setting up a transnational network of networks.

Identifying actual and potential business angels to form a network can be difficult. The usual method is that of person-to-person networking, working from one angel to another. Finding potential investee companies can be easier, as these can be located through many of the stakeholder organisations, including development agencies, incubators and banks.

Network building in the candidate countries is more difficult than in the Member States, as they are in the early stages of developing a functioning risk capital market. Consequently, the candidate countries require considerable support and assistance in setting up and managing angel networks.

It is clear that the concept of business angel networks is taking hold in most Member States. The United Kingdom is the most mature business angel market in Europe. There the networks have often operated for several years, and both their operations and their financing have stabilised. Germany, France, United Kingdom and Denmark have the highest number of networks in relative terms (the number of networks in relation to the number of SMEs).

Outside the Member States countries, there are angel networks operating in Norway, Switzerland and Monaco. In the candidate countries, there are network activities or interest to start such activities in Malta, Slovenia, Romania, the Czech Republic, Hungary and Poland.

5.4.3 Inclusiveness

The business angel community does not yet reflect the diversity of European society. Both women and ethnic minorities are underrepresented, and this can only change in time when enough successful entrepreneurs from underrepresented groups join the angel community. However, to achieve this goal, awareness-raising campaigns should specifically target this aspect and particularly encourage underrepresented groups of potential angels to join and become active.

This is important also because the underrepresented groups can be primarily active in other areas than the current angels. For example, women might be more active in services, care and education. The existing statistics give some support to this assumption. In Germany³⁶, although both male and female angels invested overwhelmingly (over 50 %) in information technology, women invested more in the service sector than men.

There are initiatives that aim to address the imbalance in the angel community. As an example, in Sweden a professional women's network Hernova (partially financed by the European Social Fund)

³⁶ FH Hannover (2002), "Business Angels in Deutschland", tbg, Deutsche Ausgleichsbank. Concerning the differences, it should be noted that due to the small sample the differences they were not statistically significant.

is trying to match women entrepreneurs and investors, and has launched an angel network, HerBAN. This development is also supported by Nutek, the Swedish Business Development Agency.

5.5 Financing angel networks

Potential financing sources for business angel network activities include public grants, success fees, membership fees, training fees, and sponsorship. Around half of the angel networks receive at least some public support from local, regional or Member State authorities. Many angel networks would not exist without this financial support, particularly in the beginning of their activities. However, the grounds for granting such initial support should be transparent and non-discriminatory regardless of the legal form or status of the network.

Public sector support has also been channelled through the European Regional Development Fund at least in Belgium and the United Kingdom. Some networks receive sponsorship from banks, accounting firms, law firms, factoring companies or stockbrokers.

One way of partial self-financing is a fee-based system, which is common in the UK. A fee can be either a mix of registration fee and a success fee, or a registration fee only. The registration fees usually range from £100 (€162) to £300 (€488) and the success fees from 1 % to 5 %, although some success fees are negotiable. A success fee can lead to deals not being reported to the network in order to avoid paying the fee. As an alternative source of financing some UK networks charge a fee for £650 per presentation of a project.

The financing of the networks seems to have an effect on their investment activities. The publicly supported UK angel networks have an average angel investment of £95 000 (€149 000), whereas the average for commercial networks was £182 000 (€285 000). Furthermore, 70 % of the investments of the publicly supported not-for-profit networks were for start-up and early stage, whereas this figure was only 40 % for the commercial networks.

The UK experience shows that the publicly financed and the commercially-oriented angel networks tend to serve different segments of the market, as the transaction fees of the commercial networks tend to be higher, which squeezes out small investors. On the other hand, a too strong public support component can have an impact on the image of the networks. If they became identified with public service institutions, this might reduce their attractiveness from the individual business angel's point of view, as they might identify the networks with bureaucracy and rigidity. However, in particular in the awareness raising stage a public support element is mostly necessary, especially because this is a general requirement for the angel market to take off.

Best practice case 8: Financing of a network in the United Kingdom

Linc Scotland is an independent, not-for-profit network that in 2001 facilitated investment in 24 high-growth companies, which raised over £5 million from member angels. This in turn levered almost another £10 million giving total funding raised of just under £15 million.

Linc Scotland finances itself through a variety of sources. The sponsors include TSB, the Bank of Scotland, the Royal Bank of Scotland, the Centre for Entrepreneurial Finance, Scottish Enterprise, Technology Ventures and the regional funds of the European Union. Regional funds cover about 40 % of the total.

It also collects a membership fee of £150 (€235) from business angels, a registration fee of £75 (€117) from entrepreneurs, and a success fee of £350 (€547). It has also introduced the practice of taking a small equity share in companies to increase the likelihood of self-financing.

More information: www.lincscot.co.uk

6 MATCHING ANGELS WITH ENTREPRENEURS

6.1 Matching Process

6.1.1 Network practices

The matching process between a business angel and an entrepreneur is a personal one, which limits the number of potential entrepreneurs one business angel can meet. Many angels also have a desire for privacy, which works against their getting an adequate deal flow. The common complaint that angels lack sufficient quality investment opportunities probably reflects the relative isolation of many angels. This contrasts with angels that communicate with their network and seek visibility – and get the deal flow.

Business angel networks provide an opportunity for angels to increase the number of potential projects they can shift through, and also an opportunity for networking and visibility. The geographical and interest area limitations of angels might lead to a limited deal flow from small networks. Although ultimately business angel deals depend on personal contact, through efficient preselection methods, networking and marketing opportunities the networks can substantially increase the possibility of finding the right persons.

Regardless of the preference of most business angels to invest in projects that are within a reasonable distance from their base, they usually make allowances for extremely interesting projects. For most business angels the accessibility of the entrepreneur's location is more important than strict geographical proximity, although three quarters of both angels and entrepreneurs in Germany are in cities with over 100 000 inhabitants.

In the vast majority of cases (85 %), German networks require a business plan from the entrepreneurs, 52 % require an executive summary, and 33 % have a specific questionnaire – and 14 % have a detailed enterprise profile. To screen the proposals, most networks used internal resources, although 9 % used a business angel committee. The average length of the screening process was 11 days and 22 % of the screened projects were allowed to the matching stage.

The German matching practices were divided between a matching meeting (57 %) and individual meetings (43 %). For actual deal closing, individual matching was preferred because it offered

discretion, efficient use of time, and individual attention. The researchers assumed that individual matching also provided a higher rate of success, although individual matching limits the selection on both the angel and the entrepreneur side.

Germany has an internet-based pre-matching service called the Business Angels Forum, where so far 1500 entrepreneurs have presented their projects. This has generated about 30 000 contacts between angels and entrepreneurs, and about 4 % of entrepreneurs have found an angel and 23 % of the angels have invested in a project from the forum.

As a business angel might not be able or willing to contribute the amount of funding an entrepreneur needs, groups of business angels can combine their forces and form an investment syndicate. Such syndicating helps the business angels to diversify their risk, provides a wider experience base for the entrepreneur, and also provides opportunities for inexperienced business angels to learn from more experienced ones. The evidence on syndication is patchy, and the willingness of angels to participate in syndication seems to vary greatly. Various studies in the Netherlands, the UK, Denmark and Finland have put the share of syndicated deals between 25 % and 45 %. In Germany, most networks (88 %) had angels that were willing to participate in an angel syndicate, and 29 % of the deals were syndicated. In the United States syndication is prevalent, as the operating mode of business angels is based on groups of angels acting together in most deals.

For cultural and geographic reasons the majority of business angel deals are still national, but this is liable to change, as even start-up businesses became more internationalised. Particularly in high-tech many European enterprises have presence in the Silicon Valley area, and benefit from the US business angel investments. Similarly, European business angels invest in enterprises there. Such powerful clustering effect is less present in Europe, although the expert group has seen some evidence on transnational investments in Europe when the fiscal and regulatory environments have been right.

For individual business angels that have a through knowledge of their field and have the contacts, transnational investing is feasible. To stimulate such transnational investments, business angels should have access to matching and support services also across borders, although locally oriented business angel networks rarely offer opportunities outside their area.

6.1.2 National matching services

National and transnational information exchanges provide an efficient tool to increase the reach of business angels, and to expand the potential set of projects in a business angel's area of interest. The use of internet as the main screening platform has expanded considerably.

In Germany, the Business Angels Forum is an internet-based pre-matching service, where so far 1500 entrepreneurs have presented their projects, which has generated 30 000 contacts between angels and entrepreneurs, and 4 % of the entrepreneurs have found an angel from the forum. The operating profile of this tool is somewhat different from the UK Bestmatch (see below), as in the forum the entrepreneurs are also active in trying to find an angel, whereas in the Bestmatch business angels are looking for suitable enterprises.

In Denmark, the Danish Business Angel Network has a site offering a matching service between angels and entrepreneurs. The service uses search agents to match the profiles of angels with projects by using preferred amounts, regions, stages, need for specific skills and preferences for the exit period.

Best practice case 9: Bestmatch in the United Kingdom

In the United Kingdom the National Business Angel Network (NBAN) has a service called Bestmatch, which is a collection of investors and entrepreneurs whose interests are tended by the NBAN network of associates. It is a means of connecting investors and entrepreneurs using the expertise of associates. Bestmatch is an information exchange, using technology to communicate essential business data and to follow potential deals to conclusion. It is supported by the Department of Trade and Industry, the London Stock Exchange, and most major UK banks.

Through the Bestmatch service business angels get a database of growing businesses looking for investment and skills in line with their selection criteria. The access is password protected, and registration provides the angels with other benefits. Currently it has over 2000 angel profiles and in the last reporting year there were 9375 completed applications in the service.

For entrepreneurs looking equity funding the service includes an associate to help, guide and advise on the suitability of their proposal and how best to present it to potential investors. The investment project is published in the NBAN monthly bulletin for six months, and for a year on the website, without disclosing identities. In eighteen months to the end of 2001, about 500 angels invested in 290 business opportunities, in total £44.3 million (€69 million). Many of these deals attracted coinvestment from banks and venture capital funds.

NBAN has also recently introduced a corporate venturing service that can identify areas of complementary interest between large companies and smaller enterprises

More information: www.bestmatch.co.uk

6.2 Leveraging effects through cooperation

6.2.1 Cooperation with other types of investors

The level of financing needed depends on the enterprise, and some of them can use a combination of financing sources, whereas others can not benefit from business angels or venture capital funds at all. Under these circumstances cooperation of finance providers can yield results that would not be available if the financiers acted alone.

Business angel networks can cooperate with each other, with incubators and with venture capital funds to leverage their experience and provide a referral service for each other. Cooperation between business angel networks is the first step in enhancing operations. For example, the German networks listed the following as the most important areas of cooperation: exchange of good practice, arranging common forums, providing common training programmes, and providing a second chance for business plans.

Incubators can act as a pre-screening service for business angels. Start-ups that work with an incubator have already passed the basic hurdles, and the incubator can provide opportunities for learning between enterprises, and the incubators can exploit economies of scale in their support operations. Business angels can benefit from the presence of a cluster of potential investee firms, and the entrepreneurs can benefit from an integrated support environment.

According to a UK study³⁷, there are potential complementarities between business angels and venture capital funds. Particularly business angels can benefit from these complementarities, but the relationship was deemed more often positive than negative for both angels and funds, and also for the investee business. A particular area where the potential of synergies could be explored is cooperation between business angels and corporate venturing.

In Germany³⁸, 64 % of angels view their experiences of coinvestments as good, particularly in terms of pooling expertise. Cooperation was successful also with the public Technologie-Beteiligungs-Gesellschaft mbH (tbg) of the Deutsche Ausgleichsbank (DtA), as this participation had a tendency to shorten the time to contract. In general, German angels often saw the participation of the public sector institutions (tbg or KfW) in deals as crucial.

Cooperation between incubators and business angels can enhance the possibilities of providing entrepreneurial expertise. For example, five Danish regional angel networks connected to incubators were set up in 2001, and the experiment has helped to maintain a constant deal flow.

Another form of cooperation is to combine angel investments with equity guarantees from a public sector entity. In Austria the i2 network works in cooperation with the SME development agency (AWS) and guarantees angel investments against total loss up to €20 000, or 50 % of investments up to €2 million.

The Italian Business Angels Network (IBAN) cooperates with the Italian venture capital association and a bank active in all of Italy. The bank sees that besides branding and public relations reasons, the cooperation can reduce its risks in SME lending, give opportunities for providing new services, provide investment opportunities for the bank's customers, and provide opportunities for private equity investments.

³⁷Harrison R & Mason C (2000) "Venture Capital Market Complementarities: The Links Between Business Angels and Venture Capital Funds in the UK". *Venture Capital*, 2, 223-242.

³⁸FH Hannover (2002) *Business Angels in Deutschland*. tbg, Deutsche Ausgleichsbank.

Best practice case 10: Regional cooperation in France

In France there is a new cooperative effort trying to combine investments of business angels and regional venture capital funds. The effort has been launched by *Union Nationale des Investisseurs en Capital pour les Entreprises Régionales* (UNICER), and aims particularly to combine the management and business experience of the business angels with the larger resources and more methodological approach of the regional investment companies. The total investment is usually between €300 000 and €2 000 000, with the business angel part being between €45 000 and €170 000.

Although the extent to which business angels are involved in deals varies, they represent between 17 % and 40 % of UNICER deals over the last four years. Often business angels joining forces with other investors set up a joint-stock company, which provides a beneficial venture fund tax regime.

A critical success factor in such cooperation is the willingness of the business angel to accept additional partners and to work with them. The regional venture capital funds can bring in financial and legal expertise that not all business angels have. The focus of investments is at seed stage.

More information: www.unicer.asso.fr

Pooling the expertise of different organisations active in SME financing can make the financing process more effective. Incubators, venture capital funds, public SME development agencies and others can increase their cooperation to provide better services for their clients.

6.2.2 Integrated approach

The process of nurturing an enterprise is a long one, and the entrepreneur needs support at all stages. If the entrepreneur has information on the financing possibilities, on the steps to take and hurdles to cross, the likelihood of success should increase. This points to a need to connect the different enterprise support mechanisms so that resources are used efficiently, and the entrepreneurs have a graduation path in front of them.

Cooperation between universities and research institutes, incubators and financiers has been singled out at European level as a crucial factor in increasing the amount of financing available for commercialisation of research. This has led to the development of European-level finance forums, where for example, entrepreneurs of biotechnology and financiers interested in this area can meet.

Denmark is exploring the idea of a business angel co-investment fund that would be closely associated with regional angel networks. Such a fund would attach itself to projects already selected by business angels. The main priority for the fund would be to cultivate close ties with business angels in order to ensure a steady deal flow. Co-investment funds need professional management with which the business angels feel comfortable with so that they are willing to share the risks and returns of their investments.

Best practice case 11: Project pipeline in Finland

Finland has a project preparation and funding model based on a public-private partnership targeting particularly pre-seed technology companies, and organised by the National Fund for Research and Development. The model is designed to put pressure on entrepreneurs with good ideas to write a business plan and get financing quickly.

The system canvasses project proposals from incubators, technology centres and knowledge centres through four Technology Transfer Centres (TTCs) operating in conjunction with the leading universities of the country. These TTCs canvas entrepreneurs' proposals (so far 250 proposals in 10 months) and select the best (54 were selected) for the investment readiness programme, where the entrepreneurs get a public grant for business plan development.

Those selected are given a two to four month timetable to develop a business plan. A regularly convened panel evaluates the business plans in one day and good ones are incorporated in a national matching system, where business angels can select the ones that interest them. Currently there are about 100 participating angels, but the target is to have 200 by the end of 2002. So far out of 20 business plans in the matching system six have received funding.

If needed, angel investment can be complemented with Sitra participation. For Sitra, these are low-risk and low-cost investments, as the evaluation system guarantees the quality of the proposals and Sitra does not need any evaluation and management capacity of its own. This type of public-private partnership acts as a lever to activate private money by providing a "force-feed" mechanism for enterprises, and by showing the public sector commitment to the results of the selection process.

The Finnish experiment combines an active project search process with investment readiness preparation, business angel matching, and introduction to venture capital funds. The catalyst in this process is the public sector through its specialist organisation, the National Fund.

More information: www.sitra.fi

6.3 Cross-border activities

Regardless of the efforts to unify the European financial markets, cross-border cooperation in the business angel market has been slow in starting. Transnational cooperation can provide new opportunities for the sharing of knowledge and experience within a relatively homogenous area. Transnational networks could become an important first step in increasing the international contacts of business angels, especially when the regional investment model is being surpassed in areas requiring specialised knowledge.

One attempt at cross-border cooperation is the current exploratory work that aims to set up a Nordic Business Angel Network, which would connect the national networks in Denmark, Norway, Sweden and Finland. This cooperation would expand investment possibilities from what is available in any one of these small countries by using a shared electronic matching platform. If such a Nordic Business Angel Network is established and proves successful, it could provide valuable lessons for other cross-border business angel initiatives in Europe.

The Connect network that seeks to link high-tech entrepreneurs to a variety of resources they need is adapted from its American origins to the European environment in Sweden, United Kingdom, Denmark and Norway. Besides giving strategic advice to the entrepreneurs, it includes a financial forum that provides a meeting place for investors and entrepreneurs.

The business angel networks are also increasing their cross-border activities. A German-Italian network operates successfully in both countries. In Austria, the Innovationsagentur provides opportunities for international partnerships for its investors through partnerships in South Tyrol and Bratislava. In Bratislava it works in cooperation with the Slovak Guarantee and Development Bank. Other networks are crossing borders and expanding particularly towards the candidate countries. In markets where investment activity is underdeveloped, angel investments are also going into traditional sectors, like construction.

The unification of European risk capital markets will increase the potential and the pressure for cross-border cooperation. Increased efficiency and the spread of best practices make such cooperation desirable, particularly towards the candidate countries.

7 CONCLUSIONS AND RECOMMENDATIONS

7.1 Conclusions of the analysis

Operating environment

Taxation

Capital gains tax has a direct effect on the return of investments. A tax environment that encourages risky investments can be favoured by either with low capital gains tax for business angel investment, or by introducing tax breaks for eligible investments that make business angel investments attractive.

Regulatory environment

It is important that both the Member States and the European institutions keep the needs of the informal venture capital market in mind when drafting legislation. Due to the informal nature of this market, this task is not always easy.

Network activities

Raising awareness

Raising awareness about the benefits and services of business angels and angel networks is the first step in developing the business angel market. Both potential angels and entrepreneurs need to be aware of the advantages of business angel networks. Raising awareness is an activity where sustained efforts are needed, and where public-private partnerships have shown their usefulness in many countries. At European level, EBAN should continue its efforts in this area.

Training activities

Business angels often need information and training to be able to fully utilise their potential. Many networks organise training for both business angels and entrepreneurs.

<i>Investment readiness</i>	Investment readiness can be defined as the entrepreneur's understanding of and responding to the investor's concerns when presenting the project. The prospects of success in seeking finance can be improved through increasing the investment readiness of entrepreneurs. The entrepreneurs need to understand the differences between sources of finance and the specific concerns of the business angel.
<i>Network integrity and quality</i>	The objective of a code of conduct is to give standard guidelines how a newly established network should operate and to increase the confidence of investors. To increase their inclusiveness, the networks and public institutions should have awareness-raising campaigns that specifically encourage underrepresented groups of potential angels to join and become active.
<i>Financing angel networks</i>	Potential financing sources for business angel network activities include public grants, success fees, membership fees, training fees, and sponsorship. Around half of the angel networks receive at least some public support from local, regional or Member State authorities. Public sector support has also been channelled through the European Regional Development Fund.

Matching process

<i>Network efficiency</i>	Business angels can increase their visibility and deal flow through angel networks. National and transnational information exchanges provide an efficient tool to increase the reach of business angels, and to expand the potential set of projects in a business angel's area of interest. The use of internet as the main prematching or screening platform has expanded considerably.
<i>Leverage and cooperation</i>	Business angel networks can cooperate with each other, with incubators and with venture capital funds to leverage their experience.
<i>Integration</i>	The process of nurturing an enterprise is a long one, and the entrepreneur needs support at all stages. There is a need to integrate the different enterprise support mechanisms so that resources are used efficiently.
<i>Cross-border activities</i>	The unification of European risk capital markets will increase the potential and the pressure for cross-border cooperation. Increased efficiency and the spread of best practices make such cooperation desirable, particularly with the candidate countries.

7.2 Recommendations

1. Raising awareness of business angels and angel networks.

By supporting the early stages of the development of a functioning business angel market in partnership with the private sector, the public sector can cost-effectively contribute to its overall

economic development and job creation goals. Sustained awareness-raising campaigns are needed in all those Member States and candidate countries where the business angel concept has not yet reached a critical mass. Such campaigns should be arranged by the public and the private sector acting in partnership. The campaigns should increase the level of knowledge of both entrepreneurs and potential angels, including angels from underrepresented groups.

2. Collecting data from the business angel marketplace

Business angels contribute to the development of new enterprises by providing equity investment, managerial experience, and their own contacts in the business community. Business angels are an important factor in sustaining new enterprises, and through that the economic development of an area, and an economy. To increase the visibility of the market and to support the public policies aiming at supporting the angel market, a concentrated Europe-wide effort is needed to gather more data on business angels.

3 Creating a business angel panel to discuss topical issues affecting the angel community.

Its informal nature leads often to a low visibility of the business angel investment market. To address this and to provide a forum where business angels could discuss topical items and report on these, it is recommended that an European-level business angel panel is convened in cooperation with the actors representing the risk capital community. Such a panel would help the European Business Angel Network in increasing the visibility of the angels at European level.

4. Paying attention to the effects of taxation on business angel activity.

The taxation of risk capital and equity investments has an effect on their attractiveness, as it directly affects the return the investor receives from his investments. A tax environment that encourages risky investments can be favoured by low capital gains tax for business angel investments, or by introducing tax breaks for eligible investments. An unfavourable taxation framework might deter investments and thus act as a drag on wealth and job creation.

5. Ensuring public financing of business angel network operations

Many angel networks already receive public support from local, regional or Member State authorities. Public sector support has also been channelled through the European Regional Development Fund. This public sector support enables the networks to increase investment readiness, facilitate matching, organise awareness raising, training and other support activities. Through these activities the networks support local wealth and job creation. Particularly local and regional authorities can reap great benefits for their region through active business angel networks, and they should seriously consider financial support programmes particularly for newly established business angel networks.

6. Promoting high ethical standards of business angel networks

Many angel networks already subscribe to a code of conduct, but more should be encouraged to do so. The development of the business angel marketplace is best supported by transparent rules of behaviour promoting high ethical standards for both investors and entrepreneurs.

ANNEX

Members of the expert group

Belgium	Mr Bernard Surlemont	Université de Lausanne BFSH1 CH-1015 Lausanne bernard.surlemont@hec.unil.ch
	Mr Frédéric Nlemvo	Université de Liège Boulevard du Rectorat, 7 B-4000 Liège f.nlemvo@ulg.ac.be
Denmark	Ms Glenda Napier	Danish Business Angels Network Langlinie Allé 19 DK-2100 Kobenhavn O gn@dban.dk
Germany	Mr Udo Neuhäusser	Bundesministerium für Wirtschaft und Technologie Referat VI A 5 (Innovationsfinanzierung) Heilsbachstrasse 16 D-53123 Bonn neuhaeusser@bmwi.bund.de
Greece	Mr Spyros Makridakis	sm@lamda-development.net
	Mr Ioannis Patiris	Ministry of Development 80 Michalakopoulou Street EL-111510 Athènes patirisi@ypan.gr
Spain	Mr Gunter Schiendl	CIDEM C/ Provença 339 E-08037 Barcelona gschiendl@cidem.gencat.es
	Mr Víctor Portillo	Ministerio de Economía Paseo del Prado N6 8 planta E-28014 Madrid vportillo@tesoro.mineco.es
France	Mr André Jaunay	Directeur territorial Conseil Régional 35 Boulevard des Invalides F- 75007 Paris andre.jaunay@iledefrance.fr
Ireland	Ms Noelle Tumson	Investment Services Directorate Venture Capital/Business Angels Wilton Park House, Wilton Place Dublin 2 noelle.tumson@enterprise-ireland.com
Italy	Mr Paolo Anselmo	Euro-Bic Vallée d'Aoste Centro Sviluppo S.p.A. Regione Borgnalle 10/L I-11100 AOSTA info@centrosviluppo.it
Luxembourg	Mr Albert Frank	Ministère des Classes Moyennes du tourisme et du logement Avenue Emile Reuter 3 L-2937 albert.frank@cmt.etat.lu
Netherlands	Ms Mira Stol-Trip	Corporate finance department Directorate General Enterprise Postbus 20101 NL-2500 EC Den Haag m.m.stol-trip@minez.nl

Austria	Ms Renate Grabherr	Innovationsagentur Taborstrasse 10 A-1020 Wien rgrabherr@innovation.co.at
	Mr Helmut Dorn	Innovationsagentur Taborstrasse 10 A-1020 Vienna hdorn@awsq.at
Portugal	Mr Nuno Goncalves	Dept of SME Financial Policies IAPMEI Rua Rodrigo da Fonseca 73 P-1269-158 Lisboa nuno.goncalves@iapmei.pt
Finland	Mr Pertti Valtonen	Ministry of Trade and Industry Aleksanterinkatu PO box 32 FIN-00023 Government pertti.valtonen@ktm.vn.fi
Sweden	Ms Birgitta Österberg	Swedish Agency for Business Development P.O. Box 47631 SE-117 86 Stockholm birgitta.osterberg@nutek.se
	Mr Göran Ekström	Swedish Agency for Business Development P.O. Box 47631 SE-117 86 Stockholm goran.ekstrom@almi.se
United Kingdom	Mr Bernard Hallewell	National Business Angels Network 40-42 Cannon Lane UK-London EC4N 6JJ bernardh@bestmatch.co.uk
Norway	Mr Truls Erikson	Norges teknisk-naturvitenskapelige universitet Alfred Getzv. 1 N-7491 Trondheim truls.erikson@iot.ntnu.no
Private experts	Mr Jean-Louis Duplat	Ernst & Young Marcel Thiryiaan 204 B – 1200 Brussel
	Ms Emma Fau Sebastian	EVCA Minervastraat 6 B-1930 Zaventem evca@evca.com
	Ms Hilde Goossens	Vlerick Business Angels Network C/o Vlerick Leuven Gent Management School B – 9050 GENT hilde.goossens@vlerick.be
	Mr Christian Saublens	EBAN / EURADA Avenue des Arts 12, bte 7 B – 1210 BRUSSELS info@eban.org
	Mr Alfons Westgeest	Ernst & Young Marcel Thiryiaan 204 B – 1200 Brussel alfons.westgeest@ey.be
	Mr Peter Jungen	Business Angels Netzwerk Deutschland Gustav-Heinemann-Ufer 54 D – 50968 KÖLN peter.jungen@netcologne.de

	Mr Franco Rizzo	Business Angel Netzwerk Ostwestfalen Hans-Boecklerstraße 20-22 a D – 59423 UNNA
	Mr Risto Kalske	SITRA PO Box 160 Itämerentori 2 FI – 00181 HELSINKI risto.kalske@sitra.fi
	Mr Ben Lacor	NEBIB Postbus 154 NL – 3620 AD BREUKELEN nebib@nebib.nl
	Mr Rui Delgado	Gesventure Rua Jose Manuel Cerqueira alfonso Santos 3 - 1° Esq P-2685-344 Prior Velho rdelgado@mail.telepac.pt
	Ms Nuria Bosch	CIDEM Provença 339 E – 08010 BARCELONA
	Mr Martin Carr	Business Link Hertfordshire 45, Grosvenor Road St. Albans UK – Hertfordshire AL1 3AW martin.carr@herts.businesslink.co.uk
	Ms Erika Caruana	Project manager sisters@maltanet.net
	Mr David Grahame	LINC Scotland Queens House 19, St Vincent Place UK – GLASGOW G1 2DT david_grahame@lincscot.co.uk
	Mr Colin Mason	University of Strathclyde Level 14, Livingstone Tower, Richmond St Glasgow G1 1XH colin.mason@strath.ac.uk
	Mr Staffan Gullander	Ekonomiska institutionen Linköpings universitet S-58183 Linköping stagu@eki.liu.se
	Mr Jacques Putzeys	Angel Bourse Venturers House Prince Street Bristol UK – Bristol BS1 4PB jacquesp@angelbourse.com
European Commission	Mr Albrecht Mulfinger	Head of Unit Enterprise Directorate-General, Access to finance European Commission B-1049 Brussels albrecht.mulfinger@cec.eu.int
	Mr Vesa Vanhanen	Enterprise Directorate-General, Access to finance European Commission B-1049 Brussels vesa.vanhanen@cec.eu.int