

EBAN statement for immediate release

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The impact of the financial crisis on the activity of business angels and early stage investors - What should policy makers do to make sure that great innovations find access to finance at their early stages?

The current financial crisis severely affects access to finance for small businesses, who represent 99% of companies Europe-wide and are responsible for the majority of economic growth and employment. Tightening market conditions for access to credit and late payment issues from clients are making it hard for SMEs worldwide to meet their working capital requirements. They are seeking alternative ways to source finance for the growth of their business, in particular through equity financing if they are at the early stage of their development. The crisis has generated an unexpected flow of capital demands to business angel networks (BAN) across Europe which clearly demonstrates the current lack of access to bank credit. This is creating some important challenges for early stage investors but also opportunities which policy makers should help to tackle and leverage.

The financial crisis increases the equity gap¹ - More business angels are needed

BAN and seed fund managers across Europe are witness to a worrying phenomenon. The companies that come to seek equity finance at the moment are not only the usual high potential start-up, but also those companies which had achieved 3 to 5 million euro revenues in sales after 3 years, so-called "gazelles" who traditionally did not have to worry for their follow-on financing. This has meant extraordinary good deal flow for business angels², who have the opportunity to finance great companies at a valuation which has come down from 20 to 30% in the last months. And this trend is likely to continue in the coming months. These opportunities have consequently generated an acute lack of access to finance for those who would generally be suited for angel finance: highly innovative yet risky businesses.

At the same time, many business angels have lost money on the stock markets and/or on real estate. While great opportunities at attractive valuations are out there on the market, most will want to stay focused on their portfolio, making sure that they have enough money for follow-on round investments. Angel funding for newly formed early stage businesses will not come easy in the next 12 to 24 months, and while entrepreneurs will focus on their cash flow they will often need additional funding for their growth in that time period. The climate for exits is now poor. Only business angels with "deep pockets" will be able to afford new investments.

The financial crisis is generating opportunities for the smaller pool of early stage investors. As the availability of traditional capital becomes scarce, the demand for equity is rising. Redundancies or layoffs are likely to create a new generation of entrepreneurs and start-ups, increasing the need for additional start up and early stage risk capital. Business angels are needed not only for their capital, but for the mentoring they bring to new companies. This is particularly true during these challenging times.

The impact on business angel networks (BANs)

BANs bring together entrepreneurs looking for equity finance with business angels. In recent years, they have become increasingly professional and sophisticated, providing platforms for syndication, co-investment, as well as capacity building opportunities through investment and investor readiness programmes. They have become an essential element of the entrepreneurial support ecosystem across Europe.

The financial crisis is putting angel groups at risk. Some of their members, especially recent members who have not previously experienced a downturn are no longer making new investments and may soon decide to withdraw from the network. BAN's success fees are likely to decrease as well as

¹ Equity gap: the phase between 500.000 and 3 million euros where high potential start-ups have the greatest difficulties in accessing finance. In some countries the gap starts from 150.000€ on to 3 million€.

² Business angels, high net worth individuals with management and/or entrepreneurial experience who invest in unquoted businesses

revenues generated from membership fees or sponsorship, which will make it harder for groups to sustain their activity. However, BANs must be able to leverage the additional opportunities which are coming their way as a result of the crisis. They need to have enough financial and human resources to attract new business angels to the market, build their capacity to turn them into serial angels, but also retain existing investors.

What can policy makers do to support the early stage investment market

1. Attracting more investors to the market

BANs as well as early stage funds need the support of policy makers to attract more investors to the market in three ways: **awareness raising** on the role of these investors and what type of companies they back; **investor readiness** to build capacity of new and existing business angels; reinforcing **fiscal incentives** available for them across Europe. Business angels need to be activated not only for their availability of capital but also for their role as coach and mentors of young companies.

2. Improve transparency on the market – monitoring angel activity

Given the current economic climate, investors or would-be investors will tend to become risk and complexity adverse. What does risk really mean? What is the level of risk associated with becoming a business angel? While the USA and the UK have gathered data on rates of return for investors to report on the level of risk and increase the transparency of the market, there is no such data available at European level. Existing reports have had a resounding impact on the perception of the angel market and in attracting new angels to groups. European policy makers should support a **Europe-wide study to increase the interest of potential investors in supporting high potential start-ups**. Research efforts could also help policy makers and intermediaries in this market to appreciate the impact of the crisis on the member states (at the moment, the UK economy seems to be worst hit than that of France or Switzerland), and on the different sectors.

3. The role of trade associations and business angel groups

Trade associations represent the angel and early stage investment market in a number of EU member states. They act as an intermediary between policy makers and their members, providing visibility to their activity and results. Policy makers should support, in particular during these challenging economic times, these structures that act as a relay to the early stage market, and promote the exploitation of public private partnership opportunities at national level such as co-investment funds. Moreover, trade associations can become involved in implementing or coordinating the implementation at regional level of capacity building opportunities for investor and entrepreneurs which increase the number of deals done and which are crucial at the moment. Finally trade associations have a role in supporting training/professionalization of BAN and seed fund managers in their respective countries.

Business angel groups have historically struggled to fund their operations. Entrepreneurs often cannot afford to pay introduction fees while business angels are often keen to invest funds into the company but not for supporting the BAN and seed fund structures. In recent years business angel groups have started providing a number of add-on services to their members, actively supporting the growth of the number of successful companies accessing financing as well as the number and capacity of angel investors. During this crisis, policy makers should leverage on existing structures and support their actions aiming to bring new business angels to the market and to fill the equity gap.

4. Reinforcing the collaboration between business angels and venture capital funds

Policy makers should support an increased collaboration between the different actors involved in financing high potential companies at different stages of their development. The financial crisis is putting a pressure on valuation for all financiers, which means for business angels and early stage VC funds that later stage VCs, investing over 3 million euros per company, will put pressure on valuations when negotiating with early stage investors. Policy makers should support the organization of regional/national workshops for these actors to reduce asymmetries of information, but also help build common investment agreements and solutions to co-investment.

EBAN is the European trade association for business angels and early stage investors. It currently federates 90 organizations in 25 countries, representing the interests of angel networks across Europe. EBAN has recently opened its full membership to early stage venture capital funds, in an effort to represent all financial actors helping entrepreneurs with both capital but also mentorship and filling the equity gap. For more information about EBAN and its members, visit www.eban.org