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Angel Investing Trends and Characteristics in the EU

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Abstract: The financing of entrepreneurial ventures in the European Union is facing many challenges, but its actors are constantly striving to improve its market conditions in order to provide support to entrepreneurs in the early stages of development. Business angel investments, as the most common source of financing in the early stages of enterprise development in the European Union, have been recognized as a form of investment that transcends national borders. The growth of business angel investments has been slowed down by the global pandemic, but there is no doubt that this form of investment is growing, and business angels have long not been just individuals who invest only in the early stages of enterprise development, so by uniting these individuals, there are created new investment concepts that expand their activities into later stages of company development. In 2020, business angel investments accounted for the largest share of the European investment market, or about 58% of the total investment market in the early stages of enterprise development. In 2020 alone, these investments amounted to as much as 7.67 billion euros, and in 2019 to as much as 8.04 billion euros. Disorders in the economy caused by the pandemic will undoubtedly affect all segments of the European economy, but the survival and development of small businesses are part of the economic recovery after the crisis, so all hope lies in that investments of business angels and other forms of early business financing will continue to grow. It's not odd that such investors are currently looking for companies to finance outside domestic economies, because geographical distance in the conditions of a high degree of globalization is becoming less and less important. However, cross-border investments remain a challenge.

Key words: business angels, financing entrepreneurship, alternative finance, informal finance, early stages of entrepreneurial development

JEL: D53, F65, L26

Introduction

Business angels are most often successful entrepreneurs, people who have been in managerial positions for a long time or owners of successful companies with considerable knowledge and skills in their field, which allows them to use it to invest in other companies that need expertise and capital at the same time. These investments are usually informal and without intermediaries, i.e. done directly through the founders' agreement. These investors are therefore often referred to as informal venture capital.

Business angels invest their own money, individually or with others, in companies with which they have no family ties (Mason et al., 2016). They can also invest within a union in which one angel usually takes the lead. Angel investors often operate as "small investment groups within which they enlarge their capital and coordinate investment decisions, and with the help of their lawyers and accountants they conclude contracts and invest in small companies, most often start-ups." The angel market is very heterogeneous and localized (Prowse, 1998). In the case of these investors, there are no rules on the amount of money and other aspects of the investment agreements, but they are a great choice for initial seed investments. The amounts that angel investors usually provide range from ten thousand euros to millions of euros.

Angel investors usually offer their experience, contacts, knowledge and other forms of intangible contributions in the industry in which the company operates (Tenca, Croce, & Ughetto, 2018), which can help with legal issues, sales and marketing of products, as well as other elements of importance for the development of initial business. Due to this way of investing, it is considered that they provide "a smart and patient capital."

Business angel investments have been on an upward trajectory in the world, primarily in America and Europe. There are no precise data, but it is believed that business angels in the United States represent the informal venture capital market and that they have the largest reserves of free capital for investment. It is estimated that every year more than 100 thousand independent investors finance from 30 to 50 thousand entrepreneurs in the amount of 7 to 10 billion dollars (Njegomir et al., 2017). There are about 28,000-33,000 business angels in the European Union who are members of networks that provide information about them. However, it is estimated that there are over 300,000 angel investors in Europe who provide about 60% of the total investments in the early stages of a company. Despite the disturbances caused by the outbreak of the COVID-19 pandemic, it is believed that this informal investment market will continue to grow in the future.

Characteristics of angel investors in Europe

Business angels or angel investors are successful and wealthy individuals who prefer to invest money in promising projects in exchange for a share in the company ownership, very often without a managerial role. According to some studies, up to 80% of business angels are wealthy entrepreneurs (Harrison et al., 2010).

In the past, it was believed that business angels who invest capital and knowledge in start-ups are mostly successful former managers or entrepreneurs over the age of 50. Today, business angels are much younger individuals. Start-up entrepreneurs who successfully sold their businesses at a fairly young age have found that investing in business angels is an opportunity to foster and mentor young entrepreneurs.

Business angels are particularly important from the perspective of the regional economic development, as most of their investments are local (Harrison et al., 2010). However, as of late, angel investors have been looking for companies to finance outside domestic economies. Geographical distance in the conditions of a high degree of globalization is becoming less and less important. However, cross-border investment remains a challenge.

The way we do business and organize things, and the way business angels invest their money, change over time, although due to their informality there is not much literature on the subject. Also, the literature thought of angel investors as a homogeneous category and therefore not much research has been done on how much these investors differ in terms of personal characteristics, risk attitudes, investment strategies, portfolio management and post-investment inclusion (Croce, Ughetto, & Cowling, 2020). Furthermore, studies have failed to present a profile of the type of business ventures in which business angels invest and the extent to which investors can improve the performance of these ventures in line with previous experience (Croce, Ughetto, Bonini, & Capizzi, 2021).

The business angel market has changed from an isolated and rather inconspicuous market made up of individuals investing alone or in small temporary groups, to one in which these angels have become visible groups of investors or angel unions, uniting and channeling funds from individual investors to entrepreneurial ventures (Mason et al., 2016).

During the 1980s and 1990s, as the business angel market was slowly developing, business angels invested mostly independently, or within temporary groups of business associates or friends, in ventures that they found through personal social or business networks. During that period, this form of investment did not work efficiently, as it was relatively difficult for investors and entrepreneurs to find each other. After a period characterized by a low level of professionalism, the first business angel networks appeared, first in the United States, then in Canada, and even in Europe.

In the late 1990s, the business angel market began to take a different shape, when angels began investing within mutual funds groups. The Band of Angels was founded in Silicon Valley (USA) and is considered the first such group. Angel groups arose for two main reasons: first, business angels are characterized by difficulties in investing in relation to formal venture capital, which is in some ways more protected because it uses different investment instruments, which was especially evident during the dot.com crash; second, after the aforementioned breakdown, venture capital shifted to later stages of investment, which somewhat limited business angels in continuing to fund business ventures, but it was still suggested that angels would continue to provide financial support after the initial stage. Angels recognized the benefits of investing within a group, some of these being: easier investment and less effort of each individual, exchanging experiences and knowledge, learning from experienced investors, providing networking opportunities with like-minded investors, creating investment opportunities in which they would not be able to invest individually, providing a chance to make larger investments by acting together and securing additional investments and exit from investments without the need for subsequent financing with formal risk capital (Mason et al., 2016).

Although business angel financing is usually linked to the early stages of company development, this may not always be the case, as their entry into corporate financing depends on the projected rate of return and the level of risk at that stage. In Anglo-Saxon economies, business angels are considered the only investors in the early stages of a company's business. These investors usually invest capital on an informal basis in projects that are similar to previous projects in which they have invested, or for which they already have enough experience.

Some time ago, business angels invested in companies primarily in the early stages of business. Recently, these investors have also been investing in later stages of a company’s development, especially in the continuation of financing their portfolio companies in order to compensate for the lack of suitable VC companies. Most angel investors focus on certain sectors, but of course not all. Most often, companies in the field of information and communication technologies are the focus of business angels' investments across Europe. Other important sectors in which these investors most often invest are biotechnology, medical technology or consumer products (Business Angels Europe (BAE), 2016).

Potential of business angels in Europe

The European angel market, and the capital market in general, is not as deep as the one in the United States, where beginners have more ways to get their initial funding, but also more ways to raise funds in later stages of development. The big problem of the European capital market lies in the pronounced fragmentation of the market (Mason, Botelho, & Duggett, 2021)

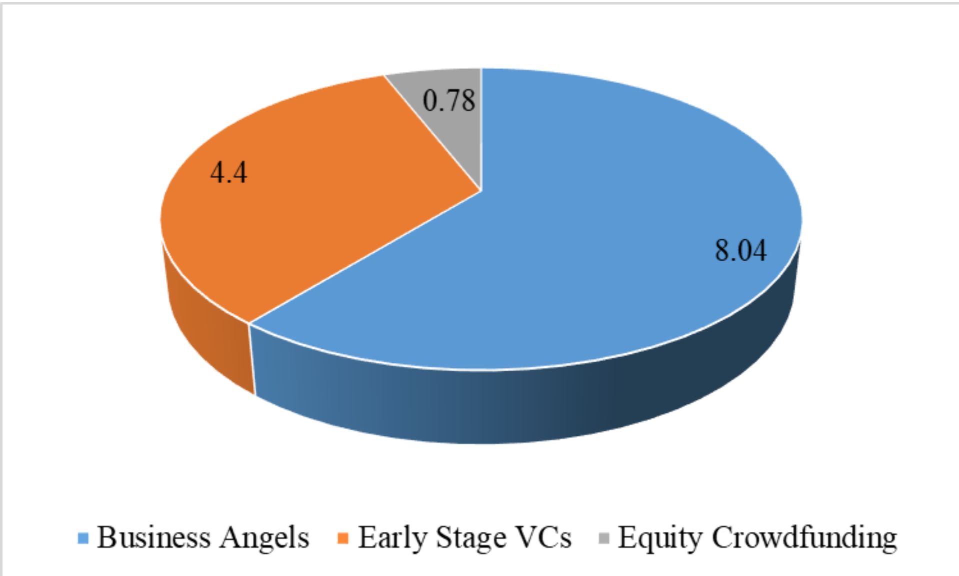
The European venture capital industry is characterized by lower funding, lower average investment per venture, lower funding and lower investment in later stages of financing (Duruflé, Hellman, & Wilson, 2018). The European Union recognized the need for changes in the European market, and in 2014, the Capital Markets Union (CMU) initiative was launched, which aimed to further deepen and integrate the market. Such initiatives are now even more necessary in order to prevent the fragmentation of the European market in the direction of preserving investments, but also in the context of recovery from the crisis caused by the COVID-19 pandemic.

It is well known that angel investors play a key role in promoting economic growth and entrepreneurship by helping to fill the "financing gap" between demand and supply of equity at an early stage (Wiltbank, Read, Dew, & Sarasvathy, 2009). An appropriate offer of financing sources and an easier access to them becomes a necessity, because the provision of capital affects all aspects of business operations and is a significant factor in achieving the development of enterprises (Đekić & Ristanović, 2021). Some of the most important non-banking sources of financing for small businesses in developed and, as of late, in transition countries are crowdfunding, venture capital funds and business angels. These forms of financing are often related to the early stages of company development, but using these sources of financing is becoming increasingly common in the later stages of company development as well (Đekić, Brzaković, & Janošik, 2019). According to the data of EVCA (European Private Equity and Venture Capital Association), the total volume of investments in the early stages of the company's operations in 2013 amounted to 7.5 billion euros, of which as much as 5.5 billion euros were business angels' investments. This resulted in the financing of 33,430 companies, which contributed to the creation of 184,170 new jobs. The average investment per company was around 166,000 euros, and the average investment of a business angel was around 20,000 euros (European Commission, 2015a).

Business angel investments in Europe amounted to about 6.1 billion euros in 2015, almost 6.7 billion euros in 2016, and in 2017 they increased by about 9% compared to 2016 and reached the amount of almost 7.3 billion euros, and so on.

European business angel investments decreased by 4.5% in 2020 compared to 2019, bringing the (visible and invisible) market to an estimated total investment of 7.67 billion euros in 2020 (compared to as much as 8.04 billion in 2019). The previous decline in business angel investments was recorded in 2008 due to the financial crisis.

Graph 1. The three most common forms of company investment in the early stages of company development in 2019



Source: (EBAN, 2019)

There are about 28,000-33,000 business angels in the European Union who are members of networks that provide information about them. Of course, there are others about which networks do not provide data. The average network has about 70-75 registered angels, although not all are active. It is estimated that there are at least seven times more business angels than within the EU networks (European Commission, 2017e). The latest estimates show that in 2019 there were a total of 410 networks, and that there was a total of about 322 thousand angel investors on the European market, counting those who are and those who are not in networks. Business angel networks provide a communication channel through which entrepreneurs can present their investment proposals to potential investors, and the investors can examine investment opportunities without compromising their privacy.

The following table shows the movement of the number of investors, networks and business angels' investments for the three-year period, starting in 2015.

Table 1. Movement of basic characteristics of business angels' investment activity for the period 2015 - 2020

Year	Investments in millions of euros	Number of networks	Number of investors	Number of ventures
2015	6069	371	303 650	32 940
2016	6672	414	312 500	38 230
2017	7274	401	337 500	39 390
2018	7450	410	345 000	37 200
2019	8040	404	345 000	36 020
2020	7670	408	322 000	35 830

Source: (EBAN, 2016, pp.. 1-2; EBAN, 2017, p. 6; EBAN, 2018, p. 6; EBAN, 2021, pp. 10-11)

Assumptions for future business angel investment trends

Angel investors are one of the main sources of financing for the European companies in the early stages of development, which, in addition to financing, provide development support and mentoring. The economic and social impacts of business angels show that they play a key role in the economy as they contribute to the development of private capital, business experience and skills that support the growth of small businesses. Angels' investments should be considered an important means that should encourage others to support entrepreneurs and innovation.

Business angel networks provide a communication channel through which entrepreneurs can present their investment proposals to potential investors, and investors can explore investment opportunities without compromising their privacy (Mason & Harrison, 1997).

As mentioned, during 2020, there was a decline in investments of angel investors, and this is the only decline since 2008. The market for visible angel investors has actually been growing steadily since 2011. The European investment activity of angels in 2020 is approximately 80% higher than in 2011, and this growth is expected to continue in 2021.

Despite the uncertainty created by the pandemic, the effects on the investment community at an early stage varied significantly across European countries. Despite some initial difficulties in adjusting to the "new normal", networks and individual investors have used digital technologies to continue to assess and monitor initial investments.

Over the past few years, the market for angel investors has grown in terms of the total amount of invested funds, the number of deals and the number of business angels, which is also expected in the future. Angel investors are playing an increasingly important role in the economy of countries around the world. As a result, they have attracted the attention of policy makers.

Governments typically provide financial support to BANs (Business Angels Networks) to enable them to improve market efficiency by connecting angels with entrepreneurs seeking finance (OECD, 2011). At the beginning of the development of this market, institutional support is of particular importance, as evidenced by the example of Great Britain, where certain networks of business angels were shut down after losing government support. Network development requires sustainability and the existence of a commercially viable model, especially in the early stages, when it is necessary to provide investment preparation and investor training programs. Following the example of the developed countries of the world and Europe, which have supported the development of the business angel market, guided by their importance for the development of entrepreneurial spirit and willingness to take risks, developing countries should also work on performing more focused activities.

The government of each country has a big role in attracting investors, so business angels should be talked about as investors, especially in the region, since their capital is necessary, and they still do not appear in this field, or they do, but insufficiently. Also, the EU regulators should promote and support cross-border angel investments.

The angel investment market has developed significantly in many countries around the world, especially in the last 15-20 years. In some countries, policies to encourage more angel investors seem to have played an important role. This includes supply-side measures, such as tax incentives and the creation of co-investment funds.

An adequate entrepreneurial ecosystem is key to a successful angel investing. Entrepreneurship does not function in a vacuum. It can only flourish in a healthy entrepreneurial ecosystem in which many stakeholders play a role, including entrepreneurs, investors, large companies, universities, governments, service providers, etc. Governments can help by providing appropriate legal and financial conditions and by helping to address market failures. However, the main actors in building the angel market must be the angel investors themselves.

Summary, recommendations

Angel investors are the primary source of funding for new ventures and appear to be largely heterogeneous in terms of personal traits and characteristics. In addition to the benefits of capital infusions, companies in which they invest benefit from the entrepreneurial and investment experience of business angels, knowledge about the industry and a network of business contacts. These competencies are transferred directly to the firm; they form the basis on which the company's capabilities are built and are responsible for superior performance. Therefore, it is considered that the presence of greater availability of capital, together with an additional set of non-monetary contributions, affects the growth prospects of financed ventures.

The investments of European business angels have a growing trend, and their influence on the development of companies is growing. With this, business angels have strengthened their position as the most important source of financing for start-ups and small and medium-sized enterprises in the early stages of development.

Business angel investments accounted for the largest share of the European investment market in 2020, followed by Early Stage VCs and group equity financing. These three forms of investment at an early stage had stable growth between 2015 and 2019, but declined in 2020 due to the Covid-19 pandemic. Business angels invested around 6.1 billion euros in Europe alone in 2015, and in 2019 these investments reached 8.04 billion euros. In 2020, however, business angels invested 7.67 billion euros, which was almost 58% of the total investment in the early stages of European business.

The European capital market is highly fragmented, but what has been recognized is the need to unify the market and move towards a single-type functioning, in order to provide opportunities for the most diverse activities of investors such as business angels, outside the local framework. Also, states can provide massive support to the development of business angels, and they often provide financial and other incentives, which is especially important in the period after the crisis caused by the pandemic. Despite the fact that the investments of business angels in 2020 decreased compared to before, as well as the fact that investors are considered to have postponed their investments in the previous period due to market instability, it is believed that this market will continue its upward trajectory in the future.

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