

## **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 is severely affecting 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 across Europe which clearly demonstrates the lack of access to bank credit. This is creating some important challenges for early stage investors but also interesting opportunities which policy makers should help to tackle and leverage.

#### **The financial crisis increases the equity gap<sup>1</sup>**

Business angel network 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 angels<sup>2</sup>, 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, the vast majority of business angels have lost money on the stock market 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. New cash will not come easy in the next 12 to 24 months, and while entrepreneurs will focus on their cash flow they will probably necessitate additional funding for their growth in that time period. Deferred returns are the biggest problem for investors at the moment. Only business angels with “deep pockets” will be able to afford new investments.

The financial crisis is generating opportunities for 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 likelihood of success both for entrepreneurs and investors.

#### **The impact on business angel networks (BANs)**

BANs are those entities bringing 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 programs. They have become an essential element of the entrepreneurial support ecosystem across Europe.

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<sup>1</sup> Equity gap: the phase between 500.000 and 3 million euros where high potential start-ups have the greatest difficulties in accessing finance

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

The financial crisis is putting angel groups at risk. Some of their members, especially those younger members who have not experienced as investors one or several downturns, are getting cold feet and may decide to either withdraw from the network or stop making new investments. Success fees are likely to decrease as well as revenues generated from membership fees, 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 resource to attract new business angels to the market, build their capacity to turn them into serial angels, but also retain existing investors.

## What should policy makers do to support the early stage investment market?

### 1. Attracting more investors to the market

Business angel networks 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.

### 2. Improve transparency on the market

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 seems to be worst hit that 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.

Business angel groups have historically struggled to fund their operations. Entrepreneurs coming to them do not have any finance, while business angels are keen to invest in the company and not supporting structures. In recent years business angel groups have starting 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 build common investment agreements and solutions to co-investment.

*EBAN is the European trade association for business angels and early stage investors. It federates 90 organizations in 25 countries, representing the interests of two thirds of the 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](http://www.eban.org)*