

## **BUSINESS ANGELS – POSSIBILITY FOR EUROPEAN SMES**

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**Abstract.** Access to finance remains one of the top problems for SMEs in Europe, mainly because of their high relevance on traditional bank loans. In this paper, the main characteristics of European SMEs will be analysed. As one of the top problems for this class of enterprises in European Union is access to finance - the paper will evaluate the possibilities of Business Angels in solving this issue. The paper will also seek the answer of whether the possibilities of Business Angels meet the financial needs of SMEs and what could be done in order to enhance the positive outcome of their possible cooperation.

The main conclusion of the paper stands that while having a great potential to finance and enhance the outcome of SMEs, so far, the performance of Business Angles had been rather poor. The broad fragmentation of the market, the lack of unified terminology and the absence of well-formed unified legislative base are highlighted as the main reasons for poor private investments in European SMEs.

**Key words:** SME, Business Angels, alternative investment

**JEL code:** O16

### **Introduction**

This paper will stress the problem of SME's access to finance paying special attention to one of the alternative financing opportunities – Business Angels. The author will look through statistic data, reviews and publications in order to examine whether Business Angels can be considered as worthwhile opportunity for financing SME's.

Annual report of European SME's 2013/2014, presented by the European Commission on July 2014, claims, that Small and Medium-sized Enterprises (SMEs) still form the backbone of the European economy. According to the statistical data mentioned in the report, some 21.6 million SMEs in the non-financial business sector employed 88.8 million people and generated EUR 3.666 trillion in value added. Expressed another way, 99 out of every 100 businesses are SMEs, as are 2 in every 3 employees and 58 cents in every euro of value added. Stability and growth of SME's are vital in dealing with such topics as unemployment, increase of export

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market share as well as overall economic development. Even though there is a fair work done so far, access to finance still remains one of the top problems for SMEs in Europe. Access to finance was rated as the fifth most pressing problem SMEs face - 14% of EU28 Member State **SMEs stressed it to be the most pressing problem (Access to Finance..., 2014). Nevertheless,** the author assumes that the real size of this problem might be more intent. For instance bank loans, which are widely recognised, have several cons. After the crisis banks are less risk-taking, thus, even if accessible this way of gaining the finance became more challenging. Another problem which banks face is the quality of their capital, which is a certain boundary for further credit activities. What is more, traditional bank lawns do not provide any additional support except credits.

Alternative investment continues the development. Such topics as seed capital, securitisation and other ways of funding have been widely discussed, mainly because of the extra possibilities they bring. In this paper the author will focus on Business Angels, a special class of private investors. On the top of everything, Business Angels, besides the financial investments can also help with business management and share their own business experience, which at the end, can turn to be even more valuable. The top target of this paper is to prove the hypothesis that Business Angels can be considered a good alternative of finance captivation and that they can give the valuable support to SMEs. First thing to be done is the **analysis of the structure and main characteristics of SME's in Europe. Then, a brief analysis of** alternative investments and evaluation of Business Angels will be done. In order to enhance the analysis, the author will use the following research methods:

- Monographic method;
- The method of economic analysis;
- The method of graphical visualisation.

The object of this paper is the access to finance for SMEs. The main aim of this research is to evaluate the possibilities of Business Angels in financing the SMEs on the basis of the analysis of SMEs in European Union and problems they face to access the finance.

In order to reach the aim mentioned, several tasks have been identified:

- 1) To analyse the structure of SMEs in European Union;
- 2) Highlighting the main problems SMEs face;
- 3) To understand if there is a need in finance and how big is it;
- 4) To analyse the activity of Business Angels in Europe;
- 5) To evaluate if Business Angels are capable to meet the needs of SMEs.

## **Research results and discussion**

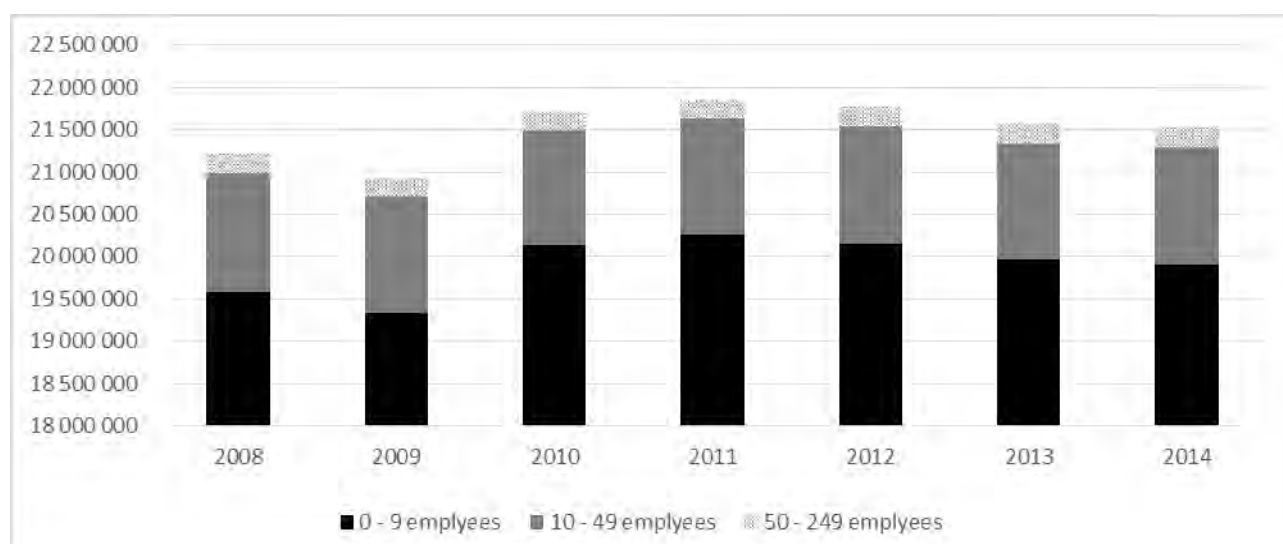
To start, it should be unified what types of enterprises are considered to be SMEs in Europe. Within the framework of this paper the author will use the definition proposed at Official journal of the European Union (European Commission, 2003).

**The criteria of SMEs in Europe**

Category of a company	Number of employees	Turnover	or	Balance sheet total
Micro	less than 10	< EUR 2 million	or	< EUR 2 million
Small	less than 50	< EUR 10 million	or	< EUR 10 million
Medium	less than 250	< EUR 50 million	or	< EUR 43 million

**Source: author's summary based on Official journal of the European Union L124/36, 20 may 2003**

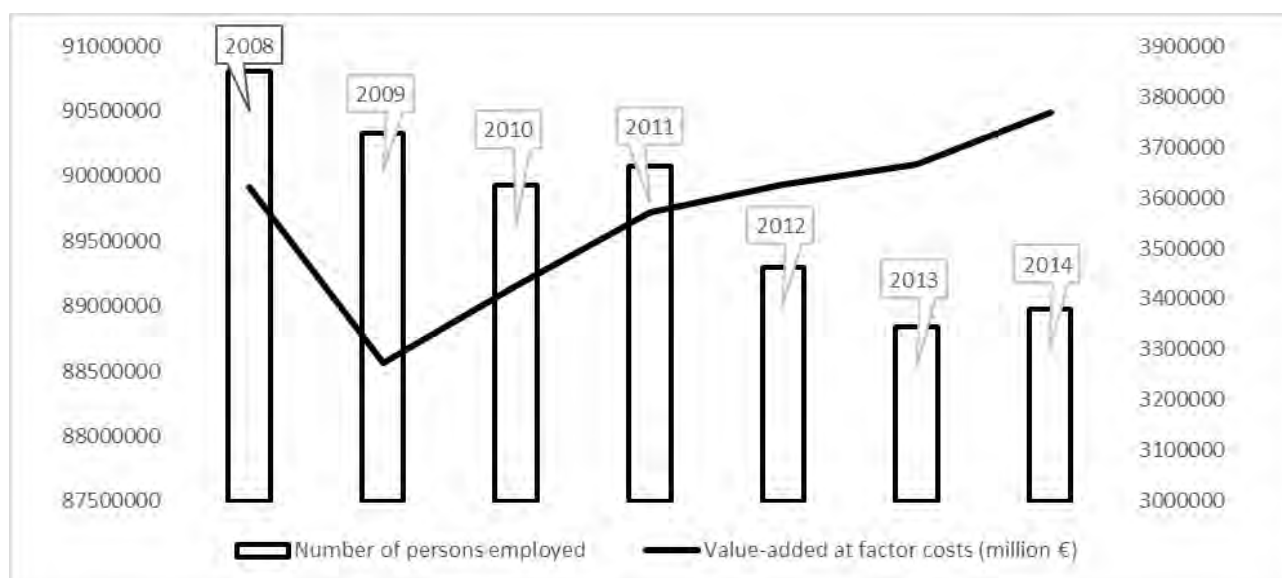
From the table above, one can conclude, that the SMEs are the enterprises with total balance sheet less than EUR 43 million or turnover less than EUR 50 million and with less than 250 people employed. Second aspect to be aware of is the total amount of SMEs in Europe – or in other words, SME's market share.



**Source: author's construction based on Database for the Annual report on European SMEs 2014**

Fig. 1. **Number and size of SMEs in the EU28 by employees**

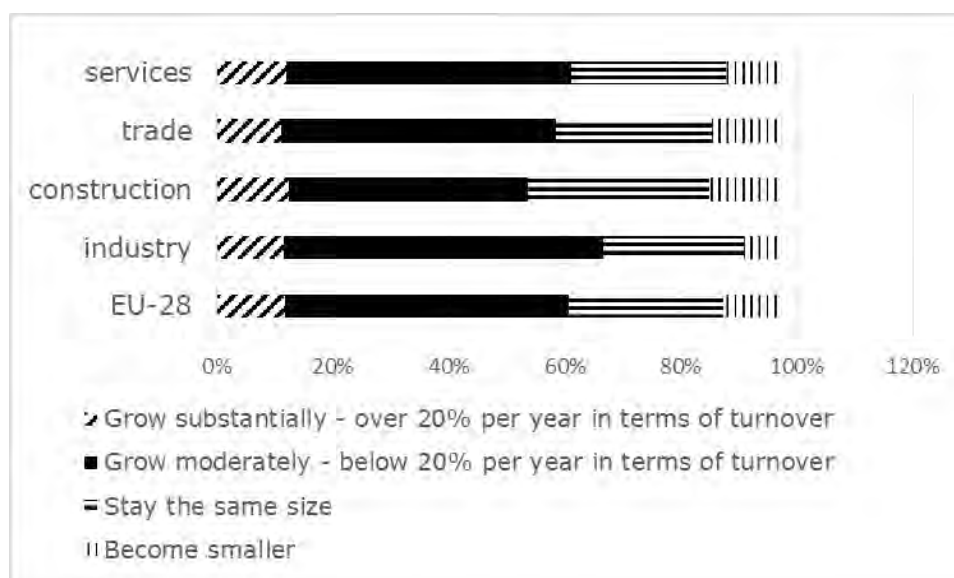
While analysing the structure of SMEs micro enterprises should be highlighted as they form approximately 92% of all European SMEs. This high proportion varies from 82% in Germany up to 96% in smaller economies, such as Slovakia, remaining vital all over the EU (Annual Report on..., 2014). SMEs have been called the backbone of the European economy and this is not only because of their prevalence in the market. In 2014 SMEs formed around 67% of working places and generated around 58% of all European Union GDP. These data becomes even more interesting when it is reminded that those are for non-financial institutions only (European Commission, 2014).



**Source: author's construction based on Database for the Annual report on European SMEs 2014**

**Fig. 2. Number of employees and value-added factor cost of European Union SMEs, EUR million**

Data above shows interesting dynamics – while working places declined for six years, generated value added factor managed not only to regain the losses of 2009 but also tends for new highs. On the one hand such tendency shows the increasing output of enterprises that might be quite a positive aspect if problem of unemployment in Europe is not neglected. Another important issue is the economic sector European SMEs represent. Besides all the data on SME sector relevance are crucial for building the right strategy of finance attraction. Later on the author will identify several reasons of why the support of Business Angels can be considered as one of the alternatives for European SMEs. According to the statistics in 2014, the further mentioned sectors formed approximately 78% of European Union SMEs accounting 71% of the value added created by SMEs: wholesale and retail trade, repair of motor vehicles and motorcycles, construction, manufacturing, professional, scientific and technical activities **and accommodation and food (Survey on the Access..., 2014). While mentioning these leader groups wholesale and retail trade sector was named as prior, strongly outperforming the others in means of employment, value-added at factor costs and number of SMEs. When speaking about the creation of new working places and boosting economy the question of sector relevance is a must. Even though supporting the economy, retail trade, which was identified being among the first rows, can't handle the whole recovery of European economy. The author suggests that going from money-movement boosting to value or product creation is vital. Concluding the overall reasoning of what SMEs in European Union means for the economic sustainability the expectations of SMEs to grow, creating up to 740000 new jobs in 2015 (European Commission, 2014) is highly crucial.**



**Source: author's construction based on Database for the Annual Report on European SMEs 2014**

**Fig.3. SMEs growth projections 2014-2016**

Such confidence of SMEs about the possibilities of upcoming growth is a very positive feature. Several positive effects could be hit, for instance, by implementing new technologies or investments in research and development. Survey done by the European Central bank identified the most pressing problems SMEs had to face so far (Survey on the Access..., 2014). According to the latest results, access to finance was named as the fifth most pressing problem among European SMEs. The analytical part of the survey (European Commission, 2014) stressed the following conclusions - micro enterprises consider the problem of access to finance the most pressing, whereas large enterprises find it least pressing and more innovative enterprises experience more access to finance problems than less innovative enterprises. From all information presented above the author assumes, that access to finance will form a great deal of everyday agenda and what is more, in the nearest future this problem might enhance. This assumption finds support in the World Bank featured indicators. It was claimed, that quite a part of SMEs already have outstanding loan or line of credit. For instance, in high-income countries 46% of small SMEs and 60% of medium SMEs employing 20 to 99 employees claimed to have outstanding loan or line of credit (World Bank, 2014). Both, assuming the expectations on growth of SMEs to be right, and keeping in mind their towering place in the EU economy the demand for finance in the upcoming years will grow. The author believes that alternative investment might offer the necessary support for the development.

## **1. Alternative investment**

The common problem of alternative investment sector is that so far, there is no unified definition explaining what it is. Among all, Chartered Alternative Investment Analyst Association also mentioned the absence of union consensus. In Introduction to Alternative Investments paper it was stressed, that alternative investment is a largely new and rapidly changing field. It was assumed that consensus would always remain elusive (www.caia.org).

Klausner ([www.forbes.com](http://www.forbes.com), 2013) shared quite a similar view. Even more, in 2013 he noted that the complexity of many alternative investments have necessitated that they have been used by institutional or very high net worth investors only. Even though there is a lack of union explanation the high necessity of alternative financing, especially in the SME sector, might play a crucial role. In relation to this topic High Level expert group report might be recalled (European Commission, 2013). The report was dedicated to SME and infrastructure financing overall noting their high importance. Besides all, a well-known fact was recalled saying that financial intermediation in Europe is still largely bank-based. It was claimed that around 80% of debt financing to the economy is provided by banks, in contrast to the US where bank financing is as low as 20% (**High Level Expert...., 2013**). Knowing the situation in bank sector and related aspects, the author claims having such a high bondage on the bank sector in some form might slag the overall development in Europe. This seeing finds support in mentioned HELG report - outlined suggestions mentioned in the report were inspired by the aim to find the proper balance of roles between bank and non-bank financing. While ascertaining that the topic of alternative investment is crucial, the author will evaluate the possibilities of Business Angels to solve the problem of access to finance and support the SMEs.

## **2. Evaluation of Business Angels**

Concept of Business Angels is both – wildly known and poorly managed. On the one hand, there is vast information available on this topic. EBAN Tool Kit wildly presented Business Angel and Business Angel network definitions in June 2009 (**Introduction to Business..., 2009**). This publication gave an introduction to Business Angel activity in Europe presenting a summary of different Business Angel types and core elements of Business Angels' networks. Prior to this, Jeffrey Sohl gave a solid analysis in his working paper "Angel investing: changing strategies during volatile times", where he identified trends in the Angel market by examining changes in characteristics and investment behaviour during a time of market expansion and contraction. Finally, in 2012 the European Commission presented the "Evaluation of EU Member States' Business Angel Markets and Policies" – where it was claimed that visible Business Angels market in the EU27 may be a little below 30,000 members – those who are members of networks that provide data on their activities in the EU and about 250000 Angels in networks overall. The total Business Angel market being, perhaps seven time as big (**Evaluation of EU ..., 2012**). In order to understand if Business Angels can be considered as worthwhile opportunity for financing SMEs it would be wise to light a definition of who Business Angels are. As European Trade Association for Business Angels, Seed Funds and other Early Stage Market Players ([www.eban.org](http://www.eban.org), 2013) explains, a Business Angel is an individual investor that invests directly or through their personal holding their own money predominantly in seed or start-up companies with no family relationships. Business Angels make their own investment decisions and are financially independent - a possible total loss of their Business Angel investments will not significantly change the economic situation of their assets. They invest with a medium to long term set time-frame and are ready to provide, on top of their individual investment,

follow-up strategic support to entrepreneurs from investment period to exit. They respect a code of ethics including rules for confidentiality and fairness of treatment, and compliance to anti-laundering. While acknowledging other offered definitions it can be concluded that there are no mismatches in overall approach. There is one more common thing mentioned in many sources. Business Angels market being mostly informal has a division in visible side where data on networks and syndicates are more or less available and invisible side where no information is strictly available (Evaluation of EU..., 2012). According to the data provided by EBAN, the **total value of the visible segment of the Business Angels' market in Europe in 2010 was around EUR 660 million**. According the prior estimation the size of non-visible segment might vary around EUR 4-5 billion, that is about 25% of the size of United States market (Evaluation of EU ..., 2012). **Therefore, the assumption that Business Angels in Europe have vast possibilities to expand their activity becomes rather sound**. It is interesting, that according to the certain estimates there are potentially 350000 individuals only in France with sufficient financial resources to invest EUR 100000 without exposing themselves to that risk by over 5%. (Evaluation of EU..., 2012).

Perhaps one of the main questions when evaluating the potential of Business Angels for European SMEs is the correspondence of necessary and provided investment amount and sector of the economy. According to SAFE report (European Commission, 2014) only 32% of the EU27 SMEs reported of willingness to obtain more than EUR 250000. When comparing the provided survey data to the information given by EBAN the author concludes that in case of proper cooperation Business Angels and SMEs could find themselves in a win-win situation. The data of EBAN suggests that investment per Business Angel tends to vary from as low as **EUR 18000 to over EUR 150000 (Evaluation of EU..., 2012)**. **At this point it should be reminded** that Business Angels tend to co-invest with other investors, Business Angels, early stage funds and others. It means that the demand of SMEs could be satisfied in quite a big extent. Another question goes to sector relevance. In many countries analysed Business Angels (approximately 50%) invested in healthcare and biotech sectors. The top list implied creative industries, **environment and clean technologies, finance and business service (Evaluation of EU..., 2012)**. All the highlighted sectors are of a great importance when speaking about research and development, which stresses the possible positive outcome of better Business Angel inclusion.

European Business Angels carries quite a good potential to support SMEs. Firstly, the average amount of money needed by SME corresponds to the possibilities of active or potential Business Angels. Secondly, the attention should be given to possible expansion of Business Angels, by latent and hidden Angel activation. Even though there is a great potential for European SMEs to engage in more alternative finance captivation, the lack of unified and arranged system is one of the main drawbacks to fully benefit from the possibilities Business Angels might possess. Moreover, when reviewing 20 years of research on the Angel segment of the venture capital market J. Freear called for longitudinal studies of Angel and entrepreneurial behaviour, information flows, links to other market segments, information

quality, formal and informal networks and the latent Angel problem (J. Freear, 2002). There seems to be quite a number of various Business Angel networks as well as different opportunities for SMEs provided by regional government or the European Union. The author **believes that all the work and research done so far, even though valuable enough won't give** the wanted effect as long as this information stays rifted. The author suggests thinking about the creation of European Union Business Centre of Alternative Investment. Such an organisation could bring together the needs of SMEs and the potential of Angels all over European Union ensuring better cohesion and greater economic growth. This would strongly ask for deep organisational scheme, division in regions or economic sectors and the possible involvement of the European Investment Bank or equivalent. As long as there is no unified legislative, academic and informative base created, the growth rate of various Business Angel **networks won't meet the needs of SMEs. Moreover the unified support from the authorities all** over the EU would be highly beneficial. Few steps to be implemented in order to enhance the positive outcome of Business Angel activity were reflected in the Evaluation of the European Union Member States Business Angel markets (Evaluation of EU..., 2012):

- **The support for the creation and operation of Business Angels networks;**
- **The tax incentives or tax relief schemes;**
- **The co-financing schemes.**

Even though the study was based on only eight European countries, the country-to-country results varied a lot. For instance, the effectiveness and success of tax schemes aiming to support **Business Angels varied greatly (Evaluation of EU..., 2012)** - this again, might be explained by the lack of unified and fine planned policies. According to the OECD study, the initial support from the EU or national governments led to a dramatic increase in the number of BANs in Europe while the investment activity of these BANs varied a lot (OECD, 2011). When speaking about co-financing schemes they seem to be rather effective. Nevertheless, the author would like to spotlight the question of differences and further possibilities of co-investment schemes and various approaches used in different countries. Such an analysis could be beneficial in order to understand the needs and best possible actions for the region or a specific sector of economy. Summing up the research part of this paper it becomes clear that with proper leading and effective government policy the alternative investment of Business Angels can be boosted a lot. The author believes that Business Angels have the potential to support European SMEs and boost the economic development, decrease the bank-addiction and enlarge the research and development.

## **Conclusions, proposals, recommendations**

1. Access to finance remains a high problem for SMEs in European Union.
2. Regarding the expectations of SMEs to grow, summarised using the method of graphical visualisation, the need for additional finance resources in the upcoming years will increase.



3. Business Angel market has the potential to satisfy the needs of SMEs in finance resources.
4. Besides the possible financial investments Business Angels offer extra time for development, more detailed product analysis and support in new strategy implementation as well as management skills of experienced professionals.
5. **Business Angels can't be expected to be equally active** in all sectors represented by SMEs.
6. According to the statistics, Business Angels choose to invest in healthcare and biotech sectors among others.
7. As it is stressed in various studies there is a lack of unified and arranged system that would organise the market of alternative investment in Europe.
8. Creation of well-structured and single legislative and informative base might enlarge the number of active Business Angels in the European Union.

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