

ANGEL FINANCING IN EARLY STAGES OF COMPANY DEVELOPMENT

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—Abstract —

Capital is like spirit of businesses. No businesses can sustain its development without having sufficient capital. The type and source of funding available for any business majorly depends on stage of company development. Because the companies in early stages of development have high risks and lack of sufficient collateral, traditional financing sources are not an option for these kinds of companies. Today angel financing together with venture capital is one of the outstanding instruments which provide capital that the entrepreneurship and companies in the early stage of development need in the financial markets. This paper examines the emergence and evolution of angel financing in the world and evaluates the current situation of angel financing in Turkey.

Key Words: *Entrepreneurship, Venture Capital, Angel Financing.*

JEL Classification: G24, L26.

1. INTRODUCTION

The entrepreneurs generally don't have sufficient capital at the establishment and in early stages of a company. Debt financing is the only option for the entrepreneurs in order to establish and expand their companies in case of insufficient capital. On the other hand traditional debt financing sources such as loans are not often granted to these kinds of companies due to their insufficient collateral and their high riskiness. But the high risk level at the early stages of company means that these companies may provide much more return relative to traditional investment opportunities for investors.

Alternative funding options such as angel financing, venture capital have emerged for the companies in early stages in recent years due to their possible high profitability in future. This paper examines the emergence and evolution of angel financing in the world and evaluates the current situation of angel financing in Turkey. Since the fundamental nature of business angel market is informal and many business angels have a desire for anonymity and don't want to reveal information related to their investments and also national and international organizations (such as angel networks, OECD, IMF) don't include all business angels, it is very difficult to find reliable statistical data about angel investing. On the other hand this study gives a general idea about the evolution angel investing in world and Turkey.

1. EMERGENCE AND EVOLUTION OF ANGEL FINANCING IN EARLY STAGES OF COMPANY DEVELOPMENT

The people who supported Broadway shows financially were referred to as angels in the early 1900s. William Wetzel firstly applied this term to business, where the financing of early stage enterprises can feel like money from heaven for entrepreneurs (Preston, 2007:5). The words business angels or angel investors, informal investor and informal venture capital are used for this kind of investors interchangeably. We will use the business angel term during our study. A business angel is a person, partnership, or corporation that provides his, her or its own funds to invest in private companies especially in early stage companies. Business angels invest their own money they or their families and companies have earned, while venture capitalists invest money they have raised from other financial institutions and wealthy individuals. (Hill and Power, 2002:5). Business angels

also provide strategic and operational expertise together with funds for entrepreneurs (OECD, 2011a:28).

Business angels can be an individual or an angel group who league together in order to evaluate and invest in entrepreneurial ventures. While business angels have a long history, business angels have begun to form angel groups for collectively evaluating and investing in entrepreneurial ventures since mid-1990s (Kerr, Lerner and Schoar, 2011:6). The angel investment sector is growing and becoming more formalized and organized through the angel groups and networks. The United States (US) and the European Union (EU) are the leading parts of the world in the business angel market with a total of 340 business angel networks/groups. Turkey has only 5 business angel networks/groups in 2009.

Table 1: Number of Business Angel Networks/Groups in the World, 2009

Country	Number of Business Angel Networks/Groups
United States	340
EU-27	335
Canada	30
New Zealand	17
Switzerland	13
Australia	11
Norway	8
Turkey	5

Source: OECD, 2011b:153.

The typical angel investment cycle includes the following stages:

- Being aware of the investment opportunity.
- Conducting an initial screening to assess initial interest in the investment and whether it fits to his/her investment portfolio and area of knowledge/experience area.
- Meeting with entrepreneur, detailed evaluation of the business plan, review of references and market research.
- Negotiating over valuation and level of participation with entrepreneur
- Following investment, hands-on support in the form of management advice/mentoring and networking.

- Exit from the business through initial public offering, selling his/her share to investors, venture capital or entrepreneur (Centre for Strategy and Evaluation Services, 2012:6).

Business angels are increasingly recognized as an important source of equity capital at the seed and early stage of company formation (Harrison and Mason, 2010:vii). They generally operate in a segment which falls in between informal founders, friends and family financing, and formal venture capital investors and their typical investment size is between USD 25000-500.000.

Table 2: Equity Investors at the Seed, Early and Later Stage of Company Growth

Informal Investors		Formal Investors	
Founders, friends and family	Angel investors Typical investment size: USD 25.000-500.000	Venture capital funds Typical investment size: USD 3-5 million	
Seed stage investments	Early stage investments	Later stage investments	

Source: OECD, 2011a:21.

Many of today's largest and most successful companies for example Apple, Amazon and Google, were all effectively launched with the financial help and entrepreneurial expertise and support of business angels.

Table 3: Role of Business Angels in the Development of Successful Companies

Company	Business Angel	Business	Investment	Value at Exit
Apple	Mike Markkula	Computer hardware	\$91.000	\$ 154 million
Amazon.com	Thomes Alberg	On-line bookshop	\$100.000	\$ 26 million
Blue Rhino	Andrew Filipowsky	Cylinder for replacement propanium	\$500.000	\$ 24 million
Lifeminders.com	Frans Kok	Internet email reminder service	\$100.000	\$ 3 million
Body shop	Ian McGlinn	Body care products	£4.000	£ 42 million
MI Laboratories	Kevin Lich	Kidney medical treatments	£50.000	£ 71 million
Matvon	Iavn Semenko	Bulk containers	£15.000	£ 2,5 million

Source: Ramadani, 2009:253.

The US business angel market is the biggest market in the world. The market showed an upward trend until 2001 and market size reached 30 billion dollar and

then this trend reversed and declined to 17,60 billion dollars with the negative effects of global financial crisis and trend has moved upward again since 2010. The share of seed/start-up stage investing in total angel investing has shown a fluctuating course between 55% and 31%.

Table 4: Major Business Angel Market Statistics of the United States

Year	Total Investments (billion dollars)	Share of Seed/Start-up Stage Investing in Total Angel Investing (%)	Number of Entrepreneurial Ventures by Angel Investing
2001	30,00	45	48000
2002	15,70	47	36000
2003	18,10	52	42000
2004	22,50	52	48000
2005	23,10	55	49500
2006	25,60	46	51000
2007	26,00	39	57120
2008	19,20	45	55480
2009	17,60	35	57225
2010	20,10	31	61900
2011	22,50	42	66230

Source: Center for Venture Research (CVR) (2002-2012), *CVR Analysis Reports (2001-2011)*, <http://wsbe.unh.edu/cvr-analysis-reports>, [Accessed 12.02.2013]

The EU has the second biggest business angel market. We can see the same pattern in total angel investments as the US, there was an upward trend, then a downward trend due to global financial crisis and the Eurozone Sovereign Debt crisis. The statistical information given in Table 5 only covers investments done by EBAN (The European Trade Association for Business Angels, Seed Funds and other Early Market Players), and therefore might not represent the whole angel investment activities in the European Union.

Table 5: Major Business Angel Market Statistics of the European Union

Year	Total Investments (thousand euro)	Number of Deals where Business Angels Invested
2005	124.579,00	631

Year	Total Investments (thousand euro)	Number of Deals where Business Angels Invested
2006	179.351,00	1.170
2007	158.128,00	964
2008	140.636,00	1.021
2009	210.422,97	1.240

Source: European Commission (2013), Access to Finance: Business Angels, http://ec.europa.eu/enterprise/policies/finance/data/enterprise-finance-index/access-to-finance-indicators/business-angels/index_en.htm, [Accessed 15.02.2013]

3. ANGEL FINANCING IN TURKEY

Angel financing emerged belatedly in Turkey as an alternative financing opportunity especially for early stages of company development due to unstable economic and political developments arisen from successive financial and political crises in 1990s and early 2000s. Turkey made structural reforms in the context of the transition program to a strong economy after 2001 financial crisis and recovered from the crisis in a short time and Turkish economy gained stable and positive outlook and also major credit rating agencies S&P, Moody's and Fitch raised its credit ratings in parallel with these positive developments in Turkish economy. The positive developments in Turkish economy caused the number of enterprises to increase by decreasing financing costs and also caused new financing sources such as venture capital and angel financing to emerge.

Angel financing has had a short past in Turkey relative to the US and the European countries. The Code numbered 6327 Amending the Individual Pension Savings and Investment System Law and Certain Laws and Statutory Decrees which created the infrastructure for angel investment in Turkey was adopted on 13 June 2012 and the regulation on angel investments prepared by Undersecretariat of Treasury was published on 15 February 2013. These legislative frameworks set out the regulatory guidance and also provide the essentials of tax reliefs for the business angels.

There is no formal statistics about angel investing in Turkey yet. However major business angel networks and their dates of establishment obtained from their websites in Turkey are given in Table 6. It is projected that the current number of business angels will increase from about 50 to above 600 persons and funds

provided by business angels will increase to 400 million Turkish Liras between 2012-2017 as a consequence of incentives provided by the new legal framework about angel financing (Arslan, 2013). Moreover we can find right data about activities of business angels in Turkey after these legal regulations and establishment of Business Angels Association Turkey.

Table 6: Major Business Angel Networks in Turkey

Business Angel Network	Date of Establishment
METUTECH-BAN	2000
LabX	2006
MersinBAN	2006
Galata Business Angels	2010
Inventram	2010
Links Angel	2012
Business Angels Association Turkey	2011

Source: Data obtained from business angel network websites.

4. CONCLUSION

Angel financing has become the primary source of outside equity financing and support for start-ups in a number of countries since 1990s, although it isn't taken notice due to business angels' invisible characteristic. Business angels provide not only funds but also strategic and operational expertise for the companies in early stage of development. Business angels are becoming organized through the angel groups and networks in order to match entrepreneurs and angel investors and also finance some projects together as the business angel market has expanded rapidly.

The US and the EU are the leading parts in the world with a total of 340 business angel networks/groups. Total investments by business angels in the US and EU respectively is 22,50 billion dollars in 2011 and 210 million dollars in 2009. Turkey has had a short past in angel financing relatively, legislative frameworks such as the Code numbered 6327 Amending the Individual Pension Savings and Investment System Law and Certain Laws and Statutory Decrees and the regulation on angel investments which formed the basis of angel investment and set out the regulatory guidance and also provide the essentials tax reliefs for the business angels, published respectively on 13 June 2012 and on 15 February 2013. It is projected that the current number of business angels will increase from about

50 to above 600 persons and funds provided by business angels will increase to 400 million Turkish Liras between 2012-2017 as a consequence of incentives provided by the new legal framework.

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