ANGEL NETWORKS FOR THE 21ST CENTURY: A REVIEW OF BEST PRACTICES IN EUROPE AND THE USA.

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ABSTRACT

Developments in web technology are creating new opportunities for entrepreneurs and venture investors alike and facilitate the emergence of new breeds of introduction services connecting these parties more efficiently. The paper relies on clinical analyses of over 40 identified "best practice" angel networks in the US and Europe to provide a systematic study of the newest and most innovative practices in angel networks, focusing in particular on the use of information technology to facilitate the flow of ideas and capital to startups and early-stage companies and its implications for tomorrow's private equity markets and the financing of high potential ventures.

INTRODUCTION

Informal venture capital represents a pool of high-risk growth equity estimated conservatively at 10 times the size of formal venture capital, a significant force in the financing of startup firms and hence of critical importance to economic development. Angel networks are taking full advantage of the new information technologies to become more efficient in generating deals and distributing information about private equity activities, significantly reducing the informational and search costs associated with the old "atomistic" format of angel investing. Yet little is understood about the key success factors of angel networks for the 21st Century. This paper provides a survey and typology of best practices in angel networks in two major geographic areas, Europe and the US, focusing in particular on the use of information technologies such as the Internet to facilitate the flow of ideas and capital to startups and early-stage companies and its implications for tomorrow's private equity markets and the financing of high potential ventures.

ANGEL INVESTORS AND NEW VENTURE FUNDING

Informal venture capital, also referred to as angel capital, represents a pool of risk equity fundamental to the startup and initial growth phases of high-potential ventures. The term “angel” originated in the early 1900’s and referred to investors on Broadway who made risky investments to support theatrical productions (Utterbach et al., 1999). Today, the term refers mainly to high net worth individuals who invest in and support start-up companies in their early stages of growth[1]. In addition to providing financing, angels typically support the company by providing guidance and assistance with recruiting, management, networks, distribution connections, etc. Also referred to as informal or independent investors, they are said to represent the largest pool of equity capital in the US, many times larger than formal venture capital (Wetzel, 1986a, 1986b).

The willingness of many angels to invest (1) in first-time entrepreneurs, (2) at the search or seed levels of development, and (3) to get involved at reasonably small amounts of capital (less than $100,000) makes invaluable contributions to the pre-formal venture capital development of many technology ventures. An early study by Freear and Wetzel in 1987 on the financing of 284 New England high-tech firms founded between 1975 and 1986 found that, out of the 62% that had to rely on external equity for their growth, individual angel investors were the most common source of funds providing 177 rounds of equity financing for 124 firms. Ninety firms raised equity from venture capital funds in 173 rounds. Table 1 below summarizes how individual angel investors and venture capitalists invested in the rounds of financing.

Table 1
Angels and venture capitalists contributions to new venture fundings

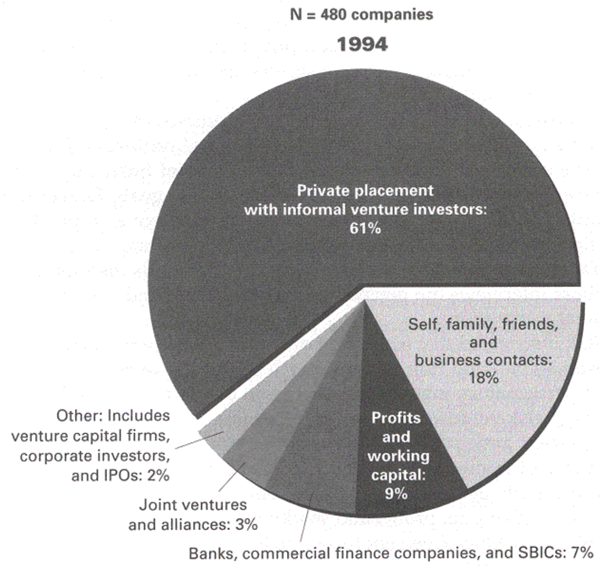
Financing Round ($k)	Number of Individual Angels Investing	Distribution of Angels Investing (%)	Number of Venture Capitalists Investing	Distribution of VCs Investing (%)
<250	102	58	8	5
250–500	43	24	14	8
500–1,000	15	8	31	18
>1,000	17	10	120	69
Total	**177**	**100**	**173**	**100**

Source: Freear and Wetzel (1987)

A more recent study by Benjamin and Margulis (1996) similarly finds that more than 61% of the 480 startup firms in their sample were financed through business angels.

[1] In the US, the term "angel" is often associated with "accredited investors" defined under SEC Rule 501 as an individual with a net worth of at least $1 million or earnings in excess of $200,000 per year (Levin, 1994). Jack Levin, 1994 "Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions, (CCH, Inc. Chicago).

Exhibit 1
Preferred sources of financing for US startups (1996, N=480)



Source: Benjamin and Margulis, 1996

In recent years, angel investing has seen rapid growth and increased systemization. Evidence of increased activity and systemization can be found in the increase in angel group enrollment and activity. From 1995 to 1998, the number of members in the Band of Angels organization, a Silicon Valley angel group, grew from 12 to 110 (McLaughlin, 1998). The Band of Angels invested in 19 deals in 1995 and 23 deals in 1997. The average investment per company increased from $290,000 to $535,000. The growth in activity and systemization is occurring not only in Silicon Valley, but also across the U.S., in Europe and in other countries. For example, in the last five years, the Boston/Route 128 area has seen the emergence and growth of at least a dozen new and different angel groups (Utterbach et al., 1999). In Europe, starting from a few confidential entrepreneurs' clubs in 1995, angel networks and other new venture support groups now number in the hundreds.

ANGEL NETWORKS AND VENTURE SUPPORT SERVICES

The market for informal venture capital is said to suffer from two related crippling inefficiencies: the extreme discretion of most business angels and the high search costs of angels for businesses and businesses for angels (Riding, 1997; Wetzel, 1986a). These inefficiencies are often invoked to support the existence of a "funding gap" preventing valuable opportunities from being materialized.

As a response to these perceived shortcomings, a number of organizations have been created, referred to alternatively as match-making services, angel networks, venture support bureaus or business referral services (Harrison and Mason, 1996). A forerunner in the effort was the Venture Capital Network (VCN) established in 1984 in New Hampshire, now called the Technology Capital Network operated by the MIT Enterprise Forum. From these pioneering days, angel networks have mushroomed and taken on more and more different shapes and modus operandi to cover more varied business realities.

The development in the 1990's of the "network economy", capitalizing on the new opportunities created by the internet, has also affected the angel network community. From mostly limited access subscription services, venture support networks have developed new means of serving the needs of both investors and entrepreneurs: from matchmaking events to internet cocktail parties à-la-First Tuesday, from incubators to specialized publicly-listed early-stage funds, new means of closing the perceived funding gap have been hatched. This study investigates innovative best practices in the angel networking field across a number of countries in an attempt to understand the key drivers of "performance" in this vital field of endeavor.

RESEARCH METHODOLOGY

Any major effort to understand best practices in the global networked economy needs to take a global perspective. This research effort surveys 40 leading angel networks across 8 European countries (UK, France, Belgium, Spain, Switzerland, Finland, the Netherlands, Germany) and the US. Open-ended interviews of business angel network managers were conducted by phone or through face-to-face meetings. The interviews, taped or recorded, covered a number of different aspects of the networks' operational histories as well as underlying motivations and rationales. The aspects covered in the surveys are detailed in table 2 below.

Table 2
Key survey items

- History of the network
- Organization: sponsors, physical facilities, annual budget, funding
- Number of employees and status
- Business model: Inscription fees, sponsors, combination, other.
- Event organizers
- Sponsors
- Choice of venue
- Selection criteria for guest speakers, if any.
- Number of members (investors/entrepreneurs) and evolution of that number
- Other statistics on affiliation
- Registration process: how to become a member angel, commitment, screening.
- Type of services offered by the network to members: meetings, newsletter, conference, information, web-site, access to screened/unscreened deals, etc.
- Type and source of deals offered to members
- Type and source of member angels: Age distribution, wealth, how active, track records as entrepreneurs, etc.
- Databases managed: do they keep track of deals done through the network?
- Number of deals done through the network introductions.

- Target scale of operation, or definition of "satisfactory" performance for the network
- Performance measures
- Marketing tools used
- Contacts with other angel networks
- Biggest challenges thought to be faced in the coming years and how to address them.

Table 3
Sample of angel networks

Angel Network Name (founding year)	Country
First Tuesday - London (1998)	UK
British Venture Capital Association (1983)	UK
Natwest Angels Service (1995)	UK
National Business Angels Network (1997 as NBAN; LINC before)	UK
European Technology Forum (1998)	UK
Great Eastern Investment Forum (1994)	UK
Venture Capital Report Ltd (1978)	UK
Xenos (1997)	UK
Cambridge Network (1998)	UK
E-Start (1999)	UK
OION - Oxfordshire Investment Opportunity Network - Oxford	UK
Group Professional Networks (1994)	France
IPEN - International Private Equity Network (1996)	France
BusinessAngels.com (1998)	France
International Venture Capital Forum (1997)	France
Planet Start-Up (1999)	France
Capital-IT (1999)	France
Defi Start-Up (1998)	France
Leonardo Finance (1995)	France
Invest'Essor	France
ICEVED - Intl Center for Venture Development (1999)	Spain
Sitra (1996)	Finland
Smart Capital (1999)	Switzerland
Vlerick Business Angel Network - Gent	Belgium
WABAN - Mons	Belgium
SOCRAN - Liege	Belgium
BAMS - Business Angels Matching Services - Louvain La Neuve	Belgium
BeBAN - Brussels	Belgium
NEBIB	Netherlands
BAND	Germany
Business Angels Club Berlin	Germany
Colorado Capital Alliance - Boulder	USA
PEAK - Boulder	USA

A TYPOLOGY OF VENTURE SUPPORT SERVICES

This study does not focus on characteristics of business angels per se but investigates the innovative operating models of venture support services, or business angel *networks*. The Bank and Finance Commission in Belgium (CBF) defines a Business Angel Network (BAN) as a "structured network which offers business angels the possibility to access projects in need of financing". As such, the typical roles undertaken by BAN include part or all of the following: (1) Identify investors and entrepreneurs; (2) Organize some channels through which the two parties can meet; (3) Coach and mentor entrepreneurs and their projects; (4) Provide feedback mechanisms for entrepreneurs to build on investor comments and suggestions; (5) Facilitate later rounds of financing by providing connections to banks and venture capitalists; and (6) Guarantee the confidentiality of all parties involved.

The business angel network literature typically distinguishes four fundamental types of networks (Coveney and Moore, 1998; Mason and Harrison, 1997) but the survey conducted here supports the need for a finer typology.

Table 4
Typological dimensions of venture support services

Typological Criteria	$\Leftarrow$	$\Rightarrow$
Financing Mode	Private	Public
Profit Orientation	For Profit	Not For Profit
Preferred Financing Stage	Early Stage Preferred	All Stages
Investment Sectors	Specialist	Generalist
Screening and Support	Active	Passive
Geographical Reach	Regional or Local	National or Pan-National
Type of Services Offered	Introduction Services Only	Broad Offering (coaching, mentoring, incubating, team building, funding, etc.)

Financing Mode

Where most of the early players on the European scene were publicly funded and supported, a number of new actors are set up and operated on purely private grounds. Examples include BAMS, BusinessAngels.com, First Tuesday, etc. Independent of their public or private nature, most networks rely heavily on sponsoring and subscription revenues to operate. A EU commission report estimates that, on average; a BAN can only breakeven after 5 years of existence (EBAN, 1998).

Profit Orientation

Profit orientation can often be related to the financing mode, with public BANs often operating relatively simple forums for introduction on a non-profit basis, whereas private BANs tend to offer enlarge service offerings and clearly intend to generate revenues from the activities. Hybrids do exist, such as NBAN in the UK, financed both by the Department of Trade and Industry (DTI) and private sponsors such as Barclays and Lloyds.

Preferred Financing Stage

Even though by definition BANs were mostly created to bridge the early stage funding gap, some do not hesitate to invest in all stages of a company development. For example, PEAK (Colorado), OION and NBAN have little restrictions in terms of stage of financing.

Investment Sectors

An extreme case of specialization are the First Tuesday internet "cocktail party" and matchmaking events. Other BANs seem to have followed the latest fashion into "new media" projects: the International Venture Capital Forum of Sophia Antipolis has struggled in 1999 to maintain a decent representation of biotechnology projects in its annual lineup simply because of a lack of projects presented. OION defines itself as high tech oriented.

Screening and Coaching

Some intermediation services take very active roles in screening projects to be presented to investors and coaching them to ensure consistent quality and satisfactory presentation. The International Venture Capital Forum in Sophia Antipolis for example actively screens projects submitted for presentation at the annual matchmaking event (keeping less than 25% of the all projects submitted) and requires attendance and participation at presentation coaching sessions organized by a major sponsor, Deloitte and Touche. Others provide a more classic *caveat emptor* approach.

Geographical Reach

In the UK, networks such as OION (Oxford) or LINC (Scotland) act primarily on a local basis, whereas NBAN offers a nationwide coverage. Similarly in Germany, the Business Angel Club Berlin has a regional focus, where BAND claims a national reach. In France, Invest'Essor focuses on the Paris area, where BusinessAngels.com has a national audience, as does NEBIB in the Netherlands.

Two interesting outliers with a pan-national dimension are worth mentioning. First of all, BAMS operates across Belgium, Luxembourg and Northern France. Second, and most notably, First Tuesday operates a network of local chapters now represented in some 65 cities across Europe. The First Tuesday model is described in more detail below.

Types of Services Offered

From the traditional matchmaking role, BANs have developed a broad range of service offerings for entrepreneurs and investors alike. Even in matchmaking, a number of models have evolved. The simplest introduction format is the non-threatening networking event organized by First Tuesday: screening is minimal and anyone with an interest in the internet economy is welcome to join the fray. At the other hand of the spectrum are pay-for-service matchmaking groups which actively match investors and projects for a fee. Beyond matchmaking, BANs are also offering business plan coaching, directly or indirectly (the International Venture Capital Forum for example partners with Deloitte and Touche for the active coaching of selected projects before presentation at the annual investment conference), active financing support, team building and management recruitment services, incubation support (logistics, shared offices, etc.), and even direct investment into the projects.

OF COCKTAIL PARTIES AND VIRAL NETWORKING: THE FIRST TUESDAY FIREBALL

First Tuesday's debut was nothing short of astounding. Modeled along the lines of the *Churchill Club* or the *DrinksExchange* in San Francisco, in what is referred to as the Silicon Valley format, First Tuesday offers an informal cocktail-party style forum for anyone interested in the new economy and new media, i.e., the Web. The gatherings appeals to both actual and would-be entrepreneurs, investors and professionals alike, anyone with an interest in keeping abreast of the latest developments in the field. No gimmicks, no beauty contest[2], just a friendly, casual atmosphere and a chance to mingle with like-minded individuals who share a common interest in the cause of the Internet. And a chance to hear speeches from highly visible flag bearers of the new economy.

By late 1999, a short year after the first gathering in a crowded and noisy London pub, First Tuesday had been launched across Europe and the rest of the world, in 17 cities, creating venues where anybody with a bright idea could come to start building a new media business. By March 2000, First Tuesday had operating chapters in 38 cities over four continents: London, Amsterdam, Budapest, Tel Aviv, Geneva, Hamburg, Sydney, Moscow, Frankfurt, Paris, etc. with more opening every month. Over 40,000 people had requested announcements and information from all over the world. More than 10,000 people were attending First Tuesday events

[2] "Beauty Contest" is the colloquial name for the more classic angel network presentation model, where entrepreneurs are given the opportunity to present their projects to a select audience of potential investors, hopefully to arouse their interest and ultimately entice them to part with their money.

worldwide every month, and more than 60 cities were on the waiting list to get onto the First Tuesday bandwagon.

The First Tuesday business model relies on at least five different revenue streams: (1) Matchmaking, physical and on-line; (2) On-line job databases; (3) Special conferences and events, mostly financed through sponsors and subscriptions; (4) Website revenues for advertising services provided to a very targeted clientele; and (5) Brand licensing through partnerships with international service providers.

Beyond the traditional BAN support functions, First Tuesday is also adding to the mix the ability to actually invest directly or indirectly in projects, to leverage the resources of its extensive chapter base, and to tap the large intellectual bandwidth of its members and partners.

INTERNET AND BUSINESS ANGEL NETWORKS

A common theme encountered across all surveys is the tremendous impact the internet economy is having on venture support services. Not only is the new economy putting a reinforced urgency on the need to network but the new information technologies on which the economy is built are also changing the very channels through which these networks can be established.

Dis-intermediation is already taking place according to many angel networks surveyed: it is becoming more and more difficult for many classic matchmaking services to charge for their basic introduction services since entrepreneurs find it relatively easier to access the financing sources without their help. More refined billing systems are taking shape, for example with introduction services taking direct equity stakes in their pupils or charging only on a success fee basis.

At the same time that some of the classic foundations of startup intermediation are being attacked, opportunities are also being created all around. Active and continuing venture support services, in the form for example of incubators and hatcheries, are emerging everywhere. The strict financial focus is giving way to a broader definition of "resourcing" the firm, to include help in structuring management team, recruiting key players for growth, or establishing solid boards of directors and advisors.

The reduction in search costs also means entrepreneurs have a better ability to shop their deals around, increasing the likelihood of funding and a better match with investors. Increasingly, projects can be found on multiple network services at the same time.

NEW ACTORS EMERGING IN THE BUSINESS OF BAN

Still nowadays, most BAN operate on the basis of match-making. Their major purpose remains to provide services and opportunities for meeting offers and demands for finance of start-ups and early stage businesses. From a financial point of view, these actors are playing the game of economies of scale and try to quickly gain a critical mass to finance their activities through membership fees and consulting services. Consequently, most BAN try to build volume and keep an equilibrium between BA and businesses in an attempt to remain neutral. It is interesting however to notice that many BA complain about the services provided by BAN and in particular about the lack of selectivity and the poor quality of projects they provide. For instance, BA comment very often that only second hand projects go through organized networks[3].

Consequently, there are pressures on BAN, as there on any intermediaries, to add value to their services. As far as the services for BA, this means being able to develop the credibility and the confidence on the projects that are proposed to them. This requires the ability to organize a very strong selection among the projects, to structure them and going as close as possible to investment recommendations[4]. During our visits, we observed emerging initiatives that are going to that direction of helping the entrepreneur to structure its business, hiring professional management, developing the business plan, managing intellectual property rights, etc. These actors are often backed by BA and are mostly issued from the private sectors. Some are developed by individuals acting as a network of "professional" business angels like Innode in Belgium, others group professional partners coming from complementary horizons like the Vlerick Venture Coaching backed by a legal firm, one of the big five, a major bank and the University of Gent, others are purely spin-outs of major players like the recent Arthur Anderson initiative to develop business incubators while others are ex-consultants backed by business angles like Peak Business Development Cy in Denver (Colorado).

Our expectations is that BAN will evolve toward such new profile. Moving toward a role of investment recommendations and business coaching, exerting a very high selectivity on projects, financing their activities through participation in the projects (shares or options) and with a much smaller base of BA that trust and rely on the network they back.

Table 5

Contrast between traditional and emerging BAN

	Traditional BAN	Emerging BAN
Core business	-Matchmaking -Education/services	-Investments recommendations -Project structuring -Business incubation
Projects selectivity	Low to moderate	Very high
Mode of financing	-Membership fees -Consulting fees -Service fees	-Combination of consulting fees and shares
Size (#of BA)	Large	Small

[3] It is actually interesting to notice that very few BAN track or provide their records of successful investment. From our fieldwork, we have reasons to suspect that a good reason for this might be their very poor performance.

[4] Although, in some countries (i.e. Belgium and UK), the legislation forbids BAN to formulate investment recommendations.

NEW VENTURE SUPPORT SYSTEMS:
21st CENTURY CHALLENGES AND OPPORTUNITIES

With the 21st Century at our doorstep, it was interesting to hear from established and new players in the business angel network community about their fears and expectations, reviewing some new modes of operations and challenging older ways of doing things.

The survey conducted here highlights the very dynamic nature of the industry, which has been riding on the coattails of the internet revolution and its networking focus. New angel networks are emerging every day, and new models are being created every other week. In particular, the new information technologies are helping bridge the decades old problem of connecting early stage projects and risk investors.

Where a clear trend towards disintermediation is already visible, challenging existing fee-for-service introduction services, the increasing resource needs of startups open up a new world of opportunities for venture support services. Equity-for-service models are being adopted rapidly, leading to more dynamic realignment of risk and returns between parties involved with launching new ventures. The attention is also shifting away from pure financial intermediation services to a more global resourcing approach, where finance is just one piece of a very complex puzzle. Increased attention is being placed on team building, management recruitment, the constitution of world-class advisory boards and the provision of highly visible and competent directors. The creation of macro-networks (networks of networks) is also seen as a natural extension of services to a global audience.

Defining what constitutes performance for venture support systems is an issue that deserves further discussion. In many instances, the creation of active venture networks is sufficient performance. Clearly, being able to provide evidence of actual startup funding and resourcing, and the consequent value creation in the economy, would be even better. Quantifying such value contribution would of course defy many systems' abilities and would be open to bias charges of one sort or another.

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