# Introduction

# In order to achieve economic growth it is key for companies to able to finance themselves in an efficient and effective kind of way. However, often the financial system is not able to support companies in an efficient manner. Especially in the case of Italy it is hard for start-ups to gather funds due to the fact that entrepreneurs usually seek debt capital, which banks are not willing to grant because start-ups in general are not able to achieve steady cash flows. The reason why entrepreneurs demand for debt, despite the fact that it is not an ideal way of funding a start-up, is because they are often not aware of the different sources of capital available (Capizzi and Tirino 2011).

The initial cash infusion usually operated by the founder of a company is often not sufficient to guarantee the survival of the start-up in the initial stages of development. Therefore, since bank loans are not appropriate and nonetheless, hard to obtain, start-ups need to seek some kind of equity funding. Equity funding is provided by specialized institutions which are venture capital funds. Venture capital investments are appropriate for early stage ventures as they do not demand for constant cash payments like in the case of loans, but instead venture capital funds bear the enterprise risk and receive returns only through capital gains at the end of the investment. Anyway venture capital funds usually tend not to finance companies before they have reached several years of age (Morrissette2007, Harrison and Mason 2000). This is because venture capital funds need to have a well defined time horizon in which to achieve returns for their investors and because they prefer to invest large sums of money (on average more than € 1 million) (NVCA 2010)in order to leverage on the due diligence process and on the management of operations. In other words assessing and managing a large company takes about the same time and effort as assessing and managing a smaller company, making early stage investments (which need funds between € 25,000 and € 500,000) not worthwhile (Hanf 2007). Therefore there appears to be a “*funding gap”* between what start-ups need and what venture capital funds are willing to give.

The actor that is able to fill such a gap is the “Business Angel” (BA). A business angel is an individual *“acting alone or in a formal or informal syndicate, who invests his own money directly in an unquoted business in which there is no family connection and who, after making the investment, takes an active involvement in the business, for example, as an advisor or member of the board of directors.”*(Harrison and Mason, 2008). The goal of a business angel is to achieve capital gains after the sale of shares of a company. Business angels are often referred to in literature as informal investors, even though recently angels have evolved and are able to organize themselves in syndicates making larger deals (about € 1 million) and investing in companies in different stages (Capizzi and Tirino 2011). Research shows that also Italian angels have evolved adopting the best practices seen on the most developed markets along with the progressive growth of the Italian informal venture capital market.

This paper has the goal to outline a descriptive profile of Italian business angels trying, to uncover all those features that cannot be assessed through a purely statistic analysis but which are still very important in order to fully understand the phenomenon of angel investing. Through a series of semi-structured interviews with Italian business angels I will investigate what are the motivations behind their investment decisions, what are the barriers they encounter in the investment process, what is their role in the companies they finance together with the effectiveness and efficiency of business angel networks (BANs). Furthermore I will analyze specifically the aspect of female business angels, investigating why they are so few compared to men and what are the differences in their behavior. The sample is composed of 33 interviews and it allowed to uncover several interesting trends in the behavior of Italian business angels as well as gathering some insight on what could be some policies and measures that could be implemented in order to incentive and further stimulate the growth of the informal venture capital market in Italy.

The first chapter of this paper will analyze the informal venture capital market and the process of angel investing, highlighting the crucial role it has in an economy as well as comparing and contrasting it with venture capital investing. The second chapter will outline the relevant literature taken in consideration to structure the analysis. The third chapter will contain the empirical analysis exposing in detail the research questions investigated through the interviews and uncovering the results. The fourth chapter will examine the main measures and policies that have been or will be implemented in Europe and in Italy which will serve as comparison with policy suggestions that are advocated by the angels during the interviews. The fifth and final chapter will include concluding remarks as well as suggestions for further research.

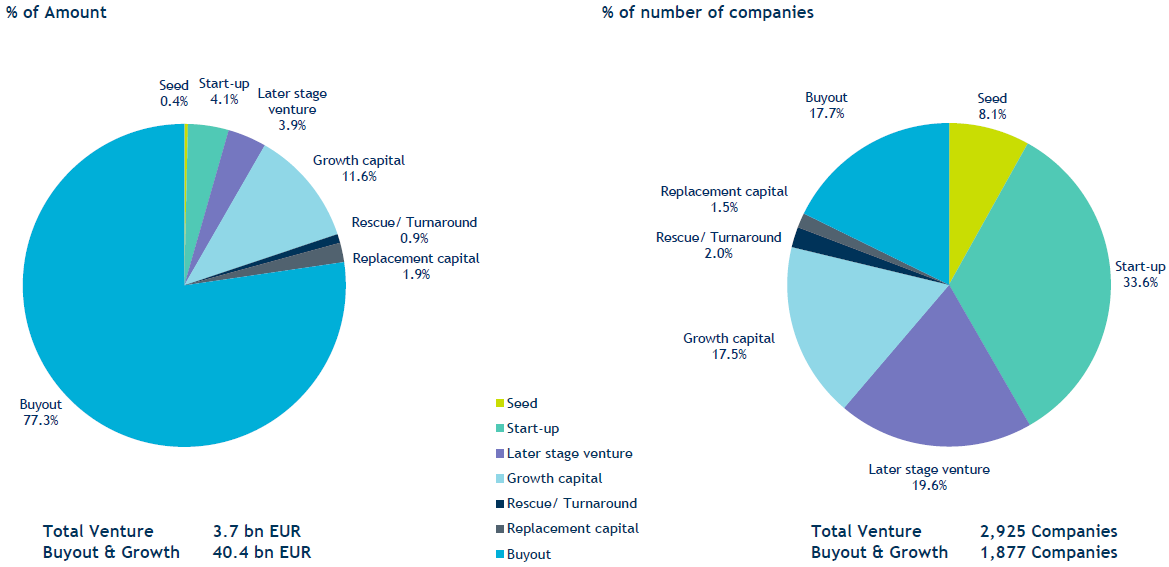
# Business Angels And the Informal Venture Capital Market

The term “Business Angel” was first used to describe wealthy individuals who financed, with their own private resources, Broadway shows in the late 1800s. These investors took on significant financial risks not just because they expected large returns but also because they were also motivated by their love for theatre and therefore enjoyed being able to promote actors and screenwriters and spend time with them (Ramadani 2008). Several researches show that still today business angels are motivated by more than just financial returns (Van Osnabrugge 1998, Brettel2002, Ramadani2008, Morrissette2007, Sullivan and Miller 1996 etc.). Business angels have been recognized as a category only very recently (Wetzel 1983) however they have been a key driver of innovation for centuries. For example at the mid 15th century Johann Gutenberg had to reach for financing from wealthy individuals in order to build his mechanical movable type printing press which started the so-called “printing revolution” making books available for the masses for the first time in history (Treccani Encyclopedia, Gutenberg, Johann, 2007). Business angels helped Alexander Graham Bell found the company Bell Telephone in 1874, financed Henry Ford’s automobile company in 1903 (Ramadani 2008) and more recently business angels are credited for the early stage financing of incredibly successful and innovative companies such as Apple Computer and Amazon.com (Van Osnabrugge and Robinson 2000).

Estimates vary and are clearly hard to perform, however according to Reynolds et al. (2004) the amount of capital provided by angels worldwide is eleven times more than the amount provided by venture capitalists, amounting to $50 billion received by approximately 50,000 companies (Morrisette 2007). Their importance for the economy is clear, however despite such a crucial role business angels are surprisingly un recognized and unappreciated by the press and the public in general (Ibrahim 2008).

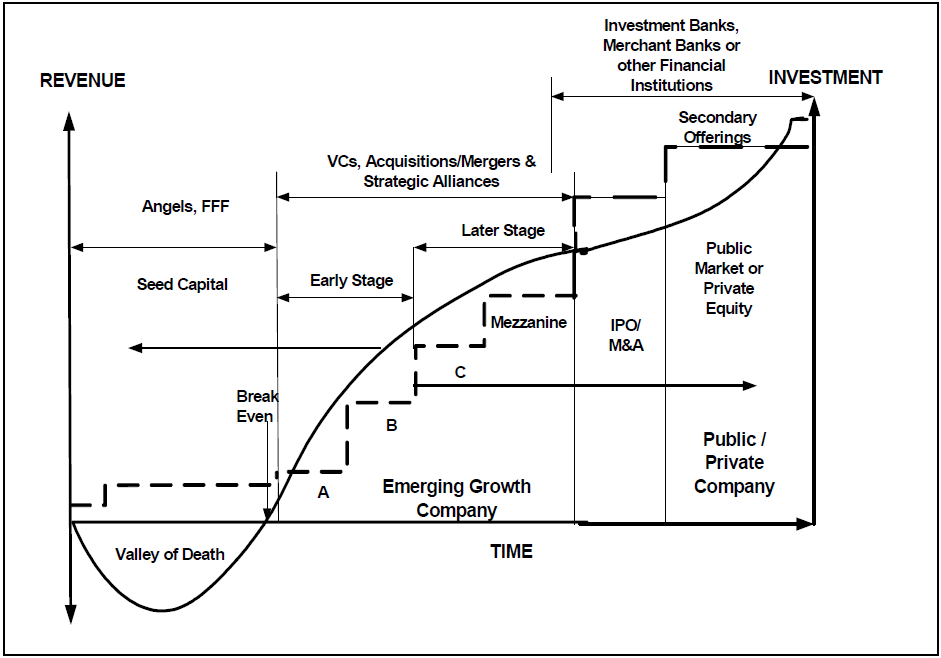
So who are business angels and what is the difference between them and venture capitalists? As previously stated business angels are individuals who invests their own money directly in unlisted companiesand take an active involvement in the business (Harrison and Mason, 2008). Business angels represent one of three main sources of financing available for start-ups. According to Hamilton (2001) and Brettel et al (2000) the first financial source for start-ups is self-funding which includes money from family, friends and fools (FFF) as well as well as business angels; at the very early stages self-funding is the main source of capital. The second financial source is capital from venture capitalists while the third one is bank debt and corporate funding (investments made by corporations). Start-ups in their very early stages of life are usually not able to achieve steady cash flows, if any. This makes debt an inappropriate financing strategy since it entails constant repayments at a defined schedulewhich startups are not able to afford. Companies at early stages need to seek for some kind of equity investment.

The traditional way of retrieving such equity capital is through specialized institutions which are venture capital funds. Venture capitalists manage money pooled from third parties in a professionally managed fund (Rose 2006).The Italian Private Equity and Venture Capital Association (AIFI) defines venture capital as *“the investment activity in the form of risk capital performed by professional operators through the acquisition, the management and the sale of shares of unlisted companies”.* These kind of investments are more risky than loans and therefore have the potential to achieve higher returns (Campbell 2003). Furthermore venture capitalists often also support the company with contacts and management expertise. The average amounts invested by venture capital funds has increased from $ 3 million in 1995 to $ 7 million in 2003 (Payne 2005), the trend within the formal venture capital market is to finance later stage deals and to avoid early stage investments (Murray 1999, Sohl 1999).



**Diagram 1 –** *2011 European venture capital market statistics - % Of Amount and Number of companies.* (EVCA 2012)

As it is possible to see from the diagram above, in 2011 the seed sector was only 0.4% of the venture capital and private equity market as a whole in terms of amounts invested and only 8% in terms of number of companies financed. This is a trend that has continued in the last 25 years.According to QianYafengyun (2010) the percentage of early stage investments in the European venture capital market was 27.1% in 1984, becoming 11% in 2000 and further shrinking to 4% by 2008. Start-ups usually do not need very much cash at the beginning of their life, typically the need less than $ 500.000 (Hanf 2007), and this is especially true for internet companies which benefit from very limited fixed costs. However, venture capitalists today have the tendency to prefer larger deals. As the funds available for investments have grown larger venture capitalists prefer financing larger deals instead of increasing the numbers of the transactions (Hanf 2007). This propensity for larger deals by ventures capitalist leaves a funding gap for companies that are in very early stages of their life and therefore they need a relatively small cash infusion which venture capitalists are not willing to supply.



**Diagram 2 –** *Funding sources during a company’s life cycle*(EBAN 2009)

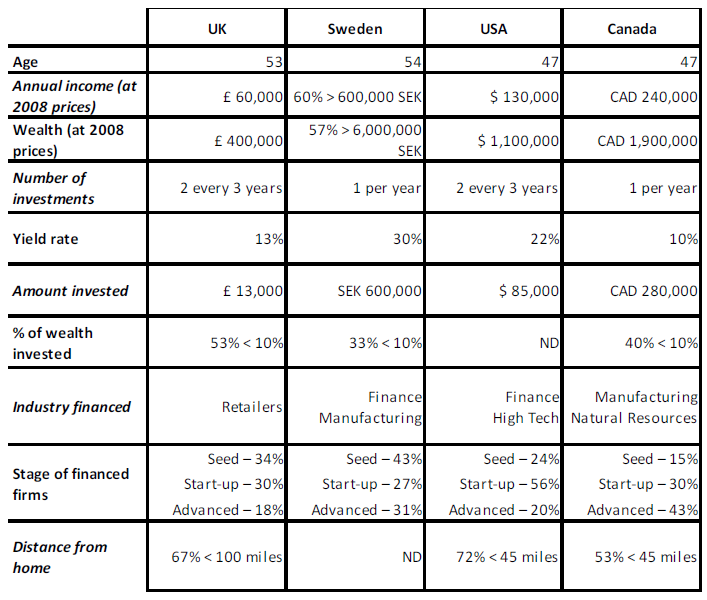
The diagram above shows the funding sources that a firm typically uses during the various phases of its development. As it is possible to see from the diagram venture capitalists enter the company when it has already started to make positive revenues. The operator which finances the company in the “Valley of Death” (before the firms makes positive revenues) are FFFs (family, friends and fools) and most importantly business angels who have the crucial role of filling this funding gap left by venture capitalists and by banks.

Business angels are autonomous non institutional investors who invest their own money in buying shares of small or very small companies with very high potential and very high risks, at the same time bringing entrepreneurial and managerial expertise. Angels aid the company more than what a venture capitalist would do and often the angel takes on the role of a very active partner in the companies he finances increasing the chances of success of the project (Mustilli and Sorrentino 2003). One key difference with venture capitalists is that angels invest their own money and therefore have more patience and can wait more time for their returns. Furthermore business angels often also have some strong secondary non financial motivations that drive them to perform their investments (Van Osnabrugge 1998, Brettel2002, Ramadani2008, Morrissette2007, Sullivan and Miller 1996 etc.), while venture capitalists look exclusively for financial returns to remunerate their investors and therefore they are not willing to invest in very risky and uncertain companies at the very early stages.Business angels in general are able to be more flexible in various aspects such as investment criteria, amount invested, exit strategy, due diligence and time to exit. The table below summarizes all the major differences that usually occur between venture capitalists and angel investors.

|  |  |  |
| --- | --- | --- |
|  | **Business Angels** | **Venture Capitalists** |
| **FundingAmounts** | € 25.000 to € 500.000 | € 500.000 to € 10 mio |
| **Investment Focus** | People and return | Return |
| **Geographical Focus** | Regional | Regional to International |
| **Flexibility** | Flexible | RatherInflexible |
| **Formality** | Infromal | Formal |
| **Accessibility** | Not Easy, prefer anonymity; Angel Groups and Referral | Highly visible; websites and business plan portals |
| **Motivation** | Motivated by visions, not just returns, emotional component | Motivated by returns and reputation among entrepreneurs |
| **Readiness to assume risk** | Very high | Relatively high |
| **Investmentcriteria** | Ideas, personal chemistry with the entrepreneur, market analysis | Rational; nearly developed product, USP, strong experienced (management) team, Financial prospects |
| **Company valuation** | Alsoimportant | Decisive |
| **Due Diligence** | Eventually limited DD, fast and light quick decisions possible | Extensive and methodical, rather slow decisions |
| **InvestmentTerms** | Flexible and ralatively simple, somewhat negotiable | Firm standards, e.g. liquidation preference |
| **Numer of investments** | Different, free to decide, less than VC | Min. annual number to be achieved, more than BA |
| **Equitypercentage** | 10% - 30% | >20% |
| **Long- Term Value added** | Operational experience, common sense advice, specific industry expertise | Managing growth, networks of additional sources of capital, managing IPOs |
| **Exit** | Flexible hard to calculate and rather late | 2 to max 7 years |

**Table 1 –** *Comparison of Business Angels and Venture Capitalists* (Hanf 2007)

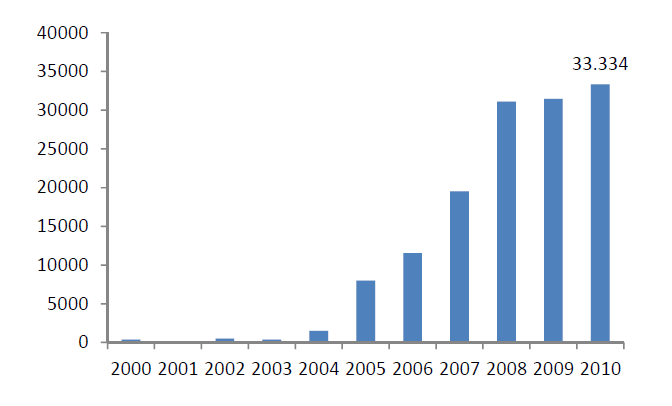
Angel investors can take on various forms, from the individual who finances only one venture in his life to help a friend or a family member, to the serial angels that make investing their full time profession (Capizzi and Tirino 2011). Angels in general are wealthy individuals between 40 and 65 years of age that have had managerial and entrepreneurial experience. The table below, elaborated by Capizzi and Tirino 2011with the use of the works of Harrison and Mason (1994), Landstrom (1993) , Gaston (1989) and Riding (1993), compares the characteristics of British, Swedish, Canadian and USA investors.



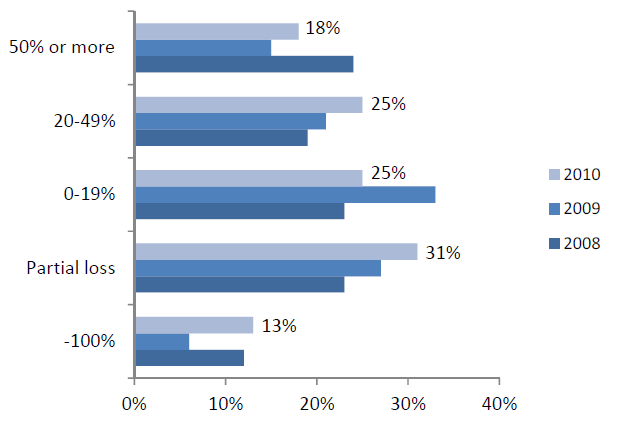
**Table 2 –** *Business angel investments in selected countries* (Capizzi and Tirino 2011)

As it is possible to see from the graph above, USA and Canadian investors are slightly younger than British and Swedish business angels. Canadian investors are the onesthat invest the most amount of money (CAD 280,000 = € 180,000) compared to $85,000 (€ 64,000) of USA investors, SEK 600,000 (€ 70,000) of Swedish investors and the £13,000 of British investors (€15,000). However the Canadian investors are also the ones that invest in most in companies in later stages (43% invest in advanced stage) but also receive the lowest yield rate (10%) while the highest yields are enjoyed by Swedish angels which receive on average a yield rate of 30%.

Regarding Italian business angels the descriptive characteristics were researched in only three studies. The first one was conducted in 2003 by Mustilli and Sorrentino the second one was by Capizzi and Giovannini (2010) and the last one was by Capizzi and Tirino (2011). The work by Capizzi and Tirino (2011), based on 2010 data, is therefore the most recent research that exposes the descriptive characteristics of Italian angels, which I will list in the following paragraph, to serve as comparison with the characteristics of International angels that were exposed in Table 2. Their study is composed of 313 Italian business angels. The study shows that the market for informal venture capital in Italy has grown exponentially in the decade from 2000 to 2010 as it is possible to see in the diagram below.

D**iagram 3 –** *Italian Informal Venture capital market size (€k)-* (Capizzi and Tirino 2011)

The market amounted to € 400,000 in 2000 and it grew to €33.3 million in 2010. It is interesting to see that the Italian market growth does not show any slowdown due to the financial crisis in 2007. The exponential growth is due to the increasing market organization that is occurred in Italy. According to the study 25% of business angels have a personal wealth between € 500,000 and € 2,000,000 while 33% have a personal wealth of less than € 500,000 and 52% of the sample invest less than 10% of their personal wealth while 24% invest between 11% and 20% of their wealth. The average amount invested in a single project is less than € 30,000 for 33% of the sample, 22% invest between €30,000 and € 60,000 while 9% percent invest the very large amounts, above € 500,000. The vast majority of the sample (77%) have performed between 1 and 5 investments in their career and 12% invested in more than 10.The preferred stage of projects are seed for 38%, start-up for 26%and early stages for 25%. The range of industries financed is very broad however most investments are performed in the ICT business (20%) followed by business services (16%) and entertainment (12%). Finally a very interesting statistic is the percentage of returns that Italian business angels are able to achieve which is presented entirely the table below.



**Diagram 4 –** *Average returns on investments* – (Capizzi and Tirino 2011)

From the diagram above it to see that in 2010, 31% of disinvestments reported a partial loss and 13% registered a total loss. This means that in 2010 44% of all disinvestments achieved only negative returns. This greatly underlines the extremely risky nature of angel investing. For the rest 18% percent of the disinvestments reported profits exceeding 50% percent. It is also possible to view a negative trend affecting returns, in fact it is possible to see that the percentage of investments which registered a partial loss has constantly increased from 2008 to 2010.

Business angels are an unofficial and unrecognized category. Therefore it is very hard for entrepreneurs to find angels and on the other hand it is also very hard for angels to have a consistent deal flow of opportunities to evaluate. The activity of business angels is systematically effected by matching problems and by insufficient information regarding deal flow. It used to be that angels only stumbled upon opportunities through friends or professional connections. In order to solve this information problem, business angels all over the world organize themselves into Business Angel Networks (BANs). BANs are public or private organizations acting as intermediaries between business angels and entrepreneurs and the can operate either at a regional or at a national level. Their main function is to match entrepreneurs seeking for funds to business angels willing to invest (Aernoudt and Erikson, 2002). Other than just matching angel networks offer other advantages to both entrepreneurs and investors. Networks for example often help entrepreneurs in preparing qualified business plans and presentation pitches (ZuKnyphausen-Aufsess and Westphal, 2008). Business angels instead, through networks, can benefit from shared knowledge making their experience as investors grow at a faster rate than if they were investing independently and they can diversify and reduce risk by investing in syndicates.

In Italy there are two major BANs which are Italian Business Angel Network (IBAN) and Italian Angels for Growth (IAG). IBAN was the first Italian network to be established and it was founded in 1999. For many years IBAN was the only Italian angel network operating at a national level. IBAN has 126 direct member and it coordinates 13 affiliated regional networks. IBAN is also one of the founding member of the EBAN (The European Trade Association for Business Angels, Seed Funds and other Early Stage Market Players) and thanks to its selection process it is considered one of the most advanced BANs in Europe. The other Italian national level BAN is Italian Angels for Growth, which is much younger than IBAN as it was established in 2007, since its foundation it has grown very rapidly and it already counts 102 members. Its operating model is based on the best practices of the most advanced networks based in the USA.

# Literature Review

The seminal work that first uncovered the existence and the nature of Business Angels was conducted only relatively recently by Wetzel at the beginning of the 1980’s. The studies similar to those of Wetzel and are often referred to as “first generation studies” which had the aim of analyzing common attributes of business angels such as gender, age, wealth, and educational and professional backgrounds. Instead the so called “Second Generation” studies had the aim of focusing on the investment process, investigating aspects such as the size of the market, the rates of returns along with their determinants or which industries are mostly financed.

As previously stated in the introduction, my analysis will expose what are the motivations that lead Italian business angels to invest, the barriers they encounter, the role they have in the companies they finance together with the evaluation of the effectiveness and the efficiency if Italian Business Angel Networks. The research will also give special attention with regards to female business angels, trying to specifically analyze certain aspects of their behavior. Finally I try to point out what could be some measures to incentive the activity of business angels in Italy. In the following paragraphs I will give an overview of all the major studies that were performed both at the Italian and international level which take in consideration the areas that I analyze in my research.

Starting with motivations it is widely recognized that business angels don’t invest just to achieve financial returns even though the financial component is indeed very important and probably fundamental. However in the literature it is possible to see that there is some debate on the importance of the non-financial component in the motivations that lead a business angel to invest. For example Harrison and Mason (2002) claim that business angels invest primarily for reasons of financial nature: “By far the most important reason for capital appreciation”, however the recognize that a series of non-financial reasons still have an impact on an angel’s decision. The same conclusions are reached also by a series of authors as for example Whittam and Johnston (2003) who analyzed the Scottish market, Hindle and Wenban (1999) who analyzed the Australian market and also San Jose, Roure and Aernoudt (2005) and Stedler and Peters (2002). Van Osnabrugge (1998) also confirms Harrison and Mason’s (2002) point of view however he highlights the fact that there are various business angels that invest primarily for non-financial motivations despite the fact that they don’t have the goal of giving any sort of charity. As a business angel quoted by Van Osnabrugge (1998) put it: “I want to be part of the entrepreneurial process. Though my main motive is not financial I don’t want to lose either though”. In his survey on German business angels, Brettel (2002) shows that 81% of the angels in his sample state that “Fun” is “Very Important” (the best possible rating foreseen in the survey) while only 46% consider “Very Important” obtaining a “high capital growth”. Ramadani (2008) in his general analysis highlights that a significant part of angels act for non-financial reasons and that altruism is a key factor, the significance of the non-financial component is emphasized also by Morrisette (2007). Finally it is interesting to report the study perfomed by Sullivan and Miller (1996). In their research they tried to segment business angels by their motivation for investment, dividing them into three categories: Economic Investors (interested in maximizing profits), Hedonistic investors (who search for non-economic or psychic income and are interested in the component of fun) and Altruistic investors (who are interested in helping society). According to their survey the three categories represent respectively 47%, 31% and 22% of the total. Therefore according to Sullivan and Miller more than half of the business angels they interviewed has non primarily non-financial motivations, specifically 22% of altruistic investors is surely a relevant percentage.

Regarding the Italian situation, as stated previously, the available literature is very scarce composed of only three main studies. The first study was performed by Mustilli and Sorrentino in 2003, a first generation study which analyzes the main characteristics of business angels in Italy. The second study was performed by Capizzi and Giovannini in 2010 and had the goal of measuring the size of the Italian informal venture capital market. The most recent major study of business angels in Italy was conducted by Capizzi and Tirino in 2011 which analyzes the rates of return of business angel investments between 2007 and 2010 along with their determinants.

In all of the Italian studies the theme of motivations for investments is only briefly mentioned just through references to international studies.

Other than just studying the motivations for investments in a static way my research has the aim of understanding how the motivations change as a business angel becomes more professional and experienced or in other words “serial” (as defined in literatiure). This theme is exposed primarily in Van Osnabrugge’s (1999) work “Do serial and non-serial investors behave differently?: An empirical and theoretical analysis”. He considers serial all those angels that performed more than 3 investments in their career. According to his statistical analysis there are indeed some differences between serial and non-serial angels. Specifically serial investors tend to invest in sectors which they know better, to invest in groups, they are less involved in the companies they finance and they consider geographical distance as a less important factor with respect to non-serial investors.

Regarding the aspect of barriers to investments, I try understand what obstacles are faced by Italian angels during the investment process and if they are able to invest as much as they would like of if some funds that are available remain un-invested. For example Maula, Autio and Arenius (2005) I their analysis of the Finnish market, Paul Whittam and Johnston (2003) in their analysis of the Scottish market and Sohl (1998) for the American market show how business angels have unused funds simply because they lack pojects to evaluate. It interesting to highlight that there is a large unexpressed potential regarding business angels, in fact Freear et. Al (1994) estimates that the number of potential informal investors is three time larger than the number of active ones. Sohl (2003) estimates that in the United Kingdom this proportion is 5:1. Probably the most important study regarding the barriers to investment is by Harrison and Mason (2002): “Barriers to investment in the informal venture capital sector” which shows that in the United Kingdom there is an abundance of capital and 90% of the angels included in the analysis would like to invest more. Also Harrison and Mason say that the lack of opportunities is one of the major barriers to investment but they notice that many projects don’t meet the angel’s selection criteria because angels are reluctant to invest in industries or project which they are not very familiar with. At the Italian level this aspect was briefly tackled by Mustilli and Sorrentino (2003) who used as source IBAN data.The result is that in 41% of the cases angels simply have “null interest” in the project.

Regarding the aspect of Business Angel Networks, I try to uncover what business angels think about the effectiveness and the efficiency of Italian BANs. The study of ZuKnyphausen-Aufsess and Westphal (2008) underline that BANs in Europe and North America have unsatisfactory performances in matching entrepreneurs with investors citing some of the major scholars on informal venture capital: “ […] in reality most North American and European BANs are relatively unsuccessful in matching business angels and entrepreneurs and offering services that provide real benefits to their addressees (Wetzel andFreear 1996; Blatt and Riding 1996; Mason and Harrison 1996; Liu 2000)”. This study also claims that sometimes BANs can increase the problems of adverse selection (“Without the help of the network, a business angel can observe and differentiate between the varied strengths signaled by the young technology ventures (e.g. a good written business plan). If these signals are influenced by the network’s services to the ventures, then the ability to differentiate will be evened out and the weaker young technology ventures will be able to send out strong signals to the business angel”). The study also claims that other operators like banks and business are more effective that BAN in bringing deals to business angels. Similar results are also reached at the Italian level by the study of Mustilli and Sorrentino (2003). According to this study BANs are responsible for 6% of deal referrals while banks are responsible for 20%. However it is key to consider that this study was performed when IBAN the first Italian BAN was only three years old.

Regarding the theme of female business angels, various studies have uncovered that women are approximately 5% of the total business angel population (Harrison and Mason 2005). Harrison and Mason find that female business angels have a certain inclination in investing in projects carried out by female entrepreneurs, however there are no significant differences regarding the approach to investments. Sohl and Hll (2007) highlight that if females are somewhat disadvantaged in investing through the traditional channels, on the other had they advantaged in finding deals carried out by female entrepreneurs and they also prefer them.

The final aspect that the research tries uncover is ways to incentive the activity of business angels. All the main examples of incentive are explained in detail further on in the paper. However literature-wise it is necessary to mention the works of (Aernoudt, San José, and Roure (2007) and the work of Harrison and Mason (2008) which describe and review critically the main forms of policy intervention undertaken in Europe and in the United States. Both researches consider fiscal measures as the most commonly used type of incentive.

# Empirical Analysis

## The Research Questions

Having explained and considered the relevant literature regarding business angels at the Italian and international level it is possible to identify several research questions that are particularly relevant to the Italian context. The research questions I defined have the aim to fill the literature gap that Italy suffers with respect to other European countries and the USA on the subject of business angels and to update research efforts made in the past, such as the work of Mustilli and Sorrentino (2003) which was indeed very thorough, but completed about 10 years ago when business angel activity in Italy was barely acknowledged and IBAN, the first Italian angel network, was still very young. As previously stated in the literature analysis the main recent works on Italian business angels are Capizzi and Giovannini (2010) and Capizzi and Tirino (2011). The first research analyzes the size of the Italian informal venture capital market while the latter analyzes the return rates of informal venture capital and its determinants.

My analysis has the goal of complementing previous research by trying to understand Italian business angels in a more descriptive kind of way also through interesting anecdotes and specific examples, giving insights on the operational behavior, the motivations for investment, barriers to investment and the effectiveness and the efficiency of Italian angel networks. Furthermore my research will try to give special attention to female angels by analyzing their particular behavior and understanding why they are numerically so few compared to men. Finally my goal is to expose possible ways and incentives to stimulate business angel activity in Italy.

The first research question that will be taken in consideration is related to the motivations that lead a business angel to invest: “*What are the motivations that lead a Business Angel to invest in unlisted companies? How important is the financial component and how important are the non-financial factors?”.* Understanding the main drivers of motivation for investment of informal venture capitalists can surely have implications on policies to foster entrepreneurship in Italy. My hypothesis on such matter is that the majority of Business Angels interviewed will have financial motivations as the main reason for investing, backed up by strong secondary non-financial motivations such as taking part to the entrepreneurial process, altruism and also having fun. A significant minority instead will have non-financial motivations as their primary reason for investing but still they are not giving charity in the sense that they don’t want to lose money. This hypothesis is in line with the international literature mentioned in the Literature Review section. However rather than understanding the reasons for investment of business angels in a static sense it is interesting to understand whether motivations change as business angels become more professional. Therefore I would like to understand if so called “serial” investors have different investment reasons from non-serial angels and if their behavior or role in the companies they invest in changes along with the motivations. Business angels are considered serial if they have funded three or more unlisted companies (Van Osnabrugge 1999). So the second research question is: “*How do the motivations for investing and the behavior of a business angel change as he becomes more professional or “serial?”* and my hypothesis is that a serial business angel will probably be more interested in financial returns rather than a non-serial business angel and will probably be less involved in managing actively the companies he invests in. A serial business angel would probably rely on techniques of financial management and analysis which are closer to the ones used by a formal venture capital fund.

The next key aspect taken in consideration refers to the aspects of barriers to investment, more specifically: “*Are Italian Business Angels able to invest as much as they would like to, or do some funds that would be available remain un-invested? What are the reasons for this?”.* My hypothesis, based both on Italian and international research is that in Italy probably funds available for investment remain unused because it is very hard for business angels to receive or find business opportunities to evaluate and because Italian business angels are reluctant to invest in sectors they are not familiar with or in geographical areas that are far away from their home.

Along with the barriers to investment it is necessary to analyze the effectiveness and the efficiency of the main key tool that angels worldwide use to select their opportunities: business angel networks. Therefore I will explore what Italian business angels think of the networks in Italy: “*Do Italian Business Angels believe that Business Angel Networks are efficient in matching entrepreneurs and investors?”.* The hypothesis is that in Italy business angel networks are useful for the very important role of spreading the concept of business angels their potential for economic development. However, probably most deal referrals occur through other channels such as personal connections, business consultants or banks.

Finally the last aspect that my research will consider is the aspect of female business angels. The intent is to give some insight on their behavior and highlighting whether there could be some aspect that disadvantages women in entering the informal venture capital market. Therefore my research question is: “*Is there a difference in the behavior of women business angels with respect to men, especially in terms of the motivations for investment? Why are women business angles just a small minority of active informal investors?”.* Regarding behavior, my hypothesis is formed taking in account a study which claims that women investors are keener to invest in projects proposed by women entrepreneurs (Harrison and Mason 2005). Therefore I would expect that also Italian female business angels would have such inclination. Furthermore I would expect that women lack the experience, background and expertise to become business angels. This is because business angels are usually either managers or entrepreneurs and there are simply very few women among managers and entrepreneurs.

The Following table summarizes the five research questions and the hypothesis.

|  |  |
| --- | --- |
| R1 | *What are the motivations that lead a Business Angel to invest in unlisted companies? How important is the financial component and how important are the non-financial factors?* |
| H1 | The majority of Business Angels will have financial reasons as the main reason for investing, backed up by strong secondary non-financial motivations |
| R2 | “*How do the motivations for investing and the behavior of a business angel change as he becomes more professional or “serial?* |
| H2 | A serial business angel will be more interested in financial returns rather than a non-serial business angel and will be less involved in managing actively the companies in which he invests. |
| R3 | *Are Italian Business Angels able to invest as much as they would like to, or do some funds that would be available remain un-invested?* |
| H3 | Funds available for investment remain unused because it is very hard for business angels to receive or find business opportunities to evaluate and because Italian angels are reluctant to invest in sectors they are not familiar with or in geographical areas that are far away from their home. |
| R4 | *Do Italian Business Angels believe that Business Angel Networks are efficient in matching entrepreneurs and investors?* |
| H4 | Networks have the role of spreading the concept of business angels their potential for economic development. However most deal referrals to occur through other channels such as personal connections or banks. |
| R5 | *Is there a difference in the behavior of women business angels with respect to men, especially in terms of the motivations for investment? Why are women business angles just a small minority of active informal investors?* |
| H5 | Women investors are more keen to invest in projects proposed by women entrepreneurs. Regarding the small number of females among angel the hypothesis is that there are very few women among managers and entrepreneurs. |

**Table 3 –** Research questions and hypothesis

## Methodology and Sample

In order to effectively analyze the research questions explained in the previous section the best way to proceed is to perform semi structured interviews with Italian business angels. Ideally the interviews should take place in person or when that is not possible the interviews should be conducted by telephone. The reason why I chose semi structured interviews is that it allows the interviewer to gather more interesting insights during the conversation. The method of semi structured interviews was used in many studies on business angels (Harrison and Mason 2000, 1994, Paul, Whittam and Johnston 2003, Brettel 2002, Van Osnabrugge 1999, Tashiro 1998, Saetre 2002, Mustilli and Sorrentino 2003 etc.). To manage to contact the business angels I began the search through the names of the investors that are public on the websites of the two main Italian networks, IBAN and Italian Angels for Growth. After having a list of names I researched them on the internet and I sent an email to all those for which I found and address asking them if they wished to be interviewed. Furthermore I used the so called “snowball method” (Harrison and Mason 2004) asking the people I interviewed if they could introduce me to other potential interviewees. Using the snowball method allowed me to reach also investors which are not members of any angel association. In all the literature that was analyzed, the difficulty of determining a significant sample is widely recognized due to the fact that business angels have a strong inclination to anonymity and also because they are not an officially recognized category (citation). The sample sizes of researches on business angels are generally small especially for the works conducted through the direct interview method. For example Mustilli and Sorrentino (2003) base their analysis of Italian investors on a sample of only 41 individuals of which only 1/3 were reached through direct interviews while the remainder was reached through an e-mail questionnaire. Other examples of studies with a very limited sample size are Paul, Whittam and Johnston (2003) (30 angels), Saetre (2002) (20 angels), Brettel (2002) (48 angels) Van Osnabrugge (1999) (25 angels), Tashiro (1998) (used 1000 responses from a national questionnaire not specific on business angels plus 10 in depth interviews with angel investors), Hindle and Wenban (1999) (36 angels), Landstrom (1995) (58 interviews through a questionnaire) etc.

For my study I was able to interview 33 Italian informal investors, 29 men and 4 women. Considering the subject, a sample of 33 is surely significant and such a sample was sufficient to underline trends on Italian business angels for every research question foreseen also considering the fact that the two main Italian angel networks count only about 100 members each. Of course there are some specific limitations which will be addressed later on in the analysis. The sample is mainly composed from members of the two main angel networks, IBAN and IAG however 8 of the individuals interviewed are not members of any association. All the interviews except for 3 were conducted through the phone since the interviewees were very spread out on the Italian territory. Another limitation is that the majority of the interviewees expressly asked to remain anonymous and that the full transcript of the entire interviews should not be published. However, the fact that their anonymity was guaranteed allowed angels to freely talk about their experiences, which allowed me to gather more insightful information.

The interview was composed of 8 questions for men business angels and 9 questions for female business angels (question no. 8 was asked only to female interviewees). The interviews were performed in Italian but for the purpose of this paper I will use the English translation (a copy of the original interview structure sent to angels is attached in the appendix).

The table below outlines the structure of the interview.

|  |  |
| --- | --- |
| Q1 | *Briefly describe your professional profile and your profile asan angel investor.* |
| Q2 | *What are the motivations that lead you to invest in unlisted companies? How much does the component of financial returns count?* |
| Q3 | *How many investments did you undertake in your career as a business angel? How many just in the last 3 years?* |
| Q4 | *What type of role do you tend to have in the businesses that you finance?* |
| Q5 | *What are the barriers or problems that you encounter in the investment process? Do you manage to invest as much as you wish or are there funds that you are not able to allocate?* |
| Q6 | *Do you believe that angel networks are useful/efficient? Why are you part of one? (or why are you not part of one?)* |
| Q7 | *There are considerably less female angels than men. What do you think is the reason for this? Do you believe that women are somewhat disadvantaged in the investment process?* |
| Q8 | *Some studies show that women business angels are more prone in investing in ventures proposed by other women. Do you agree with this statement?* |
| Q9 | *How could it be possible to promote and foster the activity of business angels in Italy?* |

**Table 4 –** Interview structure.

The first question *“Briefly describe your professional profile and your profile as an angel investor”* had the function to simply introduce the individual and get basic information about him in order to be able to possibly steer the conversation in the most fruitful direction. The second question: “*What are the motivations that lead you to invest in unlisted companies? How much does the component of financial returns count?”* is necessary to give an answer to the first research question and to find out what are the motivations that lead an individual to invest in unlisted companies. The second research question which analyzes the change in motivations and behavior that occur when business angels become serial is answered through questions 3 and 4. The third question allows to classify an angel as serial by asking how many investments he performed in his career, enabling one to compare if there are differences in answers to question 2, concerning the motivations, and in answers to question 4 (“*What type of role do you tend to have in the businesses that you finance?”)* concerning the behavior.

The third research question, on the barriers encountered in the investment process, is addressed by question 5 (“*What are the barriers or problems that you encounter in the investment process? Do you manage to invest as much as you wish or are there funds that you are not able to allocate?”)* It does not allow to only understand the obstacles in the investment process but also to understand if despite any obstacle an angel is still able to invest as much as he would like. The fourth research question, on the efficiency and effectiveness of angel networks, is tackled through question 6: “*Do you believe that angel networks are useful/efficient? Why are you part of one? (or why are you not part of one?)”.* Along with this question I always informally asked whether the investments business angels decided to finance where actually presented to them by the network as this is a key indicator of the performance of such associations.

Finally questions 7 and 8 enter in the scope of the last research question regarding women. Question 7 was asked to all angels in order to still manage to give an insight on the situation of women. Despite the fact that it is very hard if not impossible to reach a significant sample of female investors even men are able to give an opinion on why so few women act as business angels. Question 8 instead (“*Some studies show that women business angels are more prone in investing in ventures proposed by other women. Do you agree with this statement?”)* is specific to female investors and it would be impossible for a man to give an opinion on this matter.

To conclude the interview, the final question was: “*How could it be possible to promote and foster the activity of business angels in Italy?”.*  This last question has the function of gathering some insights on what Italian business angels believe they need in order in improve and expand their activity and compare these insights with solutions that have been undertaken in other countries in order to try to predict what their effects could be in Italy. Italy is definitely far behind compared to other western economies with respect to the extent of business angel activity and also with respect to state policies to incentive their operations.

## Results

Having explained the scope of the research and the method used to gather the relevant information I will proceed with the detailed analysis of the results.

### Descriptive statistics

Before mentioning in detail the answers to the research questions that were gathered through the interview process it is necessary to give some basic descriptive statistics of the sample. As previously mentioned the sample is composed of 33 interviews, 29 men and 4 women. As it can be seen in the diagram below women compose only 11% percent of the sample.

**Diagram 5 –** Gender of business angels interviewed (*author’s elaboration)*

Most of the interviewees are part of business angel networks, in my sample 14 individuals came from Italian Angels for Growth, 11 came from Italian Business Angel Network and 8 were not members of any association. As it can be seen from the diagram below the sample is almost evenly balanced between the members of the two networks but the individuals that are members of no network count for 24% of the sample. For the purpose of my analysis I consider as IBAN members also members of regional angel networks which are nonetheless affiliated to IBAN.

**Diagram 5 –** Angel network membership (*author’s elaboration)*

Most angels in the sample have mainly two educational backgrounds which are business/economics and engineering. In fact 18 business angels (amounting to 55%) have a business/economics degree. The second most represented category with 11 angels (amounting to 33%) is engineering. Together business and engineering make 88% of the sample. For the rest 1 individual in the sample has a legal background, 2 have a computer science background and quite surprisingly 1 interviewee has no higher education degree. In the diagram below it is possible to see the distribution of the educational background of the interviewees.

**Diagram 6 –** Educational Background (*author’s* *elaboration)*

It is also important to analyze statistically is the experience of the business angels. More specifically the sample is composed by 21 serial angels who count for 64% of the total and by 11 non serial angels who account for 33% of the total. Among interviewees one angel decided to not declare the number of investments in his career and therefore it was not possible to categorize them as serial or not. The distribution by experience of the angels interviewed can be seen in the diagram below.

**Diagram 7 –** Experience of business angels interviewed (*author’s elaboration)*

It is interesting to mention that the majority of the angels in the sample (58%) have had some kind of international experience. By international experience I mean that a business angel has had some kind of work or study experience abroad. The countries in which the interviewees have acquired their international experience are primarily the USA followed in order of importance by the United Kingdom, Switzerland and Germany.

**Diagram 8 –** International experience of interviewees (*author’s elaboration)*

The last interesting common trait that is worthwhile mentioning is that all of the individuals that were interviewed is that they are absolutely all self-made. In the sense that none of the interviewees invest with funds provided by family wealth. Even though there are examples of interviewees that have started their career in the family business, they are all personally successful entrepreneurs or managers. Therefore the profile of Italian informal venture capitalists seems to be consistent with what is outlined through the main international studies on the matter and also previous Italian studies (Capizzi and Tirino, 2011, Mustilli and Sorrentino 2003).

### Analysis

Considering motivations for investment, on the basis of the results achieved from the limited sample, it is possible to infer that my hypothesis can have some grounds to be confirmed. In fact almost every business angel interviewed invests for a financial reason, in the sense that if there was no possibility for financial gains they would not invest, but there are very strong secondary non-financial reasons that are also very important. Surely the main secondary non-financial reason that leads to investment is the fact that most of the interviewees refer to a component of fun and pleasure which is associated to creating and developing a new innovative company, accompanied with the curiosity associated to being in touch with original ideas and technologically advanced sectors. In addition to pleasure, also many other non-financial reasons were mentioned, such as helping the country to climb out of the financial crisis by fostering growth, learning, helping young individuals to succeed and reducing unemployment or simply being part of a network. In general some angels express themselves through the idea of the concept of “giving back”, in the sense that individuals that have been successful should give the possibility of being successful also to others with all the associated benefits to them (as returns on the investment) and to society.

In any case there are also some angels that place themselves at the extremities of the spectrum; in fact there are some individuals that invest purely for financial reasons and others that consider possible financial returns just as an additional positive occurrence. For example one angel referred to his activity as an informal investor as a “second master” referring to the great amount of things he is able to learn and the experience he gains which becomes useful also on his every day job. Or another interesting example is that of an entrepreneur which engages in angel investing in order to have social recognition and prestige which is achieved through being invited as a speaker in conferences or receiving newspaper articles about him. On the other hand there are also 6 examples of individuals that invest purely for financial reasons and for the potentially very high returns that informal investing can generate with a relatively low financial outlay. One individual actually considers angel investing as a part of his financial wealth management strategies, his goal is to consistently have 5% of his spare resources invested in very high risk and very high return investments and he considers informal venture capital as the best alternative within such segment. It appears that regarding the motivations for investment Italian business angels seem to be aligned with their international peers as the financial component is clearly key, but non-financial reasons are also very strong. Financial returns alone would not be able to explain angel investment. This is probably because due to the extremely high risk informal venture capitalists have to seek other kinds of returns to make the investment worthwhile despite the possible financial result.

The following table shows the distribution of individuals in the sample with regards to their motivations for investment. The sample is divided in three categories the first one is the one of individuals who invest primarily for financial reasons but also have strong secondary non-financial reasons for investment, the second category is the one of individuals that claim that their main driver for is not financial and therefore capital appreciation is only a secondary aspect and the third category is comprised of those individuals who invest only for financial reasons or that, nonetheless, have only weak secondary non-financial reasons.

**Diagram 9 –** Motivations for investment *(author’s elaboration)*

From the diagram above it is possible to see that the first category is the largest one in the sample with 55% followed in order by the second category with 27% and the third with 18%. Therefore approximately 82% of the sample has strong non-financial motivations that accompany them in their investment decisions. In the previous paragraphs the main non-financial motivations that were exposed by angels have been listed, however the diagram below shows in detail how many angels mentioned each of the man non-financial reasons. As it is possible to see the component of fun is the most important one as it was mentioned by 13 angels followed by the broad concept of “giving back” (8 mentions), learning (7 mentions), interest and passion for innovation (7 mentions) and being part and fostering the entrepreneurial process (4 mentions). Of course the total does not add up to 33 because each angels often gave more than one motivation and in fact the list of motivations is very broad, however for simplicity only the main ones were reported.

**Diagram 10 –** Top 5 non-financial motivations (*author’s elaboration)*

It is key to understand whether the different motivations are somewhat related to the experience of a business angel. In other words, if they are related to whether he is serial or not. As previously stated as a business angel becomes serial one would expect that his motivations would steer more towards the financial side. However from the results of my interviews there appears to be no strict correlation between the number of investments performed and the motivations that lead to investment. First of all it is important to underline that in my sample the individuals that meet the criterion to be considered “serial” (having invested in 3 or more unlisted companies in the last 3 to 5 years) compose 64% of the sample. Therefore the comparison of these two classes of angels probably suffers from some bias as the number of serial angels is significantly more than the number of non-serial angels, together with the fact that the sample is in itself very limited. As I have stated before the vast majority of business angels invest in the first place for financial reasons but they also have very strong secondary non-financial motivations. This major group of angels is practically evenly split between serial and non-serial investors. However it is possible to find both serial and non-serial investors among those who invest purely for financial reasons and also among those who consider financial reasons just secondary. In fact among those who invest for mainly non-financial reasons there is an angel who has done more than 10 investments in his career, some of which were successful and some of which were not. Still in this category there is also one other angel that can be considered serial as he has done 5 investments in his career and three in the last 5 years. On the other hand, among the 6 who have pure financial motivations three of them can be considered non-serial one individual has only performed one investment as a business angel. This is because he invests with an opportunistic strategy without too much active search of opportunities. Even though he does not exclude that he will do other investments in the future, for the time being he fits within the category of the non-serial investors. Of course the sample is too small to draw any decisive conclusion however there seems to be possibility that the experience of an angel can be unrelated to experience.

The diagram below shows in detail the distribution of serial and non-serial angels within the three categories of motivations that were outlined in Diagram 9.

**Diagram 11[[1]](#footnote-1) –** Motivations between serial and non-serial angels (*author’s elaboration)*

On the other hand what appears to change as an angel becomes more experienced is the role in the companies that he finances. In fact in this case it is possible to underline a kind of a pattern. It seems that the more active a business angel is, the less he is involved in day to day operations of his businesses. Of course almost every business angel wishes to bring value added and expertise in the ventures he is involved in but with serial angels the contribution is limited to major strategic decisions and to providing a network of contacts. A first obvious reason for this is that a person’s time is always limited and very often angel investors have also another main regular job and therefore as investments increase the time dedicated to each one necessarily has to decrease. A more interesting reason for why serial angels dedicate less time to their ventures is that they often invest in pools. This allows serial angels to diversify risk and to finance more ventures. However, usually the pools are organized so that only one angel of the group is very actively involved in running operations while the others contribute just through broad inputs. The fact of having just one angel directly involved with the company and representing all the other investors is usually the most efficient way for the pool to manage the investment. The lead investor is the most expert in the sector in which the target company operates. Of course the lead angels are able to control just one or two ventures simultaneously but at the same time the same angel can act as a backup investor in many other pools. In the sample I interviewed many individuals who are investing through pools but only interviewed three individuals who are currently lead investors or have acted as one in the past. From the interviews it is possible to infer that the many investments in pools are not just justified by a strategy of financial diversification to reduce risk but mainly due to the need of rationing money in order to be able to contribute to a greater number of projects. One angel also said that investing in pools makes angel investing “democratic” allowing also people with limited resources to contribute to progress and innovation.

The diagram below shows the distribution of angels with respect to their role in the companies they finance. They are divided in “very active” angels, in “partially active” angels and in “pure financers”. “Very active” angels are those who have very operative roles, serving in the board of directors or as managers. “Partially active” angels are those that either just contribute through broad inputs or those angels who are very active in certain investments but are just passive investors in others. “Pure financers” are those who invest their money but avoid taking part to the operations or the decisional process and sometimes contribute just by providing a network of contacts.

**Diagram 12 –** Role in financed companies (*author’s elaboration)*

In the sample the three categories are represented fairly evenly with “very active” angels and “pure financers” being exactly the same amounting each for 30% of the total. Partially active investors are slightly more representing 40% of the total. The diagram below instead shows the distribution between serial and non-serial investors of the three categories presented in Diagram 12.

**Diagram 13 –** Relation between Role and Experience (*author’s elaboration)*

Even though it is important to remind that the sample size is indeed very small and therefore it is hard to draw general conclusions, from Diagram 13 it is possible to visualize the previously cited pattern. Among “very active” angels there seems to be an equal distribution of serial and non-serial investors, non-serial investors being the majority just by one (5 out of 9). Among pure financers, on the other hand, it is possible to see that serial investors are the majority being 6 out of 10. The most interesting aspect however can be noticed among “partially active” investors. It is possible to see that out of 13 individuals, 11 are serial investors (85%). This is consisted with the fact that, as explained in the literature review section, angels in general wish to contribute to the operations of a company but as they invest in more start-ups they are forced to either reduce their overall contribution or they have to concentrate having an active role only in selected companies.

Therefore there appears to be some evidence to only partially accept the hypothesis to research question number 2. In fact from the information gathered from my sample the motivations that lead an angel to invest seem not to be related to the experience of an angel as it is possible to find and both serial and non-serial angels among every category of motivations. However it seems plausible to confirm the fact that as an angel starts engaging in more deals the time that he dedicates to his investment decreases and he becomes less involved in the daily operations ventures that he finances.

After underlying the main motivations and the roles of Italian angels it is important to analyze and understand what challenges they face during the process of investing and whether they are able to invest as much as they would like. So the next part of the analysis tries to understand what kind of barriers angels face during the investment process. Under this aspect the interviewees brought up many different interesting matters, many of which are related to the inefficiency of the Italian economic system in general. Most angels say that their main barrier is that it is very hard to find businesses that are compatible with them. So it is hard for a business angel to find a good match in terms of an investment opportunity that is both technically and commercially valid and that is carried out by capable individuals. Angels claim that business projects presented by Italian entrepreneurs are usually too raw and lack of quality, therefore it is not possible to invest because it would take too much time and effort to bring the project up to standard. An example of this is given by an angel that invests both in Italy and in Switzerland. When he tries to bring Italian projects to Swiss angels they are always rejected due to low quality. He says that he was never able to make Swiss angels join one of his investments in Italy. There is also a human aspect in the choice of the target company as most angels say that it is also necessary to establish a certain degree of trust and rapport with the entrepreneur before deciding to invest. Furthermore many of the angels I interviewed say that they are not comfortable in investing in sectors which are completely foreign to them. Even those that invest through pools like to invest in sectors in which they have some kind of experience in order to add value, money apart, and this further limits the range of possible opportunities. Another problem is that Italian entrepreneurs are not familiar with the concept of business angels and they are reluctant to let third parties in their companies. Therefore Italian entrepreneurs rely too much on banks for funding even though bank loans are not the best alternative for start-ups (Capizzi and Tirino 2011). This reluctance and scarce knowledge of angel investing makes finding an agreement with the entrepreneurs very troublesome and time consuming and many angels report that often such agreement is impossible to reach and the deal does not go through. Apart from this most angels also cite as barriers to investment the great economic inefficiencies that Italy has as country in general, like for example the fact that the legal system is excessively slow with rulings that are very unpredictable, the fact that Italy has very high taxation, the fact that bureaucracy is cumbersome and overwhelming and indeed some investors claim that they are discouraged from investing due to the severe financial crisis and the unclear political scenario. The table below shows the main barriers for investment mentioned by angels. As for motivations, for simplicity only the top 5 barriers are presented.

**Diagram 14 –** Top 5 barriers to investment (*author’s elaboration*)

What is very interesting though is that despite any barrier the majority of the business angels I interviewed manage to invest as much as they would like. They also manage to have a sufficient deal flow of projects to evaluate that eventually become actual investments. Most angels, despite highlighting some problems they encounter, claim that they wished they had more money to invest and that they actually probably already have invested too much of their wealth. One angel in particular said that his only barrier to investment is that he does not have enough money. In fact, as previously stated, most angels that invest in pools do not do so with a financial diversification logic but they do it because they have to ration their money since there are many projects that they would like to join.

**Diagram 15 –** Allocation of funds intended for investment. (*author’s elaboration*)

As it is possible to see from the diagram below, statistically about 55% of the sample is able to find sufficient investment opportunities and is happy with the quantity of funds he is able to invest. This is a quite unexpected finding considering that Italy is not one of the leading countries in terms of innovation and also considering the deep financial crisis.

Even in this case it appears that there is some evidence that could lead towards a partial confirmation of the hypothesis. In fact it is true that Italian angels encounter some barriers to investment and that they are reluctant in investing in sectors that they are not familiar with. However no angel mentioned geographical distance as a possible barrier to investment and most importantly the majority of interviewees claimed that he was able to reach a sufficient number of investments, effectively investing as much as they would like with no funds remaining unused. This could show that despite the fact that in Italy business angels are not very well known, the environment shows some liveliness with investors managing to have many investment opportunities. This would call for the necessity of more business angels in the market.

Business angels all over the world often organize themselves in networks in order to receive a larger deal flow, to better scan the opportunities and have the possibility to invest in groups (citation). Business angel networks also have the key responsibility of building awareness on angels investing and its key role for economic growth and innovation (citation). Therefore in my analysis I try to understand how Italian business angels perceive the angel networks they are part of and if they believe that they actually bring positive benefits to their activity. As previously mentioned in the literature review sometimes angel networks are not only ineffective but they also increase problems of adverse selection by making some projects appear better than they really are giving business angels a deviated perspective (citation). As it is possible to see in Diagram 5 the sample for this analysis is composed by 40% of IAG members 36% of IBAN members and 24% of individuals who do not belong to any network. There are also other smaller networks and it would surely be interesting for a further analysis to manage to include also the members of these organizations in the sample. However having a sample practically evenly composed from members of Italian Angels For Growth and Italian Business Angel Network (for the purpose of the analysis I consider as IBAN members also members of regional networks which are nonetheless affiliated with IBAN) allows to not only analyze the perception of angel networks in general but also to outline a comparison between the two. All members of the networks agree on the fact that networks in general have the potential of being very useful, however opinions vary on whether the network is actually useful in practice. A sure benefit of networks is that they are able to bring visibility to business angels and create awareness. This operation was first carried out by IBAN and, since its foundation in 2007 also IAG is contributing to spreading and informing the public about angel investing. However the main feature of an angel network is that it should be able to match entrepreneurs with angels. On this matter there are different opinions among angels and it is possible to see that there is clear distinction in responses between the members of the two networks. In general members of IAG are very happy with their network and they claim that IAG provides a very good amount of deal flows and it allows angels to form pools for investing. IAG provides a very good structure which encourages investments in pools. The standard model for investments is that a project leader which they call “champion” acts as a lead investor and other angels join him adding capital and expertise. Apart from qualitative responses it is very interesting to underline that every one of the IAG members interviewed has financed at least one project which was presented through the network. It is also interesting to say that an angel which is not part of any network said that he prefers not joining networks but that IAG is the only one in Italy “that works”. The same cannot be said about IBAN, out of the 11 members interviewed only 2 have invested in projects presented through the network while the others found all their deals through personal connections. One IBAN member actually says that not only he never invested in a deal presented by IBAN but that he also never had to regret not doing so. It is hard to actually figure out the reason for this ineffectiveness. One interviewee says that in IBAN it is hard to form pools as there are no individuals who wish to bear the burden of becoming lead investors, while another interviewee said that too many IBAN members are not truly active angels. In any case my research is not able to collect enough evidence to draw any conclusion. IBAN still has a fundamental role regarding the area of research on Italian business angels; all the major studies performed on Italian angels were performed in collaboration with IBAN. This is indeed an extremely important aspect as without research efforts it is very hard to manage to incentive the activity of angels. Furthermore I think that it is worthwhile to expose the work of one the regional affiliates of IBAN which is the BAN Campania. BAN Campania is composed of a small group of individuals, two of which were among the interviewees, who are very active in southern Italy which is relatively underdeveloped compared to the north and therefore it is very important to have angels that are specifically active in that region. The most effective way to evaluate a network is to portray how many angels were able to find at least one deal through their angel network in the last three years. This is in order to lay the analysis on factual results leaving aside opinions that in this case tend to be too be fragmented. The diagram below shows all the angels that were able to find a deal through the network (angels that are not part of any network are not included in the chart).

**Diagram 16 –** Investments through the network in (last 3 years) (*author’s elaboration)*

As it is possible to see all IAG members interviewed have found at least one deal through the network in the last three years while the same happened only in two cases with regards to IBAN. Regarding angel networks it is not possible to achieve an analysis on an overall country basis since experiences vary from network to network. It is undeniable however that efficient angel networks are crucial to assure that angels have a constant deal flow of opportunities and every angel interviewed is aware of that. Those angels that are not part of any network have other ways of achieving a good deal flows, one for example is a computer science professor at a prestigious Italian university and that is enough to bring him sufficient opportunities to evaluate.

Concerning the problem of adverse selection created by angel networks, which is exposed by the previously cited research, does not seem to be present in Italy. Some angels mentioned that their association does a very good job in preparing entrepreneurs in giving good presentations and in preparing adequate business plans, while other angels (coming from both networks) said that still the opportunities should be better filtered meaning that sometimes projects have an overall low quality. It is the personal opinion of the author that that it is probably better to see more projects than being too strict on requirements and allowing less projects to be presented with the risk of letting something good opportunity fall unnoticed.

In this situation, also concerning the limited sample size, it is not possible to lay evidence in order to fully confirm or reject the hypothesis at an overall level as there are significant differences in the responses from members of the two angel networks. What can be probably confirmed is that angel networks do fulfill the very important role of giving visibility to informal venture capitalist and making efforts to research the phenomenon of angel investing. Regarding the aspect of efficient deal referrals it seems that the hypothesis can be either confirmed or rejected depending on which network one is part of. In general from the sample it appears that Italian Angels for Growth is able to achieve more investments through its associates with respect to IBAN. The reason for this difference in performance is not immediately clear and it would be interesting to analyze in detail the functioning of the networks also taking in consideration the other smaller regional networks present in Italy also through a larger sample.

The last aspect that the research analyzes is the behavior of female business angels. Various researches have taken in consideration women among angels both in terms of behavior and in terms of their numbers (citation). On average women are about 5% of the business angels population (citation) and just taking in consideration the lists of the affiliates of IBAN and IAG together this percentage in Italy seems to be slightly smaller amounting to approximately 3.9% (the total women members of IAG and IBAN together are 9 out of a total of 228 angels) (author’s elaboration on IAG and IBAN data). Therefore the possible sample is limited just to 10-15 individuals which is indeed very small. Out of these I managed to interview only four female angels and unfortunately one them has refused to answer question 8 that is specific on women, therefore the sample is in practice limited to only 3. However being aware of the fact that women are indeed very few I decided to investigate this aspect also through interview responses of male investors (as explained in the methodology). The main response that male angels give to question on why females are so few among angels is that there are simply very few women in top management positions and there are very few women among entrepreneurs. Therefore the fact that female business angels are so few is simply a reflection of social distribution of the country. The diagram below shows the top male responses to why women are numerically so few among business angels (interview question 7).

**Diagram 17 –** Main male responses to interview question 7 *(author’s elaboration)*

However this situation is slowly improving as women are able to achieve leadership positions with an increasing frequency. An interesting insight was given by a business angel who is an engineer and an entrepreneur. He says that when he was studying (he is now in his 60’s) there were absolutely no women in his engineering class while he noticed that now many more women decide to study engineering. This is probably true also for other fields of studies such as computer science or business. Since business angels are usually at least over 40 years of age, it will take time before these women will become professionally mature and capable of becoming angels, but the situation will surely improve in the future. Another aspect that male business angels underlined in about one 15% of the responses is that women are less prone to risk than men and therefore less keen to undertake extremely uncertain investments. Respondents say that women are excellent managers but not prone risk takers and therefore they refrain from getting involved in informal venture capital. It is very important to stress the fact that this statement is simply an opinion that male business angels have regarding their female colleagues therefore its absolutely necessary to engage in further research to confirm or deny the risk propensity of females.

It is now interesting to take in consideration the answers of the three female angels that are included in the sample. They confirm that the reason that results in a very limited number of female angels is that there are simply very few women in leadership positions and very few female entrepreneurs. They also confirm the fact that an always increasing number of women is able to reach such positions even though they also claim that women have a disadvantage, having to work harder in order to reach the same results of men. Furthermore one female angel (member of both IBAN and IAG) claims that angel networks in general are so called “old boy” networks in which member are historically mostly men and women simply have a hard time fitting in. Two of the female interviewees also considers the aspect of risk aversion of females, saying that women are not willing to bear a high risk on ventures carried out by third parties.

**Diagram 18 –** Female responses to interview question 7 (*author’s elaboration).*

These three women were the only three individuals in the sample that have answered question number 8 of the interview. Even though 3 is surely not a significant sample it is still worthwhile to expose the results of their answers. Question 8 was related to the fact that female angels are more keen to invest in projects carried out by female entrepreneurs. None of the three women I interviewed ever sponsored a venture of a female entrepreneur however one of them said that she probably does suffer from this kind of bias and that she would like to invest in the company of a female entrepreneur. She said that she actually looked at a project proposed by a women for quite a long time but without being able to reach an agreement. Out of the other two women interviewed one just mildly acknowledged the possibly that there could be some favoritism of female angels to female entrepreneurs being aware of the fact that in the united states there are specific female angel networks that invest in projects carried by other females. The last woman interviewed instead said that that she is absolutely not more keen in investing in business of female entrepreneurs.

Therefore that fact uncovered by Harrison and Mason (2005) that women prefer investing in ventures of other women could find some ground for existence also in Italy. It is surely necessary to reach a wider sample in order to provide an effective proof of this since with a sample of three it is impossible to uncover any trends, however this could be very hard due to the very limited population of female informal venture capitalists. It is definitely confirmed that the fact that females are very few among angels is mainly a reflection of society, in which few women occupy the roles that lead to achieve the financial and practical capabilities that are necessary to become a successful business angels. The research uncovers that there could also be the added obstacle that women are also less inclined to undertake relatively risky investments carried out by third parties.

Having explained the results that were pertinent to the five research questions, the last part of the analysis aims at uncovering measures or ways that Italian angels believe could be useful to improve and incentive the activity of informal venture capitalists and improve entrepreneurship in general. This question was posed for last and due to the broadness of the scope of the possible responses it was not included in the research questions and therefore no previous hypothesis was formulated.

Despite the possible broadness of the potential answers, even in this case it is possible to recognize some common trends from the responses of the interviewees. The most recurrent answer, which was mentioned by more than half of the angels interviewed, was that there should be fiscal benefits, tax breaks or deductions for capital investments in start-ups and for the start-ups themselves. Of course during the interview it was difficult to uncover in detail how exactly each angel would consider implementing such incentives in the practice, since tax breaks could take very different forms. However what it was possible to infer from the interviews is that angels should be able to deduct from taxes the sums that they invest in start-ups and that there should also be tax incentives on the possible capital gains that an angel may obtain in case of a successful exit in order to encourage investment. However in some cases tax incentives, especially in the Italian context, could be considered as removals of obstacles rather than pure benefits. As one angel put it: “it is not possible that a start-up has to pay taxes before it starts making any revenues”. The tax incentives for startups that were implemented in France were often mentioned as a best practice among European countries with some angels claiming that they had a positive effect. The second mostly mentioned factor that could improve the situation of angel investing and most importantly entrepreneurship in general, is that there should be more knowledge and more information regarding the activity and the concept of business angels. Too many young entrepreneurs and individuals that could be potential angels have absolutely no idea of the existence of an economic actor such as an informal investor. It is key also in the education process that there should more knowledge about business angels and entrepreneurship in general in order to actually build in Italy a culture of entrepreneurship, through education, starting from primary schools. A significant number of angels claim that there are very few institutions in Italy, if any, that currently teach students about entrepreneurship and how to make business.

Apart from these examples which were the most cited, every angel gave some other interesting advices which could definitely be considered valuable measures to improve angel investing and entrepreneurship. Three angels proposed to establish co-investment schemes, a public matching fund in which a qualified angel commits to investing a certain monetary amount within a certain period of time and the government commits to also invest the same amount effectively doubling the investment. Of course if the venture is successful also the government will earn a return of the investment (The concept of co-investment will be explained in detail in the following section). According to one angel this type of co-investment retrieved some success in Germany.

Other suggestions were regarding some problems of the Italian system as a country in general, practically the same problems that were exposed in the paragraph on barriers to investment. Angels claimed that bureaucracy has to be reduced, as establishing a new company is excessively complicated in Italy. As one angel put it: “it kills the desire to invest”. The same problem can be associated to the legal system, which should be made more efficient. The diagram below shows the main incentives that business angels believe would be effective in improving the activity of business angels in Italy

**Diagram 19 –** Incentives to business angel activity (*author’s elaboration)*

Most angels however acknowledge, that some steps are being taken by Italian authorities. Very recently a new law decree has been passed: “*Further urgent measures for the growth of the country*” (the original title in Italian: “*Ulteriori misure urgenti per lo sviluppo del paese*”) most commonly referred to as the “development decree” which outlines some measures and incentives that have the goal to benefit and stimulate startups, entrepreneurship and innovation. This law decree has not yet been implemented but most angels are hopeful that this could be a first step to achieve some improvements. Of course it will take some time before it will be possible to evaluate the effectiveness of these measures.

It is important to note that, as previously stated, this part of the analysis is somewhat apart from the rest as it was not formulated as a proper research question since it would probably take a full separate interview to effectively cover significantly and in depth ways to improve angel investing and entrepreneurship, therefore this section of the paper aims at gathering some insight which could be used as a starting point to develop further complementary research. In any case in the next section I will briefly outline the key points of the law decree taken in Italy as well as the main measures which were taken in other countries and that could be theoretically implemented also in Italy.

# Policy Examples

This section has the aim of outlining the main policies that have been undertaken at the international level and in Italy order to incentive the activity of business angels and entrepreneurship or innovation in general. Such policies can be used for comparison with the policies and measures advocated by the Italian business angels in the last interview question that was posed to them during the research. Most importantly I will outline the main elements of that have been recently approved in Italy with the “Development Decree” in order to very if these measures coincide with the wishes of business angels in terms of policies which were uncovered in the previous section.

## 2.1 Development Decree

On December 19 2012 the law decree n.179 of 2012 containing “*Further urgent measures for the growth of the country*” was published on the Italian *“Official Gazette”* and therefore ultimately becoming law. This law decree contains some measures and policies which are specifically designed to incentive technological start-ups, nonetheless one of the sections of this law is specifically called “*Measures for the creation and development of innovative start-up companies*”. In the next paragraphs I will expose the main aspects of such measures.

The first key element of this law decree is that it foresees a specific type of company which is called an “*Innovative Start-Up*” which can benefit from the provisions outlined in the decree. The main requisites to be registered as an innovative start up is that the company must be constituted by less than 48 months it must have revenues of less than 5 million Euros, it cannot distribute profits, it must have the property rights of at least one technological invention and it must have 1/3 or more of its employees which have obtained a doctorate or have spent three years in research activities. Regarding benefits, the law decree foresees incentives in four areas which are: work contracts, corporate law, fiscal benefits and funding.

For the work contracts an innovative start up is allowed to use fixed term contracts which last for four years instead of the maximum of three allowed for ordinary companies and fixed term contracts can be renewed without no mandatory interruption. Among the corporate law measures, the most important aspect is that Innovative Start-ups are able to pay its employees with financial instruments and those financial instruments don’t constitute taxable income for the employees. Furthermore innovative start-ups don’t have to pay stamp duties and fees for the entry in the register of companies and they don’t have to pay the annual fees due to the chamber of commerce. Concerning funding the law decree sets outs the rules that will allow startups to retrieve capital through so called “crowd funding”[[2]](#footnote-2) online platforms which will be managed by banks and investment companies regulated by the Consob[[3]](#footnote-3).

What is arguably the most important element of the new law is the aspect of fiscal benefits. The law decree in fact states that individuals can deduct from their taxable income 19% of the funds they invest in innovative start ups for a maximum deduction of € 500.000. If the subject in question is instead a company, it can deduct 20% of its taxable income and have a maximum deduction of € 1.8 million. These tax breaks will apply for 2013, 2014 and 2015 and both for companies and individuals the investment must be kept for at least two years and even the partial disinvestment will make the fiscal benefit void.

Fiscal benefits are what most of the business angels that I interviewed claimed as the most effective way of giving incentives to informal venture capitalists. Only after some time, at least one year, it will be possible to assess whether such form and extent of tax breaks will have been sufficient to increase investments. Furthermore there are probably also some issues regarding which companies could qualify as “Innovative Start-Ups”, for example the fact that it is necessary for at least one third of the work force to have achieved a doctorate or something equivalent seems somewhat limiting. However this is surely a positive first step and hopefully if these measures prove to be positive they will be extended also after 2015.

## 2.2 Policies in Europe

The history of incentives implemented to aid the operations of business angels is relatively short. The first attempts were undertaken in the United Kingdom in the early 1990’s and other western European countries followed by the end of that decade (Aernoudt, San Josè and Roure 2007). In the following paragraphs I will give examples of some of the measures currently in place in Europe.

The first established approach to incentive angel investments is that of fiscal benefits. The rationale for such incentives lays with the assumption that an improvement or the worsening of taxation on investments will result in increasing or decreasing the appeal of the activity of informal venture capitalists (Harrison and Mason 1999).

Regarding Tax reliefs the UK has in place the “*Enterprise Investment Scheme*” (EIS) which allows an investor, which holds 30% or less of the shares in an unlisted company which is qualified for being part of EIS, to reduce his income tax liability up to 30% of the amount investment. The investment has to be held for at least three years and the maximum deductable amount in any given year is equal to £1,000,000. Furthermore no capital gain tax applies to the sale of such shares if they are sold after three years and in case the shares are sold at a loss at any given time, part of the loss can be deducted from taxable income of the investor (Enterprise Investment Scheme Association). On April 6th2012 also the “*Seed Enterprise Investment Scheme*” (SEIS) was launched with the aim of supporting companies in an earlier stage than the EIS. The SEIS operates in a very similar way to the EIS except that under the SEIS regime a company can receive only £ 150,000 and investors can deduct 50% of their investment for a maximum of £ 100,000 (www.seis.co.uk).

In France instead, policy makers have implemented a new vehicle, the “*SocietèUnipersonelled’Investissements à Risque*” (SUIR) which can be translated in English as “*Individual Company for Risk Capital Investments*” (Aernoudt, San Josè and Roure 2007). The SUIR is a one person company which allows to have tax exemptions on all capital gains and revenue streams gathered from investments performed through the SUIR. In order to eligible for tax breaks the SUIR must hold no less that 5% and non more than 20% of shares in companies that meet certain requirements, like for example being unquoted, being EU based and being less than 5 year old etc (Citation).

In the Netherlands investors can give loans to unlisted companies who are less than 8 years old for a maximum of € 225,000 with an interest rate that is 5% lower than the long term average rate and all the interest income received is tax free (Aernoudt, San Josè and Roure 2007). This allows companies to finance themselves at a low rate and the same time allow for investors to achieve good returns on their investments.

Apart from tax benefits, the most recent method of increasing the attractiveness of informal venture capital investments is through “co-investment schemes”. In these kinds of programs the public sector matches the investment of a business angel with equity, with some form of loan or a mixture of the two (Aernoudt, San Josè and Roure 2007). One example of a co-investment fund is the “*European Angels Fund*” (EAF) which is managed by the “*European Investment Fund*”[[4]](#footnote-4). The European Angels Fund enters in long term contracts with Business Angels granting a predefined amount of equity for co-investments upfront to each Business Angel that will be used in future investments. All investment decisions will be taken by the business angel and the monetary amounts of each individual contract lie between a minimum of € 250,000 to a maximum of € 5 million. The individuals that qualify for these programs must have a positive track record of successful investments in a targeted investment area and the companies that are eligible to be financed have to beinnovative SMEs. For the time being this program is only active in Germany and Spain however the goal for the future is to extend the plan to every country in the European union (www.eif.org). Programs similar to the European Angels Fund are present in Belgium, UK, Scotland and Germany (Aernoudt, San Josè and Roure 2007).

Another example of incentive, is that in event of a partial or total loss, a percentage of such loss is reimbursed by the public authority, which does not benefit in case of a positive return on the investment. These schemes can be set up as insurances in which the investor pays a premium for this cover. Example of such incentives were present in Austria, Belgium and Finland (Aernoudt, San Josè and Roure 2007).

# Other thanlisting various examples of policies present within Europe it is also important to outline the evidence regarding the outcomes that these policies were able to achieve where they were implemented.

Starting with tax benefits the evaluation of the effectiveness is not unanimous. According to Harrison and Mason (2009) in the UK tax incentives are the only macro-economic factor that has significant effects on encouraging or discouraging investment activities and Boyns, Cox, Spires and Huges (2003) claim that in the UK at the money invested by angels would have been 50% less if the EIS was not present. According to Stedler and Peters (2003) German angels are not that sensitive to tax benefits and also Carpentier and Suret (2005) emphasize that the tax incentive plan put in place in Quebec hardly leveraged any investment from angels.

Regarding co-investment schemes, there appears to be not much research which analyzes their effectiveness and their impact (Aernoudt, San Josè and Roure 2007). However the limited evidence seems to be positive as co-investment schemes have increased the volumes of investments in the early stage venture capital markets (Mason 2009).

For loss sharing schemes there seems to be evidence that they are overall unsuccessful representing rarely a good investment for public money as the adverse selection argument is preponderant in the decision of a business angel to guarantee his deal (Aernoudt, San Josè and Roure 2007, Mason 2009).

1. The total angels included in the chart are 32 due to the fact that 1 angel in the sample did not declare the number of investments performed and therefore it is impossible to categorize him as serial or not. The same applies for Diagram 13. [↑](#footnote-ref-1)
2. Crowd funding is referred to as the collective effort of individuals who pool their financial resources, usually through the internet to support efforts initiated by other people or organizations (Ordanini, Miceli, Pizzetti, and Parasuraman, 2011) [↑](#footnote-ref-2)
3. Consobis the government authority of Italy responsible for regulating the Italian securities market and investors. [↑](#footnote-ref-3)
4. The European Investment fund is an agency of the European Union specialized in providing finance to small and medium enterprises in Europe (www.eif.org). [↑](#footnote-ref-4)