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About business angels

The role venture capital firms play in the money and capital market is known also in Hungary – although to an extent and in a circle far from satisfactory. A portion particularly important from the aspect of national economy involves venture funding of small and medium enterprises (hereinafter referred to as SMEs) with a considerable growth potential. Much less known is, however, that an even greater economic significance is attached by the latter group to so-called business angels. They are private individuals on the capital market, who carry out enterprise development and funding activities, similarly to venture capital. Their name comes from British-American literature and they provide venture capital type funding to enterprises, and, parallel to that, they are also personally involved in the strategic control of enterprises or in the operation thereof, if need be, in order to promote their development and strengthening. They provide investment and other cooperation always on a business basis and in business arrangements, but their motives are broader and more complex than those of venture capital firms. Their activities in developing enterprises and providing venture funding to them complement those of the latter, and are often interlinked with them, which may considerably improve the opportunities of small enterprises with a good growth potential in obtaining capital.

FUNDING PROBLEMS OF SME-S

It is a worldwide problem of considerable weight that SMEs with good growth potentials, and newly started ones in particular, receive much less external funding than required by the interests of the national economy. These companies may play a crucial role in maintaining the national economy's adaptability and concomitant competitiveness, namely, its ability to adjust to any change in the opportunities, as well as external and internal conditions in terms of the variety of goods – products and services – produced. It is also known that in developed economies, a large portion of employments is in the SME sector, i.e. they maintain a considerable part of jobs. A consultation document entitled 'Bridging the financing gap' published by the British Treasury in April 2003 goes as far as stating that "small enterprises give life force to the economy – they increase lucrativeness, employment and well-being revving up life in our communities". SMEs with a good growth potential function as the engine in this sector, indirectly through production processes. Surveys have also shown that an overwhelming majority of SMEs scarcely or do not make innovation developments at all. Most of them obtain results of new developments via their production contacts, adopting them from others, and this is also how they start using it themselves. A significant role in that may be attributed to SMEs with a good growth potential functioning as the sources, which partly or fully base their activities on the work with innovation and the utilisation of their results.

The "child mortality rate" of newly started companies, however, is still very high even in well-performing economies, and only a fraction of them proves permanently and considerably profitable and economically viable in the circumstances of market competition. Similarly moderate is the ratio of success with enterprises that seek a new growth path. This certainly also means that it is often hard – or downright impossible – for such companies to receive external funding, as the owners of funds, and intermediaries in the money and capital markets even more so, are aware of the uncertainties of their prospects, namely, risks. For loan type funding, this risk entails the company's inability to comply with its debt service obligations. On investing capital, the investor's risk is dual: it stems from the company's profit generating capacity lagging behind expectations, resulting in an inability to ensure sufficiently high profits on the invested capital on the one hand, and from the possibility that due to a loss of expected growth, the invested capital itself is also lost – in part or in full, on the other hand. This latter loss is also incurred when the company does not lose operating capability, but ceases to be attractive enough for potential investors, which results in earlier investors being unable to sell their business shares in order to disinvest.

High growth potential is a bad loan collateral

In a well-performing economy laid on strong foundations, a crucial factor in loan decisions at commercial banks is the actual profitability and funds flow of the loan applicant in the period when it is to comply with its debt service obligations. SMEs promising a high growth potential are in an unfavourable position in this respect. Their peculiar positive position is usually due to the fact that their economic bases and expertise are above the average, which may facilitate their ability to achieve economic results that considerably surpass those of market actors engaged in similar activities. Consequently, on assessing their loan application, the bank should evaluate these properties in order to be able to judge the expected revenues and funds flow, and, ultimately, solvency of a company. It goes without saying that the bank itself is also required to have sufficient knowledge in the field of the financial management concerned; it is strongly doubtful, however, whether it is worth acquiring.

The developments in the area brought about a two-way global polarisation in the business policies of significant commercial banks and their business activities implementing them. One pole focuses on transaction-centred, the other on client-centred activities. The former entails the bank seeking to perform as many transactions as possible, and to maximise turnover in this, which yields high revenue. The latter, however, concentrates on providing the fullest possible service to clients, and to meet their needs as perfectly as possible, and to maximise profits through the products and services sold this way. As the above outline suggests, in-depth examination of the loan applications submitted by the companies concerned can mostly be accommodated by client-centred banking policies. The rules of economies of scale and efficiency, however, suggest that this treatment only pays off in case of clients that are big enough and have enough financial muscle to yield big deals and high profits for the bank. This, consequently, hardly includes clients whose needs bring a relatively small turnover for the bank, and which is only able to pay a slight amount for services delivered to them – such as SMEs at an early stage of development or in the course of a path modification.

Particularly difficult is in this respect for technology-based SMEs to obtain external funding, i.e. ones that primarily base their activities on innovative development and the utilisation of new innovative results. This is a global problem. The most inherent essence of working on innovation is that developers and utilizers proceed on untrodden paths and more or less unexplored territories in quest of competitive edge and economic results, in order to use these to achieve considerable economic results. On assessing loan applications, it is the chances and risks of these, and primarily the technical, economic and organisational foundations of the company that (would) have to be assessed. In such cases, the "final resort" in lending, loan collaterals, i.e. the financial securities are most often increasingly problematic: the tangible assets of such companies are represented chiefly by highly specialised assets, which consequently are difficult to liquidate, i.e. they are more or less unsuitable as easy-to-liquidate loan securities if need be. Even more valid is this for the components of intellectual property of such companies, which normally represent a considerable portion of the company property.

A key document summarising the problems of financing technology-based small enterprises is a report issued by the Bank of England in 1996 under the title *The Financing of Technology-based Small Firms,* which relies on years of examination and analysis, and was produced in a period when British economic control paid particular attention to promote development of SMEs with a good growth potential. This report pointed out, among others: "A distinctive feature of such technology-based firms at their seed, starting or early stage development is that they need real venture capital funding. The capital they need may be small, however, coupled with a fairly long term of expected investment. This role should be filled by traditional venture capital. The venture capital industry in the United Kingdom, however, has increasingly preferred further development of well-established enterprises, as well as investments in buyout transactions in the recent years, and has turned away from investing in ones at their early stages – and especially in technology-based enterprises. Unwillingness towards investments in technology-based firms at their early stages is intensified by a number of factors: it incurs high risk, requires a reasonable understanding of the technology of the investments concerned, and yields a relatively low average return on these investments."

In the second half of the nineties, a number of developed economies made considerable efforts to establish an organised capital market for the best of SMEs, where they could obtain external funding. Launched with major impetus and high hopes, such an endeavour was EASDAQ *(European Association of Securities Dealers Automatic Quotation System),* a European clone to American NASDAQ, the only permanently successful market of this type; a so-called Euro NM-markets started parallel to that, a Japanese endeavour JASDAQ or the British AIM *(Alternative Investment Market).* However, none yielded the expected boom in financing SMEs, where a considerable impact could be attributed to the impact made by the burst of the huge capital market Internet-bubble at the end of the millennium.

Development most often requires external capital

A crucial problem from the aspect of both SMEs and the national economy is that development normally requires external capital. The overwhelming majority of SMEs intending to grow can only attain their goals in the first place if provided external resources for funding their developments. This is particularly true for newly started enterprises and ones adopting a new growth path. The reasons for this are primarily as follows:

- in a high percentage of cases, their equity is insufficient for dynamic development. As a result, any development is only viable with the involvement of external capital;
- for a considerable portion of enterprises, only in the long term do developments yield an increase in profit-generating capability high enough to create a resource for repaying the external capital used for the development under an onerous arrangement, i.e. in the form of a loan or by issuing bonds. If the capital involvement also entails an interest payment obligation during the term, the withdrawal of income resulting from debt service may represent an unbearable burden for enterprises at their initial stage of growth or adopting a new growth path;
- the owners of enterprises are often unable or unwilling to assume the full risks arising from an enterprise that ultimately fails to yield the expected economic results, i.e. they ultimately do not wish to bear potential losses. Consequently, they do not undertake development or adoption of a new growth path for the company, unless they find an investor that is willing to take over a portion of these risks from them.

All these necessarily lead to the conclusion that the existence of actors in the business sphere that are both able and willing to assume at least a part of the business risks incurred is essential for a considerable fraction of new SMEs to be launched or existing ones to adopt a new growth path. This problem is also felt and represents a major obstacle to economic development in Hungary. Precisely for this reason is it essential for us to find an effective solution for this, or at least to make progress towards it, producing a considerable positive effect.

BUSINESS ANGELS ARE INDISPENSABLE

Foreign experience, primarily in the United States and the United Kingdom suggests that it is business angels rather than venture capital firms that can be expected to provide crucial seed funding or start-up capital to enterprises at their initial stage of development. The latter are willing to invest precisely in situations where institutional investors are unwilling – such as newly started enterprises in the technology sector. In addition to this, their activities to develop and fund enterprises are significantly increased, and attract particular attention in other countries, too.

Speaking about the subject that the activities of business angels are considerable not only in Anglo-American countries, it is also worth mentioning that experts consider it significant also in Finland. No actual statistical data are available in this respect, either. Round the end of the last century, specialist surveys revealed that approximately 1,500 of such investors may have been operational.

In the nineties, the Japanese economy was stagnating, and newly launched enterprises decreased in number. The government economic policy makers and the private sector paid particular attention to motivating new enterprises to be launched, and also to promoting participation of business angels. To that end, "tax regulations applicable to business angels" were adopted in April 1997.

The European Union also pays increasing attention to promote more intensive operation of business angels in the member countries, and to achieve an improvement in the conditions of launching of and growth for enterprises. This is encouraged and supported as a part of a number of programmes. Considerable efforts have been made to set up a European Network of Business Angels. The purpose of this is to promote propagation and reinforcement of business angel networks. This serves the following purposes, among others:

- represent their interests against international institutions,
- promote exchange of experience among its members,
- propagate the concept of business angels in regions where it is not completely adopted,
- collect statistical data on the significance of the activities of business angels in Europe.

The role of venture capital

During the past two decades, the venture capital industry has achieved remarkable progress. In the same period, however, their enterprise funding activities have been focussed increasingly on investments at their later – more developed – stage of development. The reason for this is mostly rooted in the fact that venture capital, similarly to any other business venture, seeks to reduce the risks assumed in their field of activity to a reasonable extent. Actually, the name we use to refer to it *(the literal Hungarian name is "risk capital", the translator)* is also mistaken and misleading: these market actors do not invest their funds in risks, but in the development of enterprises that appear worthy of it, and concomitant risk-taking is only a peculiar tool for them – in slightly polarised terms, a necessary evil. They have been specialised to be able to handle investment risks that traditional investors refuse – this is how they have created a new segment in the capital market, which they successfully exploit. However, investment in enterprises in their initial or early stage of development incurs so high risks even at these circumstances that the majority of investors are unwilling to take. Another contributing factor is that venture capital firms play an intermediary role in the money and capital market, which generated high expectations of performance for them. In respect of raising resources, they need to compete with other investment facilities, and money owners obviously confide their money to them when they are able to demonstrate sufficiently good yields. All these motivate them to seek safer investments that at the same time promise sufficient returns in their areas, which are available with investments in enterprises at a more developed stage.

Another significant motive for their attraction towards the latter is the representation of requirements concerning the economies of scale. Similarly to other profit-oriented enterprises, venture capitalist also need to comply the requirements of efficiency in their own activities directed at funding and developing enterprises, and this is why it is unreasonable for them to deal with small transactions. Apart from rare exceptions, venture capitalists always base their decisions on a thorough and diversified analysis and evaluation *(due diligence)*, which ultimately determines whether they invest funds in an enterprise, and if so, on what conditions they are willing to do so. The necessary information, analyses and evaluations may take months and involvement of well-prepared experts. An inevitable feature of decision-preparation is that the quality and cost implications of the work incurred is not proportionate to the size of the examined enterprise – the work, time and costs used for decision-preparation for a two-or-three-thousand-dollar capital investment is not much less than those required by one worth five or even fifteen million dollars; however, the chances of return are as a rule much lower even in the event of success. It also belongs here that venture capital – as an important element of its business activity – takes part in the strategic control of enterprises operating on its investment, and also helps their development using its own resources as necessary. As a rule, investments in these relatively small enterprises call to mind the problems concerning economies of scale also in this respect, as the work and other resources spent on the enterprise by the venture capitalist in order to take an active controlling part are not in proportion with the size of the enterprise.

BUSINESS ANGELS IN ENTERPRISE FUNDING

Fill a gap in the capital market

The main significance of business angel activities for the national economy is that the funding received from them relieves a remarkable shortage in the capital market. Previously, we have outlined the difficulties SMEs face on seeking external funding. Even business angels provide funding only to those that are deemed sufficiently promising by the investor, i.e., to put it simple, the best of the good ones; angels provide the latter with precisely the section of enterprise funding that is not covered by commercial banking lending activities and is also well outside the circle where venture capitalist firms invest.

The report issued by the Bank of England, as referenced above, states: "The reasons why business angels play a lesser role in enterprise funding in the United Kingdom compared to the United States should be revealed. *This market segment may be of critical significance in the success of technology-based small enterprises* (italicised by the author). A possibility of its development is offered by local and national networks that are aimed at assisting connections between enterprises and financiers. ... In the United States, it is business angels rather than venture capitalist firms that can be expected to provide enterprises at their early stage of development with the seed funding and start-up capital so critical for them. They are more likely to invest precisely in situations where institutional investors are reluctant – such as new enterprises in the technology sector."

Complement venture capital

Resulting from the nature of this issue, business angels investing their private assets work with relatively low investments. This means that financing provided by them will stay between rather firm limits, but, accordingly, also that an acceptable investment target for them may be small and medium-sized enterprises with a capital requirement too low for venture capitalist firms to be worth dealing with. According to a statement in the above-mentioned Treasury document: "It is difficult to ascertain the volume of funding originated from business angels, but estimates suggest a total annual investment of GBP 0.5–1 billion. The estimate also reveals that 75 per cent of their investments are under GBP 100 thousand, and only 8 per cent exceed GBP 250 thousand.

Another key feature of their investments is that they are much more willing to invest capital in enterprises at their starting or early stage of development than venture capital firms are. The capital originating from business angels thus may complement the activities of the venture capital industry by providing a smaller volume of financing on the one hand, and by investing at an early stage of enterprise launching or development that is not appealing to most venture capitalist firms as yet. In this way, the significance of business angels' enterprise development activity to the economy – and the national economy – is definitely enhanced by the fact that the capital provided by them often helps take enterprises to the point where they become sufficiently attractive to stand a chance of involving venture capital.

Another thing the roles outlined above clearly reveal is that business angels are no opposing competitors to venture capital but much rather potential allies thereto. By "raising" enterprises for them, they also expand the circle of investments suitable for venture capital investments. In addition, business angels fairly frequently offer options of syndicated investments to venture capital, and their participation is (also) at such times more or less a security for an appropriate quality of the enterprise concerned.

Prepare companies to be able to meet the requirements of bank financing

The essence of the role filled in by business angels in this respect can be summarised as follows.

A considerable proportion of minor enterprises with remarkable growth potential are unable to meet loan assessment requirements of commercial banks, therefore financing these would incur too high risks for the banks. Consequently, they cannot receive bank financing. This is particularly true for newly started enterprises and ones at their initial stage of development. It is also easy to see that this is unfavourable not only for the enterprises concerned, but also for banks. A bank can earn profits on a client if they transact with them. If the bank does not receive the potential client, it may save them from losses, but will not generate any profits, either.

Business angels may help enterprises operating through their financial investments successfully proceed along the development path leading from an enterprise unacceptable for bank lending, consequently, from a non-creditworthy to a creditworthy enterprise. Certainly, the story is not as simple: the business angel standing up for an enterprise, transferring its assets to them and/or involving them in its business reputation, whereby the enterprise immediately becomes creditworthy in the eyes of the bank. In the majority of cases, the business angel provides the external funding in part or in full that is necessary for the enterprise to take off – either from the starting point or from an economically underdeveloped, consequently feeble state –, and to start marching towards strengthening and the resulting creditworthiness. The latter is also assisted by the business angel, as mentioned before.

At the same time, there are cases when the enterprise could meet the loan assessment criteria in terms of the most criteria, but it proves insufficient in certain terms for the bank to approve lending. In such events, involvement of a business angel may add the necessary surplus that bridges the gap between non-creditworthiness and creditworthiness. Typical examples may be companies with managements proficient or even excellent in handling technical issues, however, weak in financial management and often in terms of marketing. Let us not think that this is a peculiar weakness of ours and others in similar shoes. The above-mentioned report by the Bank of England also points out: the weakness of British technology-based enterprises often lies in the fact that their management's brilliant technological expertise is not coupled with similar skills in terms of financial management and business.

On assessing the creditworthiness of enterprises, the expected course of business, the capacity to generate income and the expected solvency as assessed by the bank is often attributed critical significance. The qualities of the company management may again play a crucial role in this – even in a sense of their capability to produce a truly good, i.e. substantiated business plan, and also their capability to persuade the assessment board at the bank of the company's ability to implement their business plan, and yield the planned income, i.e. they will be able to repay their debt properly, among others. In certain cases, the company management may not have a sufficient ability to do so, or the necessary knowledge, and it is the business angel that makes up for such shortcomings, and makes the company acceptable and creditworthy for the bank.

The significance of all these in the business practice is convincingly proved by the fact that the National Westminster Bank – one of the banks with the highest market share in lending to British SMEs and particularly to enterprises with a significant growth potential – has assumed an active role in facilitating enterprise financing "raising" activities of business angels, and to that end they have even established their own Business Angel Service. The National Westminster Bank, as they state themselves, consider this as a useful tool to expand the bank's facilities to obtain income. Their starting point in promoting connections between enterprises and business angels is: enterprises that gather strength owing to the latter, may become suitable to join the ranks of the bank's clients or buyers of its products. Their stated goal is to add these strengthened enterprises to their clientele and client turnover, and in this way they definitely expect business angel activities to develop a number of non-creditworthy enterprises to reach creditworthiness.

The characteristics of enterprises in this circle, including technology-based ones, generally require a complex financing package adapted to their features, position and the development path in front of them. Such a package should also contain capital investment. NatWest's experiences confirm: if business angels ensure certain critical elements of such a financing package for such enterprises – particularly capital investment –, the bank will be able to join their funding in a significant portion of cases, and to formulate customised financing packages for this purpose.

Affluent private individuals making direct investments

A distinctive feature of business angels is that they invest capital as private individuals – i.e. not as part of a company –, using their private assets in relatively small, generally unlisted enterprises. (The role they play is actually not unfamiliar in terms of our earlier traditions: the Hungarian language has an expression for a 'silent partner', which is a broader category, though, but is also covers them.) On their investments, they establish a direct contact and legal relationship with the enterprise. A decisive feature of their activity is that they are wealthy as a rule, or at least definitely affluent, and profit or loss generated in such transactions is not a question of life or death. Their overwhelming majority seek significant capital gains in their investments – similarly to venture capitalists. Further similarities to venture capital firms are that they also provide enterprises with capital in exchange for an ownership share in them, and they also select enterprises that exhibit an opportunity of definitely high growth in a relatively short time, resulting in a significant increase in the worth of the company that serves as a framework to the enterprise.

Where they come from, and what they give to enterprises

There is no general rule to what walks of life business angels come from, and what history is necessary for them to become successful. Similarly, no generalisation can be established concerning their willingness – to invest their money and other resources in financing the development of enterprises – resulting from their own remarkable knowledge, expertise and experience in business life, namely in the field of organising and managing enterprises.

Practical experience, however, shows that business angels are mostly persons with a successful history in business, whether they used to be successful entrepreneurs or they were executives at enterprises of significant economic weight.

Similarly to venture capital firms, business angels do not handle enterprises they have invested their money in as passive financial investors, but they also contribute their own personal participation and movement of resources available to them to promoting their development and growth. All these may ensure participation that generates significant added value in addition to the capital. A considerable role may be assigned in this process to the utilisation of knowledge and business experience accumulated in the course of their business history. Another key element in their resources is the network of contacts built previously and used in order to promote enterprises included in their sphere if interest.

Living in hiding

An important feature of business angels is that the majority do not like to show themselves as potential investors to the general public. The only exceptions are ones that seek social recognition through this role. The majority "live in hiding" in this respect: they try to set up their activity in a way to obtain information on investment facilities, however, to be available to investment seekers only if they want to be available. Technically, it goes like this in practice: they rely on intermediary systems, organisations, databases, where investment seekers send their needs and offers, and the business angel obtains information on these without showing himself/herself at this point. Establishing and operating such intermediary systems entails costs, which someone needs to provide for in some way.

Syndicated investments

A prominent feature of business angels is that they work with relatively small investments. This would reasonably cut them off from transactions and enterprises that would meet their investment preferences in terms of qualities, but their capital requirement exceeds the business angel's possibilities and/or willingness to take risks. To bridge this gap, arrangements whereby a number of business angels make a joint investment in a major enterprise are spreading. For instance, one of them discovers such a possibility, in part or in full, and then offers joint investment to others. It is also typical for angels to join partners that are sufficiently well-versed in the field of the enterprise in question, and have a better knowledge or better contacts. Networks of business angels may also play an important role in raising syndicated investments, as this is how angels know one another, and it facilitates potential investment partners to find one another.

KEY FEATURES OF INVESTMENTS RECEIVED FROM BUSINESS ANGELS

From the aspect of enterprises seeking external funding, the key features of investments received from business angels are the following.

They assume a portion of risks

In terms of distributing risks inherent to the enterprise, investments of business angels are similar to those provided by venture capital firms. In the interest and hope of receiving a share of the profits generated by the enterprise operating with their investment, they also assume a certain portion of the risks arising from the on-going operation of the enterprise – namely that the economic results lag behind expectations, the enterprise will not be successful enough, its development starts stagnating or even that it goes bankrupt. Involvement of a business angel will obviously ease the situation of the other owners of the enterprise, and, by implication, increase their capacity to bear burdens and risks. Owners are able to and have the courage to perform developments in cooperation with and partly supported by the business angel, which are indeed promising, but without the angel's participation would exceed their financial muscle and/or would go beyond the limits of their willingness to take risks.

They do not burden the enterprise with debts

Similarly to the investments received from venture capital firms, the funds obtained in this way do not burden the company in the form of a debt, because it need not be repaid as a loan, and no interest is charged. If the enterprise fails to yield the expected economic result, it incurs no repayment obligation arising. The business angel shares the risks of the enterprise, and, certainly, also receives a share in the profits. Precisely for this reason, this money is extremely inexpensive for an unsuccessful enterprise – it is virtually free –, however, for a successful one it may be considerably more expensive than a loan. It is apparent at this point that if someone is sure of the success of their enterprise, and is capable of obtaining a loan, and bear the debt service obligation, and, on top of all these, is willing to bear risks on their own, they should not let a business angel in their enterprise merely for financing reasons. (Or it still may be worth doing so for the other assistance business angels can provide for an enterprise.)

Their funding is not based on creditworthiness

Similarly to venture capital, business angels do not examine creditworthiness of enterprises on making their investments. They do not assess whether the enterprise will be able to repay the capital provided to them at a certain point or in a certain period in the future, and whether it can pay the utilisation fee, i.e. interest up to that point. According to their business strategy, they are supposed to obtain the invested capital and the return from those that purchase their business share in the enterprise or the company acting as a framework to it. (In the continuation, we will mention that some require a current income for their investment-, and their other participation facilitating the operation and development of the company.) Owing to all these, they are able to give funding to a company that is unable to obtain credit in the market – because they cannot provide evidence to meet the bank's requirements for loan approval, concerning their future business enabling them to comply with debt service obligations, in addition, they do not hold sufficient financial securities for creditworthiness, nor an acceptable co-signer –, provided the expected growth potential and other features of the enterprise meet the expectations of the business angel.

Not even divestment burdens the company

In economic terms, a significant feature of funding from business angels is that they do not increase the burdens of the enterprise even when the investor withdraws their invested capital. According to the business arrangement applicable to the investment, divestment is not performed in a way that the business angel makes the enterprise repay the invested capital, but by selling their ownership share obtained in the enterprise in exchange for the capital invested to another investor. From the company's point of view, this represents no divestment, only a change in the identity of an owner.

They are more closely tied to the enterprise

Venture capital operates with a rather high rate of failure and, accordingly, a relatively large investment portfolio. For this reason, each enterprise in which they invested money and maybe their participation to facilitate development may be very important for a venture capitalist; their ultimate interest lies with the performance produced by their whole investment portfolio, and with the total profits made. This is what their existence depends on, and only indirectly on individual enterprises in it; at least in the sense that they take the failure of any enterprise easy, if it is sufficiently offset by success of others. Their basic business strategy and operating method ensure in the first place that they do not take an extent of risk with individual investments that alone could endanger their existence if failed.

As opposed to all these, business angels generally work with a single or a low number of investments at a time. For this reason, they can afford even less in terms of success, i.e. in terms of return on their investments, to resort to the hope that some of their relatively high number of opportunities will succeed and offset losses in addition to yielding profits. It is precisely for this reason that they may be much more closely tied to the enterprise they have invested in.

They are not under external performance pressure

As opposed to venture capital firms, business angels pass their business decisions more freely and more independently of others' value judgements. Their room for movement and the freedom of their decisions are not limited by a danger that their investors may lose patience, they not meet investor expectations for yield or that they lose the confidence of their potential investors – as they do not rely on investors. In addition, not less crucial is the factor that they are not dependent on the economic result of their enterprise financing activity in terms of their own existence, whereas business success is literally a question of survival or bankruptcy for venture capital firms, what is more, failure of an investment does not even have any consequences that business angels should be seriously afraid of. It is very typically expressed in the phrase the literature more or less seriously references the money business angels invest in this way: *play money*, in the same sense as the wealthy gamble with monies they do not indeed lack if lost.

ABOUT THE MOTIVES OF AND MOTIVATION FACILITIES FOR BUSINESS ANGELS

In order to understand the enterprise funding and development activities of business angels, we must understand their motives concerned. Even more necessary is to see the tools that can be used to motivate this activity.

For venture capital firms, the motive behind the activity is totally clear. Their motivating interest is always one and the same. It is derived from their being business organisations working in a profit-oriented system, as are other actors in the field of producing goods, and this is why the ultimate motivation for their actions is always to gain business profits. For those obtaining the necessary resources from the market in competition with other financial intermediaries, the performance pressure outlines above is also added to this. Concerning the motivating forces of business angel activities, however, the picture is not at all that simple or dull. The motives behind their investment decisions and the driving force for them to assume an active role in developing and bringing prosperity to enterprises are less linked to the same goal only.

For capital gains – as does the big brother

Even for business angels, the motive that represents their strongest drive for enterprise development is most frequently their efforts to generate profits. Attaining capital gains is an instrument to that end. In harmony with the general operating method of venture funding, they also obtain these capital gains through an increased value of their ownership share obtained in exchange for their investments, after the company operated on their money – and with their active participation – has strengthened. It is also valid for them, however, that they can only realize these capital gains if they find a buyer that is willing to buy the ownership share in question at a suitable price.

At the same time, analyses confirm that a considerable portion of business angels are also driven by other motives other than the previous one.

For current income

Some of them consider is important or even fundamental to obtain current income from the enterprise. Depending on how they build and what kind of legal framework they choose for their relations with the company in question, it may open up multiple options for them. Such an option is when the company generates profit, and pays dividends to the owners from its profit, according to the operating rules of the business company. If the business angel has acquired an ownership share in the company in exchange for their investment, and has become an owner, they are entitled to dividends in this capacity. Another method that can be implemented in the legal framework of an agreement concluded with the company is that the business angel obtains remuneration from the company for their participation facilitating company operation/development. A possible legal title is that the business angel establishes an employment relation with the company, but they may also receive remuneration for their participation in a different legal relationship, too. Also, it stands to reason that if the business angel receives remuneration from the company for certain participation, it does not affect their right to receiving a profit share in their ownership capacity, i.e. to receive dividends.

Their goal is not always money

Analyses point out that business angels in their activity may also be driven by motives that generally cannot even emerge for venture capital firms. A shared feature of these – which also distinguishes them from venture capital firms –, is that their underlying motivating factor is not directed at profit-making but is rooted in the character of human nature.

It is a driving force for a fairly large number of people – and the effort serves as a motive far from rare –, that they gain experiences through the activity carried out as a business angel. Particularly important may be in this respect – and analysts consider this need a fairly frequent motive – the *sense of achievement.* The point here is that they seek graphic evidence of their own business talent in the success of the enterprise. Some of those seeking it are in quest of demonstrating to themselves first of all that they are capable of achieving such significant results. Others wish to prove it to their environment or the world, as it may be.

A similarly human – and out of accordance with the institutional venture capital – driving force that motivates certain business angels is the *excitement* concomitant to their role, which entails their participation in the management of an enterprise, whereby they are offered a possibility to pass decisions, and to influence others' decisions, also bearing the associated responsibility. This is no novelty for the majority. As we have mentioned above, a large proportion of business angels are ones with a successful business history. They were either successful entrepreneurs, or business executives of enterprises of considerable economic weight. They are driven by the need to be *back in the arena,* to feel the tension of preparing for fight, the excitement of battle and the joy of victory. Others that have not been part of these, however, seek an opportunity to get a taste of it.

It is also a human motive to strive for *sensible and valuable activities,* namely, a possibility to spend their time with a business activity attractive to them.

A particular motive in the activity of business angels may be *social sensitivity,* too – research reveals. They are driven by a motivation to launch or develop an enterprise using their investment, which produces useful products or services for society, or considerably improves the supply of products or services necessary for a good quality of life. Alike, a motive can also be if the existence and activity of the enterprise in question generates impacts favourable for society. A typical example can be job creation or improving the employment situation of socially disadvantaged groups or strata. A motive of remarkable strength can be a favourable effect of the existence or the development of the enterprise in question on the community where the business angel lives. (Indeed, it would be totally uninteresting to analyse here whether the motives listed and classified here under social sensitivity are always rooted in genuine selflessness or precisely this is how the business angel intends to gain advantages such as reinforced reputation or influence. If the enterprise operated with their help develops, if their activity and market behaviour are decent, the angel's role in that is useful for society, and it will not be different whether their selflessness is immaculate.)

It is obvious from those outlined above: the need for the business angel to feel the recognition and respect of the community they live in towards their performance plays a considerable role among the motives of business angels.

Motivation, support

It is also fully valid for the enterprise development and funding activity of business angels: if one wants to unfold its favourable effects on the national economy, one must act for it. Other countries' practice shows that it also requires roles, motivating and helpful participation of the community sector and the government acting in representation thereof. The expedient tools for this can obviously be filtered from the motives of business angels.

The most general element of their interest is the property gains from the return on their investments. A matching tool is t*ax allowances motivating* such *investments.* However, providing tax allowances is always and everywhere a very sensitive issue, as the distribution of the central budget is ultimately a zero-sum game, and the beneficiary can only receive such advantages to the account of others. The critical question is what benefits – for example, subsequent revenues – such a waiver of direct revenues will yield to the community. It is worth examining the experiences of other countries on this issue, and we will find the United Kingdom as probably the best example. Starting from the nineties, the financial, the commercial and the industrial departments there have been seeking expedient tools to stimulate economic development, hand in hand, and they have also added tax allowances to the system under this title.

As we have mentioned above, the operation of business angels, and a possibility for companies seeking such investments to find them essentially require *networks of contacts and information systems,* as well as the organisations running these with a view to assisting them in finding each other. For business angels, at the same time, the costs incurred may represent serious burdens, and would considerably increase the transaction costs of their activity. Hardly any operational solution is seen for shifting a part or the whole of these costs to the companies seeking investment. Among the stimulating/helping community tools, it may be very important and effective if the central and/or local central organisations support the operation of such contact management organisations and institutions with money or other means, or they cater for the tasks of these themselves in full or in part. Examples and experiences are relatively abundant on this, too, in the United Kingdom, and certainly in a number of other countries as well.

TAXATION MORAL, CONCEALMENT OF RESULTS

As we have seen, the number one investment motive for business angels is to achieve capital gains through reinforcement, enhanced economic performance and income generating capability of the company. However, they only stand a chance of this if the growing performance of the company is so obvious to others, too, that they deem investment as worthy, i.e. buy the business share from the business angel. This is the point where the interest and willingness of business angels to invest directly meets or conflicts the taxation moral valid for the particular area. What they need to attain capital gains is for the company to represent rising performance in its books. If the company intends more or less to evade tax payment, it may be interested in concealing its performance. Certainly, it cannot be excluded that an (apparently) less profitable company also gets an investor, but this version promises much worse prospects of return for the business angel.

SIGNIFICANCE OF THE INFRASTRUCTURE

The infrastructure of the country or the part of the country in question may be attributed great importance in the investment decisions of business angels. For enterprises with a considerable growth potential, an indispensable condition – but not sufficient in itself – to successful activity is to build out their economic and mainly production relations easily, effectively and at an expense as reasonable as possible. This requires them to have good transportation and shipment facilities between them and their actual and potential procurement and sales markets, as well as to have similarly good communication facilities with all actors of interest to them of all markets of interest to them. This is certainly valid for all enterprises whose business activities go beyond their close environment, and it is not a unique characteristic of those operated with help from business angels; however, it is a factor that plays a decisive role in the expected potentials of operation and growth of a company that is offered to a business angel for investment.

For business angels, there is a further unique significance to the quality of the infrastructure in the region in question, and this alone may play a great role in their investment decisions. As we have referred to it earlier, a high proportion of them help the activity, development and growth of the company operating with their investment in some way and to some extent.

Apart from a minority, they require to be able to monitor their operation, and to receive sufficient insight. A large portion of them also requires to take part in the management, and particularly to have their say in strategic decisions. By implication, an indispensable condition to meeting all these requirements is to ensure satisfactory communication and transportation facilities between them and the enterprise. No matter how willing the owners of the enterprise in question are to ensure these rights to the investor, and they share enterprise management and supervision with them, if the infrastructure hinders keeping contact or keeps the business angel from being present at decision-making in person and also – according to needs or their own demands – on the premises the enterprise carries out their activities. If they judge it to be too awkward, unreliable or unreasonably time consuming or costly, it may be sufficient for them not to invest in the enterprise in question.

It goes without saying: no one will develop infrastructure spending considerable expenses for the sake of activating business angels. On making decisions, however, it could be worth considering that developing infrastructure may yield such returns, as well, and the activity of business angels may help in the achievement of goals related to economic development.

Critical significance of legal security

The problems of the client and agent relationship inevitably appear in the relationship of the investor and the company using their money, namely, that the company management use their money practically as investment agents. It is completely true for business angels, too. This is why they must consider a possibility of raising an argument with the company operating on their investment or the management thereof, which may necessitate a court procedure. For this reason, they attribute critical importance to the quality of legal security and the dispensing of justice, in terms of their willingness to invest. Certainly, continued delays in the court procedure are unacceptable for them, when the opponent has a possibility to lengthen it extensively, as this prevents business angels from enforcing their claims and rights for a long time, which allows for unfavourable and irreversible changes to take place in the company operating with their investment, affecting its performance, capacity to generate revenue and value. It is even more unacceptable for them to see a possibility of court rulings to be guided by other than economic correlations and professional and thorough evaluation of the factors.

The role of social value judgement

As outlined above, the motivation of a certain group of business angels involve an effort to earn social recognition. This, however, may only be met in a social environment whose system of values ensures strong recognition for those who achieve remarkable economic performance, and who take an active part in producing such performances. If we sincerely look into ourselves, it is easy to say how much it is met here and now, and what public recognition can be expected by those contributing to company success by assuming significant investment risks and maybe hard work. It is easy to assess the considerable role the media plays in formulating the set of values of the society-, and a ranking of role models – consequently, in positioning, for example, the stars made up using huge marketing work, or successful entrepreneurs and investors in this set of values. What we know is that the set of values is shapable. This requires a concept and plenty of expertise – which is undoubtedly available in Hungary, too –, and (unfortunately) no little money.

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