Business Angel Financing
An EU Perspective

Juho Aminoff
14 March 2018
EIF facilitates European SMEs’ access to finance

“Europe’s largest and most influential investor in European Venture Capital”

Pan-European fund-of-fund with 88% public and 12% private ownership

Invested in 300+ venture capital funds

Around €7bn outstanding equity investments

More than 170 VC fund manager relationships

4000+ portfolio companies

99% visibility on European venture market

First mover in Europe’s emerging markets and technology sectors

Co-investment framework agreements with 75+ European BAs
1. Business angel investing in Europe
2. How to foster business angel investing
3. European Angels Fund
What is a business angel?

A business angel is an individual investor that...

1. Invests directly her/his own money predominantly in seed or start-up companies with no family relationships;

2. Invests with a medium to long term set time-frame;

3. Makes her/his own investment decisions and is financially independent;

4. Is ready to provide, on top of her/his investment, strategic support to entrepreneurs from investment to exit;

5. Respects a code of ethics including rules for confidentiality and fairness of treatment (vis-à-vis entrepreneurs and other BAs), and compliance to anti-laundering.

Source: EBAN
Why are business angels important?

SMEs account for two-thirds of the total private sector employment in the EU and 85% of newly created jobs.

Business angels provide both financing and managerial experience, which increase the likelihood of start-up enterprises surviving and growing.

SMEs face problems accessing finance, particularly at their early stages and in some countries business angels are the largest provider of capital to early stage companies.

Source: European Commission, EBAN, PwC
Business angel activity in Europe is growing steadily

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Visible market (EUR m)</td>
<td>578</td>
<td>607</td>
<td>667</td>
</tr>
<tr>
<td>Share of visible market</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Non-visible market (EUR m)</td>
<td>5,203</td>
<td>5,462</td>
<td>6,005</td>
</tr>
<tr>
<td>Total investment (EUR m)</td>
<td>5,781</td>
<td>6,069</td>
<td>6,672</td>
</tr>
<tr>
<td># Investments</td>
<td>33,210</td>
<td>32,940</td>
<td>38,230</td>
</tr>
<tr>
<td># Business angels</td>
<td>288,900</td>
<td>303,650</td>
<td>312,500</td>
</tr>
<tr>
<td># Angel networks</td>
<td>469</td>
<td>470</td>
<td>474</td>
</tr>
</tbody>
</table>

Only a fraction of the market is visible…

…but on any metrics business angels are a major source of SME funding!

Source: EBAN
Finland has particularly high degree of visible business angel investment

On the other hand, countries where fewer business angels are part of formal networks have lower degree of visible investment

Source: EBAN
Finland is among EU leaders in the relative amount of VC investment…

…but even in the most developed European VC markets, investment levels are lagging severely behind global competition.

Source: Dealroom.co
Agenda

1. Business angel investing in Europe
   2. How to foster business angel investing
   3. European Angels Fund
# How to foster business angel investment?

<table>
<thead>
<tr>
<th>Supply</th>
<th>Demand</th>
<th>Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bringing more investors</td>
<td>Quality deal flow</td>
<td>Impact and sustainability</td>
</tr>
<tr>
<td>Remove tax system obstacles</td>
<td>Investment readiness (incl. regional training and support)</td>
<td>Support for sustainable and professional BANs</td>
</tr>
<tr>
<td>Tax incentives</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Co-investment funds</td>
<td>Financial literacy at schools</td>
<td>Data collection</td>
</tr>
<tr>
<td>Investor readiness training sessions</td>
<td>Entrepreneurial mind-set development (incl. links with local businesses)</td>
<td>Local BA/VC forums</td>
</tr>
<tr>
<td>Media campaigns</td>
<td>Incubators and other facilitators to educate and prepare entrepreneurs</td>
<td>Light regulation for early stage investment market</td>
</tr>
</tbody>
</table>

Source: European Commission
BA investment is (unsurprisingly) constrained by perceived too high risk.

If project risks reduce, 96.2% of BAs would have higher willingness to invest.

Source: EBAN: Why Business Angels Do Not Invest (2018), n=683
What can policymakers do to reduce risk (and boost investment)?

Public co-investment with asymmetric exit terms protects downside and boosts the upside.

EU or national grants have only a minimal impact on the perceived level of risk.

Tax breaks are considered to primarily provide downside protection.

Source: EBAN: Why Business Angels Do Not Invest (2018), n=683
What kind of tax incentives exist?

<table>
<thead>
<tr>
<th>Tax deduction</th>
<th>Reduction of specific tax base through the deduction of certain categories of expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax exemption</td>
<td>Removes a specific tax base from the scope of tax</td>
</tr>
<tr>
<td>Tax credit</td>
<td>Tax credit to be offset against a tax liability in recognition of taxes payable or paid.</td>
</tr>
<tr>
<td>Tax deferral</td>
<td>Delays the payment of a tax liability to a future date</td>
</tr>
<tr>
<td>Loss relief</td>
<td>Allows to offset realised losses against specified categories of taxable income or capital gains</td>
</tr>
</tbody>
</table>

Tax credit and tax deduction are by far the most commonly used tax incentives for business angel investments.

Source: European Commission
The implementation of tax incentives in the EU is very mixed…

<table>
<thead>
<tr>
<th>Country</th>
<th>Tax incentive(s) implemented</th>
<th>Number of tax incentives</th>
<th>Number of tax incentives abolished in 2006-2016</th>
<th>Future tax incentive(s) planned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>Yes</td>
<td>4</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>Finland</td>
<td>No</td>
<td>-</td>
<td>1</td>
<td>No</td>
</tr>
<tr>
<td>France</td>
<td>Yes</td>
<td>6</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>Germany</td>
<td>Yes</td>
<td>1</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>Greece</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>Yes</td>
</tr>
<tr>
<td>Hungary</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>Yes</td>
</tr>
<tr>
<td>Ireland</td>
<td>Yes</td>
<td>1</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>Italy</td>
<td>Yes</td>
<td>3</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>Malta</td>
<td>Yes</td>
<td>1</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>Netherlands</td>
<td>No</td>
<td>-</td>
<td>1</td>
<td>No</td>
</tr>
<tr>
<td>Poland</td>
<td>Yes</td>
<td>1</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>Portugal</td>
<td>Yes</td>
<td>2</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>Spain</td>
<td>Yes</td>
<td>2</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>Sweden</td>
<td>Yes</td>
<td>1</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>UK</td>
<td>Yes</td>
<td>6</td>
<td>1</td>
<td>Yes</td>
</tr>
<tr>
<td>12 other member states*</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>No</td>
</tr>
</tbody>
</table>

* Austria, Bulgaria, Czechia, Croatia, Cyprus, Denmark, Estonia, Latvia, Lithuania, Luxembourg, Romania, Slovakia.

Source: European Commission

Most Western countries have some form of tax incentives in place.

9/15 of EU-15 operate tax incentives vs. only 3/13 of the remaining member states (which also tend to have less developed VC markets!)

<table>
<thead>
<tr>
<th>Country</th>
<th>Tax incentive(s) implemented</th>
<th>Number of tax incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Yes</td>
<td>3</td>
</tr>
<tr>
<td>Canada</td>
<td>Yes</td>
<td>3</td>
</tr>
<tr>
<td>Israel</td>
<td>Yes</td>
<td>2</td>
</tr>
<tr>
<td>Japan</td>
<td>Yes</td>
<td>2</td>
</tr>
<tr>
<td>USA</td>
<td>Yes</td>
<td>2</td>
</tr>
</tbody>
</table>

- Austria, Bulgaria, Czechia, Croatia, Cyprus, Denmark, Estonia, Latvia, Lithuania, Luxembourg, Romania, Slovakia.
Should BA investment be incentivised through the tax system?

- Tax incentives form part of a broader set of policy tools.

- Tax incentives reduce the effective marginal cost of investing in smaller companies. As a result, in theory more investors should be willing to supply more capital to smaller companies.

- While empirical evidence on the impact of both tax incentives and grants is mixed, there is evidence that both forms of policy intervention (individually and in combination) can be effective if appropriately designed and tailored to context.

Source: European Commission
1. Business angel investing in Europe
2. How to foster business angel investing
3. European Angels Fund
Objective:

- Leverage the financing capability of BAs to provide EU SMEs with access to risk financing at the company development stage that is underserved by VC/PE players

Means:

- Offer selected experienced BAs a pre-defined co-investment commitment
- “Carte blanche” for the BA - full delegation of all investment / shareholders decisions, no direct EAF shareholdings in portfolio companies
- Standardised co-investment framework agreement (CFA) with lean governance structure to provide BAs maximum freedom to operate
Functioning

... applying the fund-of-funds approach to co-investments with BAs

- co-investment pocket EUR 250k - EUR 5m
- automatic 50:50 pari-passu co-investments
- 5y investment period/10y duration
- full delegation of all decisions
- no fee but carried interest
- vice versa exclusivity
- shared 3rd party costs
- lean administration
EAF is already operational in seven countries

- **EAF Germany** (EUR 135m, created March 2012, investors BMWi/ERP Sondervermögen, LfA Förderbank Bayern and EIF)
- **EAF Austria** (EUR 32.5m, created December 2013, investors aws Austria Wirtschaftsservice and EIF)
- **EAF Spain** (EUR 30m, created December 2013, investors Axis, Neotec and EIF)
- **EAF Netherlands** (EUR 45m, created September 2015, investor Dutch Venture Initiative)
- **EAF Ireland** (EUR 20m, created September 2015, investors Enterprise Ireland and EIF)
- **EAF Denmark** (DKK 200m, launched in 2016, investors Vaekstfonden and EIF)
- **EAF Finland** (EUR 30m, launched in 2017, investors Tekes Venture Capital and EIF)
EAF – current status

- EAF KPIs (as of 2 February 2018)
  - Total volume of EUR 319m
  - EUR 208m committed to 77 BAs
  - EUR 40.7m co-invested in 335 SMEs, hence EUR 81.4m have been invested in total in final beneficiaries

Signed BAs and portfolio companies growing by over 50% in 2017
The EAF program has proven a good instrument to support innovative European SMEs in their initial funding stages.

Deployment pace has been faster than expected, leading to compartment top-ups.

Final beneficiaries are well diversified across industries, the three most important ones being ICT, consumer goods/services, and life sciences.

Positive interim financial performance with older compartments showing better multiples, proving the positive progression of the portfolio over time.
EAF Finland – for WHOM and WHAT?

NON-INSTITUTIONALS INVESTING OWN/FAMILY $$$
- Business Angels or other private investors

DOUBLE “FIRE-POWER” AND PORTFOLIO RISK SHARING
- 2x $$$ = 50:50 matching BA:EAF
- € 0.25-5m per investor from EAF
- 5 years to build portfolio and 5 more years to follow-on and divest
- Ability to build diversified portfolio

INVESTORS WITH TRACK RECORD
- Pattern of success
- > 3-5 relevant investments /entrepreneurial engagements, first successful exits/ valuation events

INVESTMENT STRATEGY SET BY BAs
- No specific sectors
- No specific deal size
- Innovative/technology oriented early stage SMEs
- Up to 15% can be abroad
EAF Finland – HOW does it work?

ESTABLISH JOINT LP STRUCTURE WITH EAF

- Vehicle only for joint deals
- 50:50 owned by BA:EAF
- Full delegation of all decision/management to BA
- Standardized legal documents

EFFICIENT OPERATION AND GOVERNANCE

- All investments pari-pasu
- No deal-by-deal review by EAF
- Pre-agreed investment scope
- No cherry picking by BA
- Fast deal-by-deal capital calls
- Minimal reporting

50:50 SPLIT OF ALL JOINT INVESTMENTS AND COSTS

- 50:50 sharing by BA:EAF of:
  - Cost of investments
  - 3rd party deal related costs
  - Admin costs of joint LP structure

60:40 SPLIT OF PROFITS IN FAVOUR OF BA

- Deal-by-deal split of:
  - Proceeds to cover costs of investment 50:50
  - Profits 60:40 for BA

- No preferred return for EAF
- No management fee paid to BA
EIF and business angels - what else is going on?

- Recently launched initiatives:
  - BA managed funds and co-investment funds
  - Pan-EU social impact EAF

- Future initiatives and activities:
  - Pan-EU general EAF
  - New EAF countries to be added
Thank you

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