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SUMMARY

AN ASSESSMENT OF THE EFFICIENCY OF GOVERNMENT FUNDING OF BUSINESS ANGEL NETWORKS

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Principal Topic

The equity financing market for entrepreneurial companies has been documented to be characterized by inefficiencies. Firstly, there is a substantial gap between the demand and supply of early-stage capital, the capital gap. Secondly, there is an important information gap because of the inefficient flow of information between investors and entrepreneurs, which is an inefficiency especially prevalent in the informal venture capital market. Among the measures taken to solve the inefficiencies in this market was the foundation of business angel networks (BANs), aimed at matching entrepreneurs and business angels (BAs). Given the perceived failures in the private equity market, most European BANs have been publicly funded and supported. The question the proposed research tackles is to understand whether this is government money well spent, i.e. whether BANs provide a return to society that exceeds the public money spent on running the networks.

Method

We obtained the cooperation of four Belgian BANs, founded between 1998 and 2001 and representing more than 100 BAs and 58 deals, in which 54 BAs invested between 1999 and 2004. Data were first collected through in-depth interviews with both BAs, who had invested through a BAN (34 interviews or a response rate of 63%), and entrepreneurs of BA-backed companies (28 interviews or a response rate of 48%). We further gathered data from the annual financial accounts of both a sample of 85 BA-backed companies (both through BANs and not through BANs) and a matched sample of non-BA-backed companies (matched on age, industry and size).

Results and Implications

The results indicate that BANs do indeed fulfill their role of reducing the equity gap by providing a communication channel for BAs and entrepreneurs. Almost all entrepreneurs claim they could not get funding from other sources, nor did they know BAs before going to a BAN. However, BA-backed companies perform worse compared to their non-BA-backed counterparts with respect to profitability, efficiency and financial risk. This underperformance is apparent both in the year before BA participation and in the years post-BA financing. There are no significant performance differences between BA-backed companies that received BA financing through BANs compared to those that did not receive it through BANs.

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