EARLY STAGE FINANCIERS IN ROMANIA

Negruțiu Cristian Teodor[1], Tăchiciu Laurențiu[2] and Vasiliu Cristinel[3]
[1)2)3)] *The Bucharest University of Economic Studies, Romania*
E-mail: cristian_negrutiu@yahoo.com; E-mail : laurentiu.tachiciu@gmail.com;
E-mail : cristi_vasiliu@yahoo.com

Abstract
This paper deals with entities that are the firsts to provide financing for new companies (start-ups). We called them early stage financiers because they are not banks, but a very particular way of financing in exchange of equity.
The study analyses the two major types of early stage financiers - business angels (BA's) and venture capital funds (VC's). Their importance in the entrepreneurship ecosystem is extremely significant, as they are the only source of financing for just formed companies. We will see how they take their decisions, what criteria they apply and how they manage their portfolio.
The analysis is done having as reference the international literature, but looking in practice at Romanian ecosystem. We will provide also few examples of BA's and VC's from Romania and see how they pioneered the industry.
The authors intend to follow up on this research with a more complex study on Romanian entrepreneurship system.

Keywords:
Entrepreneurship, financing, early stage, business angels, venture capital

JEL Classification:
G23

Introduction
This article aims to analyse the early stage financiers industry. This industry is at a very incipient level in Romania, with just few players that started their activity. As such, there is no literature available at country level, so we consider this study as a first attempt on this field.
At worldwide level, the literature traced back its roots with original papers of Wetzel in the early 80's. His work was followed by several other authors, some of them being cited in this article. Nevertheless, most of authors acknowledge that is difficult to research the industry, since most of the BA's act very "quiet".

Early stage financing
It is worldwide accepted that entrepreneurial activity is the engine of all economies. Most of the things and technologies that we take today for granted are coming from the ideas of visionary entrepreneurs. Moreover, different studies (Sorheim, 2005) showed that new

ventures are the largest creator of new jobs in US and Europe, before they reach corporation status.

However, many entrepreneurs lack the finance required to develop their business, so they have to look for external sources. Given the fact that they are in the earliest stages of their business, they are cannot go to banks or other financial institutions for loans. Instead of this, they offer equity (part of the company) in exchange for cash and other benefits (as we will see later in this study).

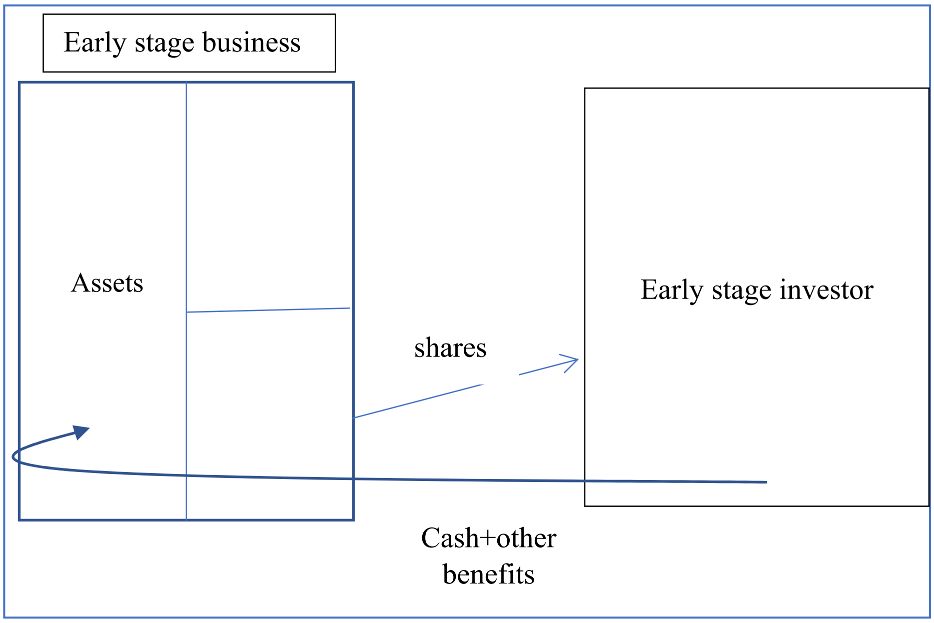

Fig. no. 1 Typical finance process

Source: adapted after SDA Bocconi School of Management, Venture Capital and Private Equity, 2018

Pending on the lifetime, value and sales/profits of a company, the financing of a company can looked as follows:

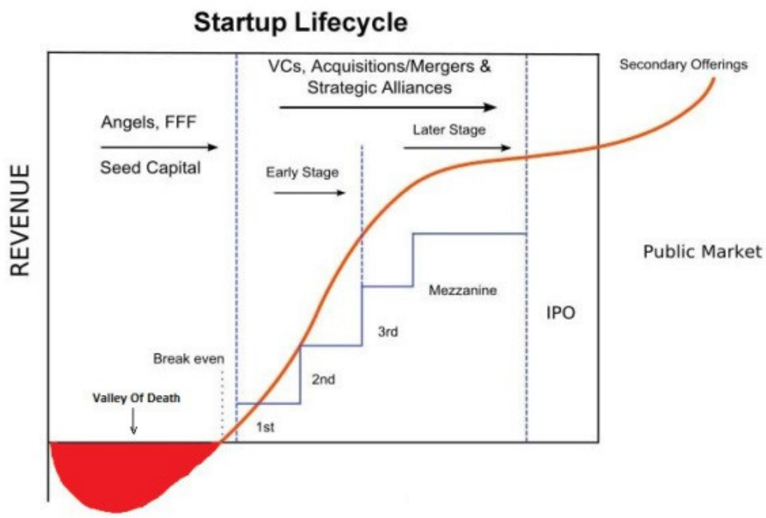

Fig. no. 2 Financing life cycle of a start-up

Source: European Business Angels Network, 2018

As said initially, our focus will on the "valley of death" so we will look into early stage financiers - the ones that are involved in the pre-seed or seed phases. First, we begin with business angels.

Business Angels

If you not consider friends & family (F&F) a business financing, BA's are, usually, the first to get involved in a start-up. As depicted in the above table, as you as an entrepreneur has a validated idea, he/she starts to look for funds to further develop the business. It is important also to understand that a BA investment paves the way for further investments. According to Mason (2008), the business angels are most significant source of financing for early stage ventures.

But what is a business angel? According to The European Trade Association for Business Angels, Seed Funds and Early Stage Market Players (further now referred as EBAN), a business angel has several characteristics. The first and most important a business angel is an individual investor (qualified as defined by some national regulations) that invests directly (or through their personal holding) their own money predominantly in seed or start-up companies with no family relationships. Secondly, business angels make their own (final) investment decisions and are financially independent, i.e. a possible total loss of their business angel investments will not significantly change the economic situation of their assets. Typically, BAs invest with a medium to long term set time-frame and are ready to provide, on top of their individual investment, follow-up strategic support to entrepreneurs from investment to exit. Last, but not the least, they respect a code of ethics including rules for confidentiality and fairness of treatment (vis-à-vis entrepreneurs and other BAs), and compliance to anti-laundering.

Mason (2008) identifies four key characteristics of business angels:

- They are investing their own money
- They are investing in unquoted companies
- They are looking for a commercial return for their investments
- They are making their own decisions
- They are hands-on investors, meaning they provide 'smart money' to start-ups.

A typical business angel is a person usually over 40 (that allowed enough time to build some wealth) and a successful cash-out entrepreneur (that already develop one/many companies that were sold). This was the case also for Romania, with typical examples like Radu Georgescu, Matei Dumitrescu and others. However, in the last period a new category emerged, that is former corporate managers who become business angels, either part time/full time. They can bring to start-ups 'quality' smart money through their expertise and network.

Due to their independent status, decision process is fairly rapid and unstructured. A business angel has no 'board' to report or financial reports to submit. Quite often, the decision to invest is subjective, 'gut feeling', based only what it may seem a future successful business. Nevertheless, there are BA's that prefer a more structured approach; sometimes it's a mind process, sometimes it's put on paper.

Maxwell, Jeffrey and Levesque (2011) identifies 8 critical factors used by business angels in the decision taking process. To each criterion is attached a critical question - a positive answer to it can bring a positive decision towards investing. Of course, the BA can consider some criteria more important than others, pending on each individual business - e.g. Protectability (IP rights) can be very important in innovative businesses.

Table no. 1 Factors affecting business angel decision to invest

Factors	Critical question
Adoption	The question relates to how easily the customers will adopt the product
Product status	Here it refers to the readiness of the product, if it is ready for the market or it needs further work
Protectability	Crucial element, it questions how easy the product can be copied
Customer engagement	It is very important to have at least one paying customer
Route to market	Related to above factor, how we reach more customers
Market potential	The questions address how large is the market
Relevant experience	This refers to founders/managers experience in this particular business
Financial model	The most important question, how profitable is the product. From the investor point of view, it looks also on the amount invested

Source: Maxwell, Jeffrey and Levesque, 2011

After the investment was done, it comes the long process of nurturing and developing the business. As pointed out before, a business angel is a 'hands-on' investor, meaning they are actively involved in the company. Very often, this is the only guarantee of a successful return of the investment. The other way around, many entrepreneurs value more the 'smart money' received vs real money.

The involvement of a business angel differs a lot pending size of the share, his personal competencies, culture of the company etc. After an in-depth literature review, Politis (2008), identifies 4 major roles:

- Sounding board / strategic role - in most of the cases, the angel takes a sit in the board, guiding so the strategy of the company
- Resource acquisition role - due to his/her extensive network and experience, the angel is able to open new doors and equip the start-up with resources usually unavailable to a small company.
- Supervision and monitoring role - being part of the board, the angel not only follow up on the results of the company, but also lay the culture for a structured reporting system.
- Mentoring role - last, but not the least, the angel is the mentor of the entrepreneur, providing advice and counselling.

We can say very briefly that the business angel were two hats - investor and consultant, but a direct stake in the company.

The last point in the discussion about business angels is their role as a facilitator for further finance. Pending a successful development, the start-up will need new and bigger rounds of financing from other investors. According to Sorheim (2005), the business angel act as reference point and a source of trust for a VC. The start-ups that had previously a successful investment from a BA are much more prepared and likely to receive a financing from a VC. Practically, the angel 'hands-over' the company to a much larger and professional financier, the venture capital funds.

Venture capital funds as second level

The venture capital fund (VC) represents the next step in the financing of a start-up. The main difference between BA's and VC's is not done merely by the size of the funds available, but mainly by the fact that VC's are entities that performs early stage investments in a professional way. While business angels are, in the most of the cases, people that have also other activities, VC's are organized as commercial companies, focusing on investment activity.

According to Groh & Wallmeroth (2016), venture capitalists are active investors by monitoring and influencing the strategic decisions of the company in which they invest. Very often, they get a board sit which gave them partial control of the company. However, per Schertler & Tykvova (2012) their presence in the company is limited in time and as participation. In most of the cases, a VC hold no more than 20% of the company equity - enough to have a voice that is listen, but also minimizing the risks of losing the money in case things get wrong.

Andrieu & Stagliano (2016) identifies two types of VC's:

1. Independent Venture Capital fund (IVC) - these are the most common and are usually limited partnerships, whereas limited partners (LP's) put together their money. The fund is administered by one or more general partners (GP's), who are also associated in the fund, but have also management responsibilities. The GP's are motivated to have a good performance since they are entitled to carry interest and portfolio return. Typically, IVC's are formed for longer periods, 6 to 10 years, but with a clear deadline. Since they seek higher returns, IVC's have higher appetite for risks, by investing in early stage companies.
2. Bank Venture Capital fund (BVC) - are investment vehicles formed by banks. Normally they are more conservative, as the banks see them as a complement to their main business. As such, they tend to invest in later stages and not only in start-ups, but also in mature companies. BVC funds have unlimited period of time or at least until there is a market opportunity.

The Venture Capital industry has evolved in US where IVC's are predominant. In Europe, BVC's have long dominated the industry, but that has changed quite a lot in the last period of time. It should be noted also the expansion of Asian VC's, particularly from rich countries of Middle East.

Coming back to Europe, it should be noted also the involvement of EU, through a specialized vehicle, called European Investment Fund (EIF). EIF defines itself as "a specialist provider of risk finance to benefit small and medium-sized enterprises (SME) across Europe". In this capacity EIF has supported over 1 mil SME's throughout Europe, as can be seen in below map.

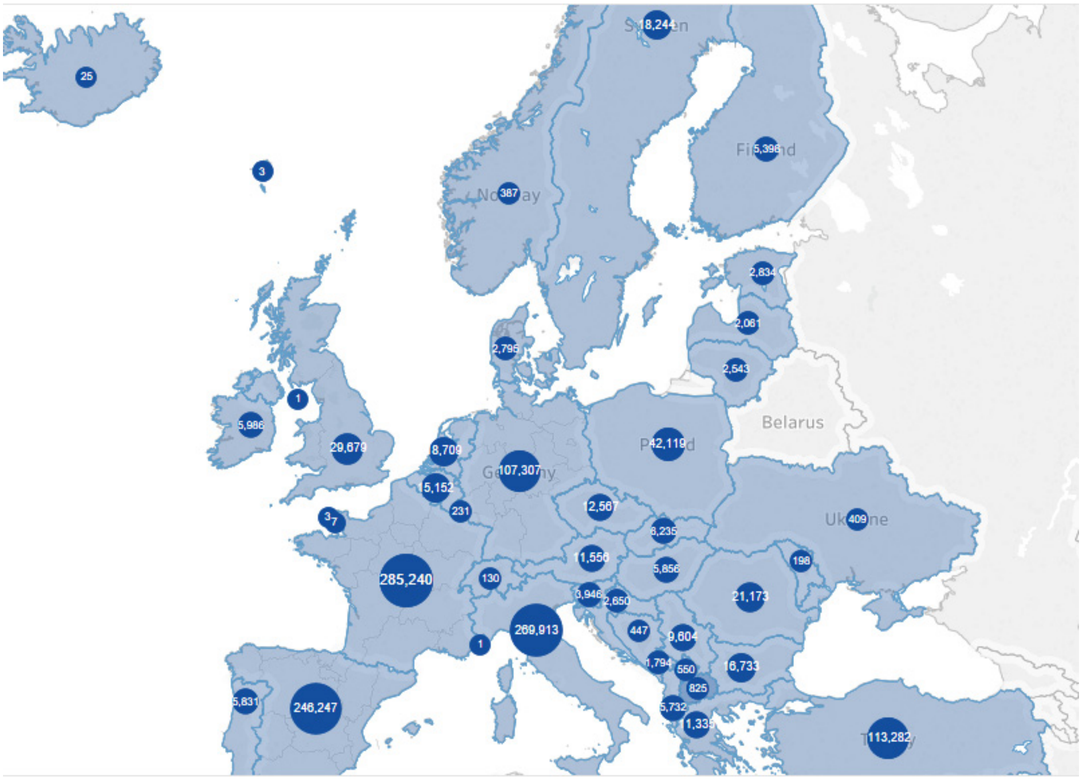

Fig. no. 3 No of SME's financed by EIF
Source: EIF, 2018

Zooming in to Romania, we noticed more than 20.000 companies financed and the numbers are likely to grow. EIF is now involved also in venture capital financing, through direct participation in two funds:

- GapMinder - https://gapminder.vc/
- Early Game Ventures - https://earlygame.vc/

Both funds collected money also from private individuals and companies, in addition to European funds. Normally, they finance start-ups following two paths:

1. Directly, through engagements with start-ups. The criteria used to allocate investments is similar with business angels, just the decision process is more elaborate and, therefore, longer.

2. Indirectly, through acceleration programs. According to EIF regulations, VC's financed via the program must develop such programs in which they select start-ups with high potential. This contributes also to the general development of entrepreneurship ecosystem in Romania. An acceleration program is typically run in cohorts, whereas the VC's select several companies to work and boost ("accelerate") their development through expertise, tools and mentorship. After successful finalization of the program, the VC injects a specific amount of money in exchange for an equity in the start-up.

Conclusions

Entrepreneurship represents the engine of any economy in the any world. Without it, the whole economic system will be collapsed. But entrepreneurs cannot succeed in the absence of financing, so this is the gas that keeps the engine running.

In this paper, we have analysed the first two types of financing actors - business angels and venture capital funds. They share similarities as regards to the financing stage (both are early stage), but differ in terms of involvement and professionalism.

The analyse was done looking at literature at global stage, but applying the concepts to Romania case. In this country, the whole ecosystem is at the beginning of its life and we expect systematic developments in the future. The author wishes to extend the research in two directions:

- Looking deeper in the financiers world
- Analysing the "other side", namely the entrepreneurs, with a special focus on innovation in supply chain industry.

References

Andrieu, R. Staglianò, 2016. The entrepreneur's choice of a venture capital firm: Empirical evidence from two VC fund portfolios. *Finance Research Letters,* 17, pp.141–145.

European Business Angels Network, 2018. *Early stage investing explained*, [online] Available at: <http://www.eban.org/about-angel-investment/early-stage-investing-explained> [Accessed 4 April 2019].

European Business Angels Network, 2018. *ACA Guide on How to Start and Manage an Angel Group*. [pdf] Available at: <https://www.angelcapitalassociation.org/data/Documents/Resources/StartingaGroup/1b%20-%20Resources%20-%20Starting%20a%20Group/1%20StartGroup_GuidebookFinal.pdf> [Accessed 10 March 2019].

European Investment Fund, 2018. *Small and medium-sized enterprises supported by the European Union,* [online] Available at: <https://www.eif4smes.com/> [Accessed 18 March 2019].

Groh, A.P. and Wallmeroth, J., 2016, Determinants of venture capital investments in emerging markets. *Emerging Markets Review*, 29(C), pp.104-132.

Mason, C.M., 2008. *The real venture capitalists: a review of research on business angels*. Working Paper., [online] Available at: <https://www.researchgate.net/publication/254813631_THE_REAL_VENTURE_CAPITALISTS_A_REVIEW_OF_RESEARCH_ON_BUSINESS_ANGELS> [Accessed 8 March 2019].

Maxwell, A.L., Jeffrey, S. and Levesque, M., 2011. Business angel early stage decision making. *Journal of Business Venturing*, 26, pp.212–225.

Politis, D., 2008. Business angels and value added: what do we know and where do we go? *An International Journal of Entrepreneurial Finance*, 10(2), pp.127-147.

Schertler, A. and Tykvova, T., 2012. What lures cross-border venture capital inflows? *Journal of International Money and Finance*, 31(6), pp.1777-1799.

SDA Bocconi School of Management, 2018. *Venture Capital and Private Equity,* [online] Available at: <http://didattica.unibocconi.eu/ts/tsn_anteprima.php?cod_ins=20260&anno=2019&IdPag=6165> [Accessed 8 March 2019].

Sørheim, R., 2005. Business angels as facilitators for further finance: an exploratory study. *Journal of Small Business and Enterprise Development*, 12(2), pp.178-191.

Wetzel, W.E., 1983. Angels and informal risk capital. *Sloan Management Review*, 24(4), pp. 23–34.