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An Analysis of Business Angels in Scotland And Poland

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Abstract: Business Angels are private individuals (or syndicates) who supply venture capital to businesses, mainly small start-up firms, in an informal investment market setting. This paper presents a preliminary analysis from the first phase of a research project that explores the emergence of Business Angels in the new EU member states of Central and Eastern Europe. It focuses on case studies conducted in Poland, and examines the role and function of Business Angels in the context of a transition economy.

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Introduction

Ever since the publication of the White Paper on Competitiveness (CEC, 1993), the European Union (EU) has sought to enhance its competitive position in the global economy through the routes of innovation and entrepreneurship. This led to an emphasis being placed on support for small and medium enterprises (SMEs) in the belief that SMEs are the main creators of new jobs, are more innovative, assist the competitive environment, and provide the dynamism for growth within both regional and national economies. In comparison to the United States, Europe has still much to do in creating this dynamism given the differences in their respective success rates of

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new job creation. It has been estimated that over the last twenty years 35 million jobs were created in Europe, compared to 68 million in the United States. The need for a new dynamism and growth in the EU has become even more imperative as it increases in size by embracing a significant number of the transition economies in Central and Eastern Europe (CEE).

The recent expansion of the EU has led to greater pressures on the its budget, which in turn limits resources that can be made available to support the SME sector. The EU argues that it is legitimate to offer support to SMEs on the grounds that they suffer disproportionately from 'market failure' in comparison to large businesses. One of the key market failures is in the availability and access to equity finance. In recent years, the supply of start-up and early stage equity finance has become more acute due to changes in the banking sector which have made lending to small enterprises unattractive for banks. The primary factors underpinning the banking sector's position on SMEs are the low margins, high overhead costs and risk involved; additionally, venture capital funds are often not able to accommodate the large number of small deals with heavy due diligence requirements. A potential solution to these problems is informal investment markets, where finance is provided by investors known as 'Business Angels'.

In some EU member states, there is a well established Business Angel market whilst in others, such as the CEE transition economies, this market and type of organisation is evolving gradually. This paper examines the functioning of an established Angel market in Scotland and compares it with the emergent Angel market in Poland. It is an apposite comparison due to the similarities in their recent development. Scotland, over the last three decades, has experienced significant structural change in its economy characterised by a steep decline in traditional sectors such as manufacturing and heavy industry, followed by a growth in businesses in the service sector such as finance and banking. This has resulted in policy initiatives which have sought to increase foreign direct investment (FDI) and develop indigenous companies through entrepreneurial initiatives. While the emphasis given to these differing strategies has varied over the last thirty years, we would argue that it is not dissimilar to the current situation and potential policy response currently faced by Poland. Poland is also losing its traditional industries and pursuing FDI attraction strategies, whilst promoting an enterprising economy. In attempting to create a more entrepreneurial culture and encourage individuals to establish new businesses, start-up companies in Poland are faced with the immediate issue of raising capital. It is argued below that Business Angels are increasingly seen to be an important, if not the most important, source of finance for new and growing businesses. With the establishment of a national Business Angel Network (BAN) and business angel syndicates, we would argue that Scotland has a mature market for the provision of equity finance. This mature market, as analysed below, has continued to evolve and provides a good example from which emerging angel markets in countries such as Poland can learn valuable lessons.

The remainder of the paper organised as follows: first, an introduction to the concept of Business Angels together with an overview of their role in the venture capital market is provided; second, an examination of business angels and entrepreneurial finance initiatives in Scotland is set out; third, the development of business angels in Poland is charted and fourth, the paper finishes with a comparison of Scotland and Poland from which conclusions are drawn from the analysis.

The Concept of Business Angels

Business angels are private individuals who invest their own money in a company in which they have no family connection in return for an equity stake. Angels comprise the supply side of an informal capital market that has developed to meet an unsatisfied demand from new ventures and small growing companies for investment funds. The problems facing new ventures and small, growing companies in securing finance has long been recognised (Oakey, 1984; Binks et al., 1992; Westhead and Storey, 1997; Murray, 1999; Cressy, 2002). These businesses are at high risk of failure, and traditional lenders such as banks are unwilling to invest (Mason and Harrison, 1996). They are also unattractive to the established venture capital industry. The funding requirements of small firms are generally well below the venture capitalists' minimum threshold level (Lerner, 1998; Van Osnabrugge, 1998a) and the due diligence and transaction costs of providing funding to small firms are comparatively higher per unit of funds invested. The combined effect of these supply-side factors is that the demands from entrepreneurs for funds to start and grow their businesses are greater than the willingness of financial institutions to supply (Wetzel, 1983; Mason and Harrison, 1993 & 1994; Deakins, 1999). Indeed, Murray (1999), in a review of problems in the financing of SMEs, concludes that capital rationing has been identified as a significant and continuing problem ever since studies of such businesses were first undertaken.

The potential of business angels and the informal venture capital market is enormous (Van Osnabrugge 1998b). In the United States, Gaston (1989) estimated that informal investors finance 30-40 times as many firms as the formal venture capital industry. Freear et.al. (1995) in their study on the financing of technology-based ventures commented that when angel and venture capital funds are segmented by the size of a round of financing, the distinctive role of angels in smaller deals is apparent. Wetzel and Freear (1996) suggest informal investors finance 20 times more ventures than the formal venture capital market and invest five times more dollars per annum. In the UK, the informal investment market has been estimated to be of significantly greater importance to the SME sector than the formal venture capital market (Mason and Harrison, 1996).

However, the informal venture capital market remains under-researched in both Europe and North America. The Bank of England has observed that 'reliable information on the activities of business angels is scarce' (2001, p.37); while Lerner (1998), in an overview of angel financing and public policy in the USA, concludes that the subject is an area ripe for more intensive research. Early work on business angels by Wetzel (1983) was followed by further studies in the United States by Freear et al. (1994) and Berger et al. (1998). Research has also been carried out in a small number of other countries: for example, the United Kingdom (Mason and Harrison, 1993, 1994, 1995; Coveney and Moore, 1998; Paul et al., 2003), Sweden (Landström, 1993), Finland (Lumme et al., 1998), Australia (Hindle and Wenban, 1999) and Norway (Reitan and Sorheim, 2000).

Notwithstanding such research, the number of studies and their depth has been constrained by the practical difficulties of investigating these informal marketplaces. Locating business angels is difficult and encouraging a reasonable response rate in survey based methodologies is problematic. Freear et al. (1994) describe researching this elusive and nearly invisible market as a 'challenge'. Two factors are at play, each reinforcing the other to create problems for the researcher: first, the nature of the market itself; and second, the attitudes of the main players, the business angels. Transactions within the informal market are private; and therefore, information about them is likely to be limited (Fenn et al., 1997). Thus, Berger and Udell (1998, p.616) suggest that the defining characteristic of small firm finance is 'informational opacity', while Prowse (1998, p.786) refers to the market for angel capital as operating in 'almost total obscurity'. As to the attitude of business angels, they have the reputation of eschewing publicity and sharing their experiences on a non-attributable basis. Benjamin and Margulis (1996, p.11) comment that informal investors 'prize their privacy'.

Business Angels in Scotland

With the continued decline of traditional industries and the limited short-term impact of foreign direct investment, Scotland has in recent years attempted to promote indigenous, innovative businesses to compete in the global economy. Its position on the periphery of Europe is disadvantageous and, in addition to an historic dependence on heavy engineering, Scotland suffers a below average level of new firm formation (Scottish Enterprise, 1993). Over the past decade, the economic development agency for Scotland, Scottish Enterprise, has pursued a policy of new firm creation through its Business Birth Rate Strategy (BBRS) (Scottish Enterprise, 1993). This has resulted in a sustained attempt to increase the start-up rate of new enterprises generally and, in more recent years, high-growth innovative businesses in particular. As well as their positive impact on employment, such ventures offer lower displacement potential and greater export and import substitution prospects (Fraser of Allander, 2001). However, over the period in which the BBRS has been in force there has been little change in the rate of new firm formation (Fraser of Allander, 2002). One of the reasons may be found in the functioning of the informal investment market in Scotland where evidence suggests poor alignment of the demand and supply sides. Entrepreneurs are often unaware of how to secure funding to establish and develop new enterprises while business angels report a lack of suitable investment opportunities (Paul et al., 2001; GEM Scotland, 2003 & 2004).

The problem of Angel identification, and their 'shyness', means that conducting research on the Angels can be difficult and poses significant methodological challenges. Despite these limitations, research on Angels in Scotland (Paul et al., 2003) shows that they typically fit the profile of Angels in other developed countries in terms of age and gender profiles. However, they differ in one key aspect in that only a minority has experience of working in a small business environment. This may reflect the structure of the Scottish economy within which the small business sector has, in comparison to competitor countries, been slower to develop. The main reason cited by Scotland-based Angels as their primary motivation to become investors was capital growth (Paul et al., 2003). However, there were other secondary reasons such as 'giving something back', now termed psychic income. Whilst most Angels are typically 'hands on', wanting to be involved in the day-to-day running of the businesses in which they invest, some do wish to remain passive investors. Therefore, the extent of a 'hands on' role adopted by Angels varies from investment to investment: ranging from offering financial advice, to providing contacts and further networking opportunities.

Scotland-based Business Angels operate in a variety of modes: as lone wolves; as a participant in private sector syndicates whose degree of formal organisation can vary considerably, and as a member of a more structured Business Angel Network (BAN). Indeed, individual angels can operate through multiple membership of any or all of these combinations. Scotland does have an advantage over many countries by having a well-established national BAN, known as the Local Investment Network Company (LINC). LINC is a public/private partnership that acts as a 'matchmaker' by providing a service bringing together Business Angels with entrepreneurs seeking investment funds. Membership is open to any individual with an interest in becoming a business angel upon payment of a nominal membership fee. As a 'network', it is a non-profit making body, though its individual members are clearly focused on supporting entrepreneurs, small business start-ups, growth businesses, and wealth creation.

A review of the BBRS (Scottish Enterprise, 2000) resulted in a change of emphasis in the support mechanisms designed to encourage an enterprising economy. Assistance to small companies with growth potential, an area in which Scotland lags behind the rest of the UK and other competitor nations, became a priority. While noting the crucial role of the informal venture capital market in financing new firms, the Global Entrepreneurship Monitor (GEM, 2002) recorded that in Scotland, personal investment in other people's businesses has declined from an already low base of 1.2% of the adult population in 1999 to 0.8% in 2002. On this measure, Scotland ranked fourth lowest of the 37 nations surveyed, GEM (2002) noting that this is of particular concern since personal investment rates correlate significantly with 'opportunity entrepreneurship' rates.

In response to the need for new venture capital by firms that struggled to secure finance, Scottish Enterprise established the Scottish Co-investment Fund in 2002 to operate in partnership with active venture capital fund managers, business angels and business angel syndicates. Within this arrangement, the private sector partner finds the investment opportunity, negotiates the investment deal and makes an offer to invest its own resources. If the opportunity needs more finance than the private sector partner can provide, the partner can call on the co-investment fund to 'co-invest' alongside it, on equal terms. Complementing this, Scottish Enterprise set up the Business Growth Fund (BGF) to provide smaller loans than the Co-investment Fund. These loans are provided within the Ł20,000 to Ł100,000 range and at least 50% of the company's financing needs must be met by non-public sector sources such as Business Angels. Since the introduction of these schemes, it has been argued that there is a further gap within the Ł2 - Ł10 million range which needs to be filled if businesses based in Scotland are to become competitive on the international stage. In order to address this problem Scottish Enterprise introduced a new scheme from April 2006: the Scottish Investment Fund (SIF).

The establishment of the Scottish Co-investment Fund and the Business Growth Fund have assisted the growth in syndication. The rationale for these schemes lies in the belief that the main funding gap for SMEs is in the Ł250,000 to Ł1 million range (Mason and Harrison, 2003). More recently, the performance of the equity risk capital market over the last few years demonstrates the effectiveness of these initiatives (Don and Harrison, 2006). Following its collapse in 2000-2001, Scotland's risk capital market has recovered, reflected in the volume and value of deals 'with a 40% increase in investment activity from 2003 to 2004 Ł843m was invested in 490 young Scottish companies between 2000 and 2004' (Don and Harrison, 2006 p.3). Their report argues that the most dramatic shift in investment patterns in 2004 was in the angel market, where Angel investment rose by 70%. This impressive result needs to be qualified by the effect of a single deal where just over half the sum was provided by Angels based outside Scotland. Nevertheless, Angel activity is still reported to have risen by 30%. The continued decline in venture capital activity in this market, noted earlier, continues and is being replaced by the number of hybrid deals. Hybrids consist of investments which involve finance from both the private and public sectors. Even when removing three very large deals from Angel performance data in 2004 (accounting for 35% -Ł60m- of the total investment), hybrids still accounted for 11% by value, Ł12m investment in 87 transactions, and were involved in 55% of all transactions. Ninety per cent of these hybrid transactions were accounted for by the Business Growth Fund, and Scottish Co-investment Fund (Don and Harrison, 2006). Improvement in current performance can also be seen by reference to evidence from the Global Entrepreneurship Monitor with informal investment activity in Scotland more closely reflecting the UK average. Though not a step change, it does indicate more stability in total entrepreneurial activity, and brings Scotland into line with the rest of the UK; and identifies it now as a relatively stronger regional economic performer. However, if the Scottish Executive is to create 'A Smart, Successful Scotland' capable of competing with other developed nations (Scottish Executive, 2001), it would be particularly advantageous to increase the flow of angel capital and its take-up by entrepreneurs in order to further support entrepreneurial activity, small firm start-up and growth.

The continuing development of sources of finance for dynamic growing businesses has been important to the promotion of economic development in Scotland. Finance pays little attention to geographic boundaries and has the ability to seek out investment opportunities wherever these are located (Klagge and Martin, 2005). Without local centres of finance there is a danger that finance will exit the periphery and flow to the centre and thus restrict economic development by limiting firm formation and expansion which in turn further impedes economic development (Klagge and Martin, 2005). Having a relatively well established formal and informal venture capital market within Scotland is advantageous; in particular, with their preference for investing close to home, Scotland based business angels provide a useful resource for entrepreneurs, which is of significance in an economy that has suffered from low rates of new firm formation.

Business Angels in Poland

This section will assess the development of Business Angel networks in Poland both at national and regional levels. This discussion begins with some broad background information on private sector development and support, followed by a commentary about the Polish entrepreneurial class before turning our attention to the contemporary venture capital market that includes Business Angel activity.

Poland was the first CEE country to reject communist rule and transform its economic system from a command into a market one. Since 1989, the Polish economy has undergone transition from a planned to a market economy with the ownership transformation process being its main feature. Privatisation as well as new firm formation gave rise to a large private sector in Poland.

Privatisation in Poland occurred in two major stages. First, the so called ‘small privatisation’ was implemented in trade, construction, light manufacturing, food processing industries, and services. The second stage, and far more complex, was based on the privatisation of large, state owned enterprises. Consequently, the country suffered a significant drop in the output of its state-owned sector, growing unemployment and inflationary pressure. This required a re-positioning of the policy stance taken by the Polish government in order to sustain domestic demand (including interest rate cuts, and strong real wage growth) (Blazyca, 2000). Though the privatisation process was conducted at a relatively modest pace, it did create considerable sectoral and regional unemployment, and pressure to develop de novo job creation (Jackson et al, 2005).

In the private sector, and especially in SMEs, the employment trends since 1990 have been mostly favourable (Roberts et al., 1997; PAED, 2004; Jackson et al, 2005). The vast majority of private enterprises expanded in terms of the volume of business and employment; the SME sector providing work for many people who were made redundant by large, state-owned enterprises. In addition, Polish SMEs created jobs for young people, who would otherwise be unemployed, and contributed 48.6% to GDP in 2002 (PAED, 2004).

In Poland, as in the wider EU, the ‘one-man’ business is the most frequent size of business. Though foreign direct investment is a significant contributor to economic growth, increasingly, goods and services are also provided by a profusion of very small enterprises and sole proprietorships (micro-enterprises). They comprise street vendors who inhabit almost every main street of many towns, private taxis, tailors and dress-makers, shoe repairers, hairdressers, metal and plastic-working shops, and a whole plethora of others. These enterprises have considerable value because they generate income, create low-cost jobs, use domestically produced raw materials and provide goods and services at prices that can be afforded by lower income households (Halverso-Quevedo, 1992). They are a major reservoir of employment both legal and illegal or clandestine, and provide part-time work. Illegal employment is a particularly Central European phenomenon, becoming most prominent in the first half of the 1990s. The scale and impact of this phenomenon can not be ignored as it generated around 8.1 per cent of Polish GDP in 1994, and provided one seventh of the total personal income of an average Pole, though also creating a burgeoning ‘grey economy’ (Grabowski and Jedrzejowicz, 1995). More recently, many of these businesses are driven by necessity due to major shocks resulting from privatisation, and require some capital usually supplied from family resources, and ‘know how’ that favours those with access to capital that does not rely on the banking sector, and the more skilled or educated (PAED, 2004).

Business decisions concerning new start-ups were significantly affected by Poland’s transition programmes, launched on January 1st 1990, which eased regulations, removed many restrictions, liberalised prices, and lowered entry barriers for private business. One of the most significant components of change, central to Poland’s strong growth since 1993, was the explosion in private sector activity (Koen, 1998). However, towards the end of the 1990s the rate of growth of the SME sector (measured by the number of enterprises) and the share of SMEs in GDP generation grew at a slower rate (PAED, 2001).

Throughout the 1990s it was clear that new firm formation was crucial to the sustainable economic development of Poland in terms of its contribution to GDP, job creation and the containment of increasing unemployment (Ministerstwo Gospodarki, 1999). However, regional disparities such as poor performance close to the ‘Eastern Wall’ and successful economic growth in northern regions still pose major problems for new firm creation as a policy instrument (Ministerstwo Gospodarki, 1999; Jackson et al., 2005; PAED, 2004).

Institutional Support and the Financial Gap

As demonstrated above, where there are market failures , a thriving private sector depends on support for SMEs and entrepreneurship. This includes State sponsored funding schemes, institutional support, training, information services and technology support. In the early stages of transition, most of this activity stemmed from foreign aid, resulting in a whole host of programmes, schemes, initiatives and institutions (Blazyca et al., 2002).

Institutional and financial support for SME promotion and new firm formation gained momentum in the mid-1990s. In 1994 there were 1,000 organisations and institutions acting in the area of SME promotion in Poland. There were 120 regional and local development agencies and foundations, 50 centres of innovation and enterprise promotion (including 20 incubators), 110 advising, information and training institutions, 180 Chambers of Commerce, 26 Chambers of Crafts, and 130 various economic associations.

The number of profit-oriented institutions working for business development, such as private consulting firms, continues to grow in Poland. But publicly funded programmes have been less developed (Tamowicz, 2004). There were only two examples of such programmes: the Labour Offices’ loan scheme to assist the unemployed who want to establish their own businesses, and the Loan Guarantee

Fund established by the Ministry of Finance. However, support for SMEs and the private sector strengthened further at the end of 1990s, reflected in various governmental pronouncements and documents (Danson el al, 2001). At the same time, the government's position towards entrepreneurship and private sector development became strongly influenced by preparations for EU membership, and by 2002 the majority of small firms was Polish owned and financed from private sources (PAED, 2004).

Following EU accession, support for entrepreneurial activity was steered by the Lisbon strategy with an emphasis on the need to boost entrepreneurship, productivity, employment, and competitiveness. In line with an overall aim of making Europe the world's most dynamic and competitive knowledge-based economic area, new initiatives in this area stem from the 2003 Green Paper on Entrepreneurship and the Commission's Action Plan on Entrepreneurship published in 2004. Its five policy areas comprised: entrepreneurial mindset, incentives for entrepreneurs, competitiveness and growth, access to finance and red tape will have a strong impact on Poland. As Grabowski (2005) observes:

> '(this) current year is crucial for the development of new strategies and priorities for entrepreneurial activity in the next 5-7 years.'

Venture Capital

Poland represents a new market for venture capital and private equity institutions. The provisions of previous legislation during the immediate post-communist transition period were insufficient to promote the functioning of venture capital funds. The first legislative change took place on February 21, 1998 with the introduction of the Investment Fund Act which made some provisions for closed-end investment funds. A further amendment was introduced on 22 March 2001 when the Polish government introduced an amendment to the Act on Investment Funds (CEC, 2002). Until then, only two closed-end investment funds were operating in the Polish market and could be regarded as similar to venture capital funds. The amendment allowed for a new type of investment fund, that is a specialised closed-end investment fund created by investment fund societies. The whole process was further facilitated by a consolidation of the Polish banking system and the creation of pension funds.

Since then, the sector has experienced growth and attracted capital and increased interest mainly from large international companies. However, the Polish government's efforts on behalf of venture capital has been limited (Tamowicz, 2003). Therefore, a majority of venture capital (in excess of 90 per cent) comes from abroad (Tamowicz and Stola, 2003). The first venture capital/private equity operations began in 1990, with the establishment of 'the Polish American Enterprise Fund'. The same year saw the launch of a small 'Danish Fund for Central and Eastern Europe and Economic Initiatives' followed by the establishment of a small 'Society for Social and Economic Initiatives' in 1991 (with the involvement of French capital among others). In March 1992, Caresbac-Polska, created with EBRD participation and US sources, marked the foundation of a venture capital (VC) market that combined foreign aid and governmental sources. Further new initiatives, for example the Bialostocki and Lubelski Capital Fund, were developed with the help and support of the British Know-How Fund. By the mid-1990s, 12 companies conducted venture capital type activities and managed total capital funds of around $660 million (Tamowicz and Stola, 2003).

The second half of the 1990s saw intensive growth in the activities of the private equity houses in Poland, and in various government sponsored programmes that were a direct result of mass privatisation (e.g. the National Investment Funds). At the end of 2001, there were 30 venture capital/private equity firms located mainly in and around Warsaw.

Despite this expansion of the VC market, Polish venture capital firms were still reluctant to invest in small start-up companies due to a continued perceived high risk in the SME sector according to the Polish Private Equity Association (Zwierzchowski, 2004). More importantly, VCs set up minimal investment levels of millions of dollars which are far too high for start-up firms. Thus, most new small and micro-firms are thrown back upon self-financing sources and find access to credit and capital for growth restricted (PAED, 2004).

However, in contrast with private equity markets operating in West European countries (where most start-up funds are also raised from domestic sources), the Polish venture capital/private equity market developed almost independently of any further involvement by the Polish government which showed a lack of real conviction in this area (Tamowicz, 2003)

Polish Entrepreneurial Class

There are various studies pertaining to the emergence and formation of an entrepreneurial class in Poland throughout the post-communist transformation period. One premise is that, due to an under-developed class of large-scale capitalists in Central and Eastern Europe, the entrepreneurial class carries the responsibility for the progress of capitalism during the transformation process (Osborn and Slomczynski, 2005).

The risk-taking and entrepreneurship of a considerable section of Poland's population allowed the economy to achieve strong economic growth between 1990 and 2000.However, Polish entrepreneurs still face important impediments to successful activity due to excessive bureaucratic and fiscal constraints from government, and the competitive shock resulting from EU membership (Wyznikiewicz, 2003).

Osborn and Slomczynski (2005), in their detailed discussion of the role and position of entrepreneurs in the social structure of contemporary Poland, note that at the beginning of the transition process the Polish class structure underwent a dramatic transformation which led to a new class composition. Its main features are the emergence of the entrepreneurial class (and potentially with Business Angels as a growing component) and the differentiation of the working class. Contrary to popular belief, the authors argue that membership of the Communist Party did not have a significant effect on joining the entrepreneurial class. The same is true for Hungary, the other country within the Soviet block where the private sector and the entrepreneurial class played an important role during the communist era.

Biographical accounts (Osborn and Slomczynski, 2005) confirm the view that many conventional features of entrepreneurial activity dominant in capitalist systems were also important in the formation of the 'new' Polish entrepreneurial class, and in the emergence of a growing number of Business Angels. However, there also were some uniquely Polish conditions that stimulated entrepreneurship, such as foreign contacts and networks as well as specific government incentives and tax holidays.

Polish entrepreneurs (including Business Angels) are better educated than the national average, and they are better off with respect to ownership or access to economic assets. As noted above, these may be distinct features of transition economies where there is still a risk adverse venture capital market, and restricted access to credit for small start-up firms.

EU membership has brought with it new opportunities but also major challenges for entrepreneurs and sustained small business growth. As Wyznikiewicz (2004) notes:

> 'However, it seems that the mental preparation of entrepreneurs for open competition in the single market… are actually more important than the timely preparation of a legal and economic infrastructure. In my opinion, in the initial period of Poland's presence in the EU, Polish entrepreneurs will have to take lessons in integration, and for many these lessons may prove painful.'

Business Angel Networks in Poland

The term Business Angel is relatively unknown in Poland although the phenomenon of private investors providing funding for business ventures is not a new one (Nasz Rynek Kapitalowy, 2004). Polish Business Angels have the same aims and operate along similar lines as their counterparts in the West. Although their activity is in line with the Lisbon Strategy of enhanced entrepreneurship, their functions in Poland are much wider. As mentioned earlier, venture capital and equity markets in Poland remained underdeveloped in the early 1990s, and Polish private entrepreneurs were often either inexperienced or unfamiliar with the way venture capital functions. Therefore, Polish Business Angels are faced with much greater challenges than their western counterparts. They also fill an important investment gap for new ventures that still exists in Poland. Polish entrepreneurs seeking funds from banks and similar institutions often face an additional obstacle as banks look for collateral or a guarantee that is equal to the sum of money they wish to borrow (Business Week, 2004).

Therefore, the potential for the Business Angels market in Poland is quite considerable, although it will take time before it is fully functional (Ambor and Tamowicz, 2004). According to Dolkowski (president of PolBAN) there are around 100 thousand people in Poland each with 1 million PLZ in disposable income (Puls Buzinesu, 2003). If only 5 per cent of them could be persuaded to invest in one or two business ventures this would provide sufficient seed capital of between 50 and 500 thousand PLZ each for around 10 thousand firms. However, it is not only about access to start-up funding since Business Angels, whether ‘hands on’ or not, also provide valuable advice, help formulate business strategies; and provide contacts and networks.

The Business Angel network in Poland is very young, and it is too early to assess its effectiveness given the small number of investment projects to date. However, there are two embryonic organisations at the national level, with regional and local networks, and these are examined below.

At the national level there are two Business Angel networks in Poland: PolBAN and Lewiatan BA (LBA), which operate within the Polish Confederation of Private Employers Lewiatan. PolBAN and LBA have the same aims and objectives as other members of the European Business Angel Network (EBAN): acting as honest brokers and a ‘marriage bureau’ for private investors and entrepreneurs who are seeking funds for their new ventures.

PolBan

PolBAN was established in December 2003 by Wojtek Dolkowski and three friends who have funded 15 Polish entrepreneurs. It forms a part of EBAN; therefore it can tap into its contacts and a wide range of networks.

It is a 'non-profitŁ organisation and its activities are now funded from a variety of sources: sponsorships (companies and private individuals), membership fees, and commission from PolBAN led projects (www.polban.pl). The organisation has an office in Bydgoszcz but also operates through a network of representatives throughout Poland. Its main aim is 'to inform wider public about Business Angels activities, seek potential investors and promote interesting projectsŁ (Puls Buzinesu, 2004). However, there are more specific aims that address a range of issues that small firms confront when endeavouring to access finance for their businesses, and promote their own activities:

- locate and support Business Angels in Poland,
- promote seed capital type investment at the start-up investment stage,
- help eliminate the 'capital gap' at an early stage of entrepreneurial activity,
- link up new projects with potential investors (BAs),
- promote new firm formation,
- improve the entrepreneurial climate and stimulate the development of the SME sector,
- support cooperation between entrepreneurs and Business Angels,
- exchange experiences and knowledge with similar organisations abroad,
- promote foreign investment through, among others, the EBAN network,
- stimulate the business environment and create a forum for the exchange of contacts and ideas, and
- advocate tax reductions for Business Angel type investment.

By 2005, PolBAN was associated with 20 Business Angels, and in June 2005 completed its first project (Gazeta Wyborcza, 2005).

Lewiatan BA

Lewiatan BA was established in April 2005, with 85 per cent of its funding coming from EU sources. It collaborates with a number of organisations such as Innovation Funds-FIRE, American, German and Irish Chambers of Commerce. However, as a constituent part of the Polish Confederation of Private Employers, it can operate at a regional level by using an existing network of their offices in various Polish cities.

Similarly to PolBAN, it currently operates as a non-profit organisation but will start charging for its services in 2007. Lewiatan BA is a very much a 'hands on' organisation and pays a lot of attention to project selection. It pre-selects projects, prepares a summary document and then passes it on to a potential investor. Once the initial meeting between an entrepreneur and BA takes place, Lewiatan BA 'takes a back seat'. Some of the less well defined projects are either rejected outright, or sent back for further amendments.

Lewiatan BA calculates the amount of yearly profit at an early stage of negotiations between an entrepreneur and the Business Angel according to Lewiatan BA's project manager (interview, January 2006). Its strict business focus has paid off, and Lewiatan BA has succeeded in facilitating start-up funds for a network of coffee bars and was instrumental in setting up an indemnity company and more recently a software company. Lewiatan's BA future projects will have an even more defined focus, concentrating on information technology, renewable energy and mass media.

Conclusion

The Business Angel phenomenon is not new, but the term has only recently become common currency in informal venture capital markets associated with small businesses. The parallels between Business Angel operations and networks in an established environment such as Scotland and in transition economies like Poland are evident. This is not surprising given that the primary motivation for Business Angels is capital growth, and that they seek to plug gaps and failures in the venture capital market wherever they appear. Also, small companies usually cite access to capital and credit as major obstacles to formation and growth of their business. Interestingly, though, is the extent to which both well founded capital markets and transition economies have a high dependence upon micro-economic features of small business formation including reliance on family assets, human capital, and specific demographic features of individuals. Clearly, the capital gap is a shared feature for the small business start-up and growth processes, and this creates similar responses from formal and informal sources of capital. These comprise key elements for Business Angel strategies that hinge mainly upon the generation of local, national and international 'networks' in order to identify and assess investment opportunities, and form partnerships with State financed initiatives for national and regional economic growth, and employment. This policy arena is a common denominator for Business Angels and small businesses alike since the SME sector is identified as the engine of economic growth and de novo job creation in areas of sectoral and regional decline following the loss of employment in traditional industries. The causes may vary, but the policy implications are very similar. In Scotland and Poland, public/private initiatives were developed to engage venture capital with small business start-up and growth. In both contexts, Business Angel networks responded to these national opportunities, and in the case of Poland quickly established European links.

The differences in the experiences of Scotland and Poland, and by extension other CEE economies, are more related to the speed of change in the transition economies and the capacity for national informal venture capital to gauge its response to demand. For Poland, and other transition economies, the majority of new capital has arrived from foreign investors as buyouts of large firms and privatisations, or as greenfield site investments. The consequences for SMEs have been a fast flow of funds to support these large firms and buyout opportunities, accompanied by economic uncertainty and turbulence that induces risk averse behaviour by potential investors in start-up firms, and a slower flow of capital into the SME sector from external sources.

Whilst this research paper has offered some critical insights into the Angel market in Poland the analysis is limited due to the recent emergence of the market. Further research will focus on the developments within the Angel market monitoring the ability of their networks to match potential investors with business opportunities. The main focus of the paper has been on the supply side of the market and further research needs to be undertaken to determine issues on the demand side. For example, are businesses seeking more than equity finance from Angel investors? Why do entrepreneurs seek Angel investment rather than bank finance? Is there a 'pecking order' that entrepreneurs are following in seeking finance for a new venture? How easy is it to secure Angel funding?

Thus, policy recommendations for the Polish economy should take into consideration some key elements of this initial exploration of the nature and role of Business Angels. First, given the problems of access to capital for start-up firms, incentives could be built into the tax structure for Business Angels that might mirror those afforded to (large) foreign corporate investors. Major economic development targets, such as regional development, regeneration, and rural economic sustainability could be linked to investment incentives in the SME sector and to rural entrepreneurial activity. Second, family sourced finance for small business is a dominant feature of start-up firms. Therefore, family focused incentives to support SMEs through tax credits on investments would acknowledge and reward this major source of finance. Third, job creation is a major element of economic policy and firmly linked to the success of new business ventures, and their survival. Business Angels play a key role in this process that needs to be better understood and incorporated into the policy arena in Poland at an 'early' stage in order to capture the full potential of this source of finance.

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