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InvestorPulse 2003 Business Angel Survey

InvestorPulse UK Angel Attitude Survey

A qualitative survey into UK Business Angel attitudes, preferences and views in 2002 and 2003

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Foreword by Jon Moulton – Alchemy Partners

Welcome to the c2Ventures | Investor Pulse Business Angel Report. As an active Angel Investor and Managing Partner of Alchemy Venture Capital[1], I agreed to write the introduction to the report because the report sets out to test and report on the views and experiences of a wide range of Business Angels and share them for free with fellow angels, companies seeking funding, advisors and government bodies who may find the content useful in helping them understand the sector in which they choose to play.

You will find some surprising findings, some less so perhaps that confirm what you already knew, together with some feedback and comment from the Angels themselves, highlighting areas that they think should be improved or changed to assist the company seeking money to be successful.

I have picked up on a couple of these comments and would like to share with you just two succinct pieces of advice gained from my years of personally investing into new companies.

They have generally stood me in good stead over the years. When I have occasionally not followed my own advice I have regretted it every time. My rules?

- Never be optimistic
- A good business plan is not necessarily a good investment – find out who wrote it

There follows empirical and anecdotal evidence of the latter in the report, and despite the sentiment in the former, may I wish you luck and a good return on your investments in 2003 and beyond.

It just remains to say on behalf of all the contributors and survey participants, that we wish you a prosperous New Year and hope that you enjoy reading the report in the spirit and context in which it is intended.

Jon Moulton is founder and Managing Partner at Alchemy Partners. A graduate in Chemistry and a Chartered Accountant he was most recently director in charge of buy-outs at Apax. Formerly Managing Partner at Schroder Ventures in London from its inception in 1985 until 1994 and before that with Citicorp Venture Capital in London and New York. Very experienced in buy-outs of a wide variety. He is a director of a number of private companies.

[1] Alchemy is a private equity advisory business based in London, specialising in buy -outs, buy-ins and the provision of later stage development capital. Minimum investment starts at £5m. Alchemy was formed in January 1997 and is led by Managing Partner Jon Moulton. Alchemy has advised on over 75 transactions which have completed with over £850 million of equity invested to date

The Survey

The survey, the brainchild of c2Ventures was main- sponsored by the National Business Angels Network and co-supported by Tornado Insider, Great Eastern Investment Forum, Insensia Capital, 2020 Chartered Accountants and AngelBourse. In addition CASS Business School provided assistance and feedback on the questionnaire content and structure and marketing support. Corporact provided the Survey format and data collection engine.

About c2Ventures and InvestorPulse

c2Ventures is a Special Associate of National Business Angel Network, and a technology oriented associate of Corporate Venturing UK. In addition it has access to suitably appropriate Business Angels of its own.

Its focus reflects the professional and personal interest of its three directors, all of who have deep experience in the area of start-up, small and large company success, especially in the Technology arena. In addition to assisting companies to find funding, the company also delivers pragmatic business oriented consulting to those companies interested and passing certain c2Ventures criteria.

InvestorPulse is the Research arm of the business, and focuses on promoting better understanding for all of the UK Business Angel community and the fostering of cross-body co-operation in this sector.

www.c2ventures.com

The Partners

A brief synopsis and contact details of each of the partners can be found at the end of this report.

The commercial partners were chosen because of their reputation, understanding, and coverage of the UK Business Angel Market.

Their business angel membership covers the SE, London, East Anglia and Scotland in particular in addition to the national coverage provided by NBAN and AngelBourse.

CASS Business School lent support in the compilation of the questions.

Corporact, a leading investor relations and Corporate Communications company provided the survey design, data engine and reporting capability.

Some of the organisations approached chose not to participate, either due to the sensitive nature of the survey questions, time constraints, or because they wished to keep the views of their Business Angels within the network that they operated or controlled.

Its Purpose

The purpose of the Survey was to investigate current feeling of the UK small and medium private investor over the last two years, and going forward into 2003. Each partner publicised or circulated the survey amongst its Business Angel Membership.

The results should assist companies seeking finance; Business Angels generally, and professional advisors and Business Angel networks and association to better understand the transaction. There are a lot of commonly held views about the nuances of the sector and the survey was designed to test these based on the responses of the sample. Where possible we have included comment from industry figures that may further illuminate or explain points of interest further.

Its publication in January 2003 is timed to spark debate and gain editorial coverage to kick off the 2003 investing season.

Any person or organisation can access the report, and quotes from the report can be used without permission for any purpose, so long as they are used in a generally appropriate context and manner with the source correctly attributed to c2Ventures.

Anyone wishing any further information, please speak to the Author, Paul Gardner of c2Ventures on 07050 263500 or email p.gardner@c2ventures.com

The survey is not intended to provide a quantitative view of the market; that is well covered by Professor Colin Mason of the Hunter School of Entrepreneurship in his annual NBAN and BVCA sponsored report into investor activity.[2]

Data Gathering

The brand, InvestorPulse was set up as a separate data gathering and research function only. Partners were happy to use this independent name in association with their own brand name to publicise the survey, without seeming to promote other networks

Each partner had their own co-branded web page set up, welcoming their members and giving access to the survey. Raw data was gathered by means of an online and Microsoft Word survey. Respondents were invited to fill out the questionnaire online, or to download or request an electronic copy of the questionnaire for emailing or posting back to InvestorPulse.

Over 75% of respondents chose to complete the survey online. It should be noted that due to the online and electronic collection methodology, and the partners who invited their investors and readers to participate, we believe that the responses will show a bias toward those who are comfortable with technology, use technology on a day to day basis and who access and distribute deal flow via the full range of electronic channels and personal networking.

Wherever stated in this report, the term Business Angel refers to those who participated in this survey, and the views reported are based on the answers given by the respondents to this survey.

[2] This report is available in electronic PDF format from the NBAN website at www.bestmatch.co.uk

NBAN states that there are thought to be about 18,000 Business Angels in the UK actively looking to make investments. It is believed that they invest around £500 million a year in around 3,500 businesses. Clearly the sample of this universe responding to the InvestorPulse survey, although representing a 9% response rate, is not significant enough to be statistically robust and conclusions about the wider community cannot be made with any accuracy.

No respondent was paid for his or her time or input; all responses are voluntary. Any comments offered by the respondents are re-produced in full and un-attributed. Anybody is able to obtain a copy of the report for free from the c2Ventures website at www.c2ventures.com

No hard copies are available of the report in an attempt to keep the costs of the survey at a minimum.

Report Structure

The structure of the report is set out as follows:

- Investor profile
- Deal flow
- Investment criteria
- Two year investment history
- Forward investment intent
- Angel Comments on the Market

Additional Comment

As well as the main sections the report includes contributions from the Survey Partners.

Their brief was to write articles of interest to the UK Business Angel community, of a provocative, informative or educative nature that would add to or illuminate the results of the survey and add a human perspective to the sterling work of Professor Colin Mason of the Hunter School of Entrepreneurship at Strathclyde University.

Contributors include:

- Jon Moulton – Founder and Managing Partner, Alchemy Partners
- Bernard Halliwell – Managing Director of National Business Angel Network
- Paul Gardner – Managing Director of c2Ventures
- Grant Hawthorne – Managing Director of Great Eastern Investment Forum
- William Owen and James Cooper – serial investors
- Nicky Griffin - Olswang and Partners
- Stephen Kelly – Senior Partner 2020 Chartered Accountants
- John Calverley - Chief Economist of American Express Private Bank

Survey - Investor Profile

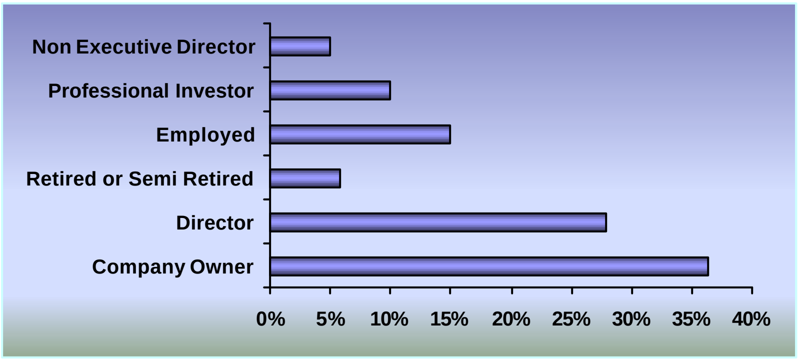
The purpose of this section is to get a feel for the type of investor who responded to the InvestorPulse 2002 UK Business Angel Survey.

70% of survey respondents polled stated that they lived in London, SE England or East Anglia, although there was also a significant response from the Midlands.

5% of respondents were female confirming the generally held view that this is a male dominated industry, although this figure is up from the generally quoted one of 1%.

The breakdown of investors by profession illustrated that the vast majority of respondents, some 70% have direct *current* experience of running companies, which for any company seeking investment in return for equity and potential Angel participation in the running of the company is good news. 15% of investors polled are employed, investing in either the company that employs them, perhaps as a result of recent tax legislation, or other private companies.

Graph 1:Profession of Business Angel



The degree of management participation in their investments varies widely.

> *39% of Angels have active management involvement in the majority or all of their investments, another 40% have involvement in selected investments only, and 21% have no involvement at all.*

Whether this is due to time constraints, availability, or because their investments are in AIM or OFEX listed companies where Board or NED involvement at the average level of Angel investment is rare is not clear.

We were interested in the Average Business Angel's investment experience and breadth, not just their commercial experience.

> *We asked the question regarding the number of AIM or OFEX investments held by investors and the answers ranged from zero to over 300. An amazing 30% of the respondents held over 90% of the AIM and OFEX listed investments. The average number of AIM or OFEX investments held was 10.*

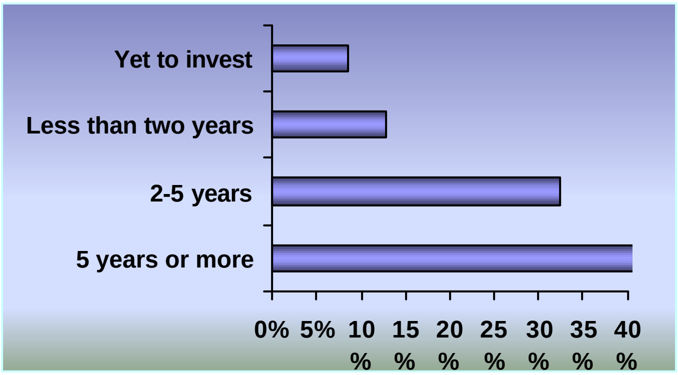
The number of Non Executive roles held by Business Angels in their investments ranged from 1 to 15 although the average number is 2. On average a further 1 or 2 Non Executive Directorships were held outside of their direct investments.

Experience

Almost 75% of respondents have been involved in Angel Investing for over two years or more, so most will have been exposed to the worst of the downturn. This has injected a substantial degree of realism into a Business Angel's negotiation with the management team in relation to company valuation.

> *44.76% of Business Angels asked still thought that valuations by management of their companies were too high, only 8.6% thought that they were too low.*

Graph 2: Length of time as Business Angel



Geography

It is been an often held view that UK Business Angels don't invest outside of their immediate geography – a constraining factor for many businesses not located in the investor hot spots of the UK – and another reason why so many of the Business Angel thrive on a purely local or regional basis. However, this survey found that perhaps due to the economic climate, investing nets are being cast further a-field, perhaps this merely reflects the fact that electronic media means that connecting companies and investors is simpler and no respecter of geography.

Area	Percentage
Locally (within 50 miles)	17%
Regionally (within 150 miles)	30%
UK wide and Overseas	53%

Table 1: Investment Footprint

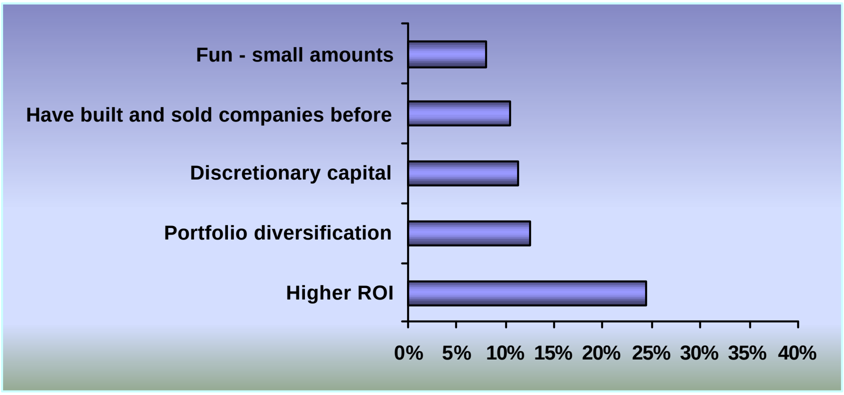
Why Invest?

The survey also sought to shed some light on the reasons why Business Angels invest into private or closely held companies.

Given that the focus of the survey has been on investment activity over what is generally regarded as the worst period for general investing in several generations, we expected to see a lot of evidence that investors are optimising their tax positions.

However, when asked to identify and rank what were the top three reasons behind choosing to become a Business Angel investing in private companies, tax planning and tax optimisation came surprisingly low in the results.

Graph 3: Top Five Reasons for Private Company Investing



Tax and EIS Considerations

Only 6.1% of responses indicated that investors were looking to optimise their tax position, with this being the eighth most popular category. Furthermore, only 50% of those indicating this reason chose it as the primary reason for investing.

> *Almost 65% of respondents stated that the attractions of EIS relief when considering an investment was either not important or only somewhat important – a pretty bullish call in today's environment. A further 12.5% are not aware of what EIS is or its benefits.*

This is clearly either an opportunity for education by Government, Financial and Professional Advisors or a clear sign that Taxation incentives for the risks taken by investors are not yet widely appreciated, or seen as scant reward. We have highlighted some of the Business Angel contributions on this matter later in the report and in particular on page (16) where you will see a contribution from two leading Business Angels on how they use the system to their advantage.

Risk Sharing

Around 55% of Angels interested in doing a deal liked to share the risk, and to be able to access other investors. However only 15% and 16% respectively preferred to invest with friends or as part of a syndicate or club – a desire to keep business, friends and family separate perhaps?

> *The UK Business Angel represented in the survey is a solitary investment creature, almost 60% [3] of them preferring to invest on their own or though their own investment vehicle, with another 9% taking advantages of private placements offered by brokers and advisors.*

Investor Status

Considering the FiSMA regulations around financial promotion, we wondered how many of those responding had been offered the opportunity to get confirmation of their investor status, important if they are to receive financial promotions from organisations or companies seeking funding other than those holding the appropriate regulatory authorisation.

> *Over 70% of investors have never been offered a certificate confirming HNWI[4] or Sophisticated Investor status by any professional qualified to do so. A further 57% are not aware that they can get such a certificate of investor status simply and easily from a number of national sources.*

Nevertheless, we asked in terms of investment sophistication and capability, how the respondents would describe their status, if at all.

Status	Percentage
High Net Worth Individual	19%
Sophisticated Investor	56%
Other	20%
Don't understand Term	5%

Table 2 : Self-Assessed Category of Investor

Stage Of Investment

With the global turndown in business, we imagined that Business Angels would be looking at more financially sound and more mature companies in which to risk their capital. Over the period in question, 2000 to 2002, we asked what was the preferred stage of business in which they considered investing.

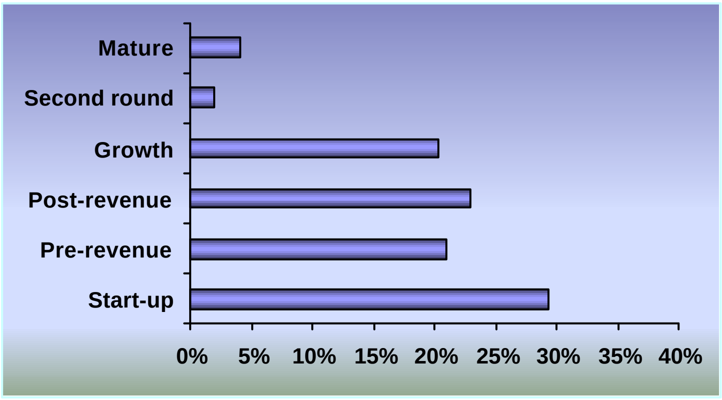
Surprisingly, the answers were significantly weighted toward the earlier stage investment, despite the past and current market conditions. Whether this reflects the opportunity and desire for larger speculative returns over so called 'safer' investments or whether the response reflects confidence in the future over the reality of returns right now, is less unsure. Elsewhere we see that the average Business Angel is a lot more inclined to accept a lower return than was expected in the late 90's and over a longer period.

[3] Professor Colin Mason's research stated this figure at 65% for 2001

[4] High Net Worth Individual

This early stage bias is consistent with NBAN research for 2001 that puts the figure for early stage attraction of investment money at 65%.

Graph 4 : Preferred Stage of Business



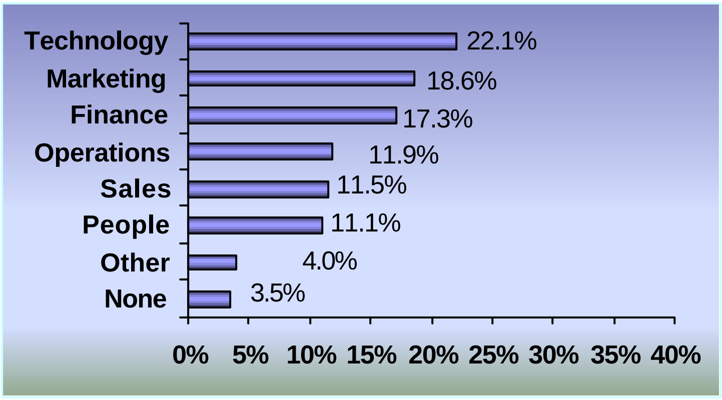
Due Diligence Services

In the world of the Venture Capitalist, due diligence is a time consuming and expensive resource, but necessary to properly evaluate deals that can be in the many millions or above. Although Angel Groups have access to trusted counsel and some experts, indeed many perform the function themselves for other VCs, in general Business Angels have to trust to judgement and a faith that the management professionals in whom they are investing are experts, or at least competent in their respective fields.

> *Almost a fifth of Angels polled said that they would welcome assistance in understanding or validating the financials. Over a quarter would welcome assistance in better understanding technology*

So we asked in which areas would a typical Business Angel like assistance in assessing the viability of a potential deal. Regulatory and other barriers to the provision of such a service were not taken into consideration. The top three answers perhaps suggest that if addressed properly and cost effectively, assistance in helping the investor understand better the key components of a company's offering could speed the funding process, and perhaps ensure a better rate of survival and success in their investments.

Graph 5 : Due Diligence Support Areas



Contribution - CGT Minimisation – Leading serial investor

An Alternative Approach – CGT minimisation versus EIS

William Owen and James Cooper lead a syndicate of serial angel investors. While the tax breaks available under the Enterprise Investment Scheme are attractive, they can lead to irrational investment decisions. Alternative structures may be less tax efficient but can reduce the risk associated with this type of investment.

The market for floating private companies is dead. Price earnings multiples for sales to trade buyers have dipped. This should be a perfect time to invest in high growth private companies with the prospect of selling out when the next frothy cycle comes around.

However, it is our view that EIS relief is encouraging angels to over price their investments. When the chief executive of Wonderwidgets values his company at £3 million, the acid test is to ask yourself whether you could sell Wonderwidgets for this price and to whom. The CGT deferral and income tax reliefs are designed to cut the cost of investing in small companies. Too often, the benefits are being handed over to those companies in the form of inflated company valuations.

EIS investments have other difficulties.

A report in the Financial Times last year indicated that fifty per cent of all venture capital firms were now insisting on a priority return of two times their investment before management took out a penny.

They also use financial structures to encourage managers to aim for a particular exit date. An investment structure that is compatible with EIS is almost certainly not going to be able to give the angel comfort on these issues.

We prefer an investment structure that is not EIS compliant but does have the benefits of business asset taper relief. It takes some of the sting out of the argument about the company's value. Perhaps most importantly, it improves the prospects of the angel getting his money back within a reasonable time frame, regardless of the timing of the ultimate exit for shareholders.

As an example, if our syndicate invest £400,000 in a company valued at £2 per share we would subscribe to (i) £400,000 of Loan Notes at 6%, repayable in 3 years or on exit (whichever is earlier) plus (ii) an instrument which gave us the right to subscribe £400,000 for ordinary shares at a price of £2 at any time up to the time of flotation or sale. Assuming the business does not go bust, this gives us our capital back after three years with, effectively, an option to subscribe to shares exercisable once an offer has been made for the company and the value is known.

In order to enjoy an effective CGT rate of ten percent after two years, it is essential for taper relief purposes that the right to subscribe at £2 is not granted by way of an option. This is because the taper relief 'clock' only starts running once the option is exercised and as the exercise date is likely be at the same date the company is sold the option route would create an unnecessary tax liability.

Our solution is to subscribe to fully paid up 'A ordinary shares' with a low nominal value - say 1p. The A ordinary shares will enjoy the same rights and be identical to ordinary shares except that if the company is sold or listed they become deferred shares which are valueless *unless the investor pays a premium*. In the example above the premium would be £1.99. The taper relief clock should start on the payment date of the one pence and not the £1.99 pence

When agreeing the loan terms remember to structure the loan as an instrument that is a 'debt on security' and not a 'qualifying corporate bond', so that a CGT loss is available if the loan cannot be repaid.

An angel with ten investments is likely to have one or two outright winners and one or two total losers. For outright winners, where a sale occurs just after the three-year period is up, the EIS route has considerable attractions. For the total losers, EIS structures are likely to see as much as 52 per cent of your investment returned through lower tax compared to 40 per cent under our structure.

But most investments turn out to be mediocre performers where the initial pre-money valuation proves to have been much higher than the real value. Exit may take several years. For those seven or so companies the Loan Note structure can pay off handsomely as it gives the angel a chance to either getback his loan or to negotiate a conversion price to give fair value. Those of you who enjoy modelling can have endless amusement working on the theoretical return on a typical angel portfolio using either of these two structures.

Unfortunately the £25k angel may not have enough influence to negotiate this type of deal. The answer is to join a syndicate. Or alternatively you could try and work the same 'magic' on your investments that a local farmer achieved with his clapped out old tractor. He drove it down a lane and turned it into a field. Then he sold the field to a House builder.

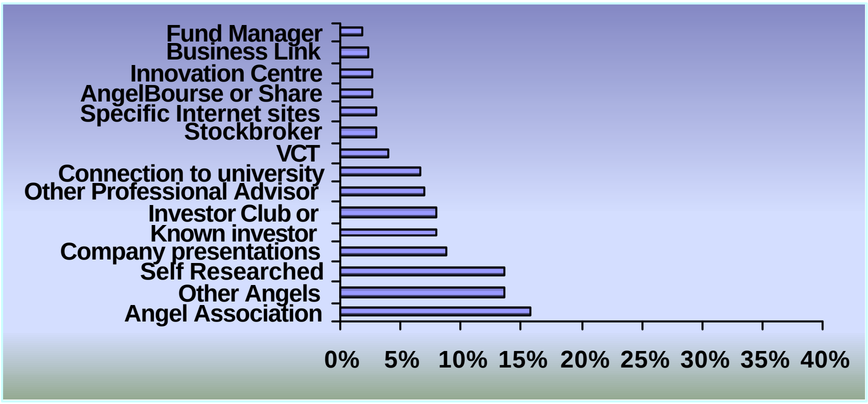
Survey - Deal Flow

Business Plan Sources

The biggest complaint from Angels about plans they are sent relate to the lack of focus on their sector of interest. Understandable if approached directly, less so if approached via their preferred introducer.

Investors still prefer to research their own investment opportunities despite being members of various associations and groups. One of the most reliable sources of good quality business plans is via other investors and Business Angels.

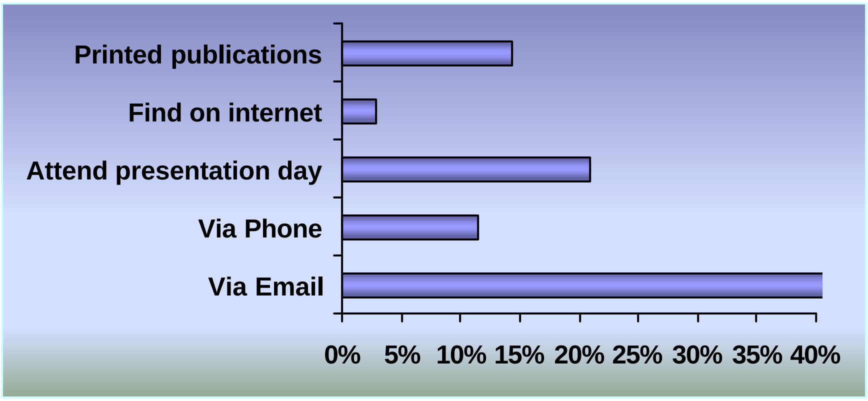
Graph 6 : Preferred Source of Investment Opportunities



Business Plan Communication

We were interested in how the survey respondents were made aware of businesses in which they could invest, and how many of them made use of online or electronic communication in accessing deal flow over the last two years. Over 40% of Business Angels access opportunities via email approach from their association or authorised advisors.

Graph 7 : Communication Preferences



There is still a highly significant number who eschew completely electronic communications, and prefer to read about the business in printed format, or attend company presentation days where there are distinct social and networking benefits in attending. It would be an interesting exercise to compare the success rates of businesses seeking funding with their initial communication route to the investor.

Angel Association Membership

The majority of Business Angels are members of at least one Angel Association or Network, most being a member of 2 or 3. These however tend to be quite regional in nature, and not all Angels get to see good business opportunities from outside their immediate community, a view shared by a good few Angels judging from their comments. This leads to a good deal of research into investment prospects by the investors themselves.

Business Plan Quantity and Quality

It seems that there is a perceived problem of quality, not quantity in terms of business plans being seen by Business Angels with most roughly happy with the number that they see. 50% see up to 3 plans per month, with another 40% seeing up to 10 submissions. A few well-known or well-connected investors, around 10%, get over 10 plans a month.

Only 20% of investors would wish to see more, with the vast majority of almost 69% happy with the number that they receive, thus making the connection between investor and company even more difficult. Only 11.4% wish to see less month by month.

'How much is too much? The research indicates that 88% of respondents want only to see at first contact, an executive summary or short précis.

Exec Summary	Short Précis	Full Plan	Financials only
64%	24%	10%	2%

Table3:Required Business Plan Detail

The reality being that like resumes, the recipient of a new plan probably spends less than two minutes evaluating the initial submission, so attention has to be grabbed by an articulate, compelling and concise writing style talking about an exciting cash generating business opportunity.

> *Almost 84% of plans received by this Angel community are rated as average or poor, with only 16% of plans meriting an above average score. Not one of the respondents rated a single business plan excellent. This, together with the recent market conditions, probably accounts for the less than 2% funding success rate mentioned elsewhere*

Survey - Investment Criteria

We asked some basic questions that we thought would be of most use to a management team putting together a plan for presentation to a funding body or bodies.

First Hurdle Failure

We asked what were the main reasons for not funding a company once it had passed the 'business plan filter' and ongoing meetings were underway. Our experience tells us that plans usually fail at the first hurdle due to a **lack** of:

- Clear financials
- A scalable business model that includes a clear marketing and sales plan
- A 'must have' product or service rather than a nice-to-have product or service
- A clear exit, and realistic valuation
- Understanding that it is the team that gets the funding, not the plan

We wondered if the Angels who responded to the survey shared these views or could offer any others. We asked, once you have met the management team, but then have subsequently decided not to proceed to the next stage, what were the main reasons for your decision?

Management, Management, Management

As in Real Estate, where Location, Location, Location is the mantra, it is nearly always down to the management, their skills; their experience, both functional and in guiding a company to profitability, and how they gel with an investor, group of investors or institution interested in them that very often defines the success or not of the funding, especially more so if a representative from the funding source is to sit on the board or be a part of the management structure.

> *'As an investor, I back management teams'5.*

Despite common guidance to the contrary, it was not factors like non ownership of intellectual property, lack of clear exit, dislike of the product or service, little market potential for the product or service, unrealistic valuation or failure to agree investment equity terms that scored highly in the reasons for refusal, (one presuming that these had in the majority been dealt with in earlier meetings).

It was the complete and utter focus on management issues by potential investors that meant in many cases negotiations on the above never even started.

> *Deal breakers! Tied in first place with 20% each; management quality and lack of commercial reality. In joint third, with 19 % were poor financials, and in fourth place, just to hammer home the point, dislike of the management team with 10.4% of the vote*

[5] Jon Moulton – Serial investor and Managing Partner Alchemy Partners

There is surely a lesson to be learnt there for companies seeking investment. For you to be successful you must show quality management, preferably with experience of growing a business rapidly, and capable of gro wing with it to at least the next stage, or as importantly, recognising that you may have to get someone else to do it instead of you.

Duration of Investment

The majority of Angels surveyed, some 82%, expect to be invested for 4 years or more. Whether this reflects current tax regimes, or is the amount of time that Angels believe it will take to get them to their desired liquidity event at the multiple that they require is less clear. There is still an 18% hardcore of investors, perhaps the professional investors amongst the respondents who expect to see a handsome return on their capital within 1-3 years.

Return on Investment

There is some good news though, Angels know that the days of triple digit returns are long gone, and they are equally divided as to their expectations around the return on their investment. We feel that more plans, instead of promising the earth, could actually afford to show a lower return more in line with Angel expectations currently.

Gross ROI	50% - 100%	101% - 151%	151% - 200%	200%+
Percentage	28%	25%	20.3%	26.8%

Table 4: Expected Gross Return on Investment

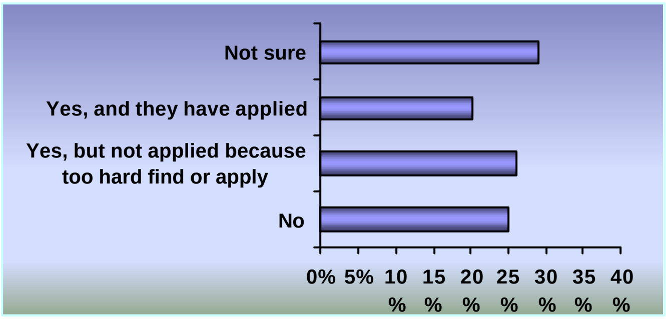
Companies are always advised to seek EIS eligibility if they are able, as it makes them more attractive to investors. According to our Angel group, non-EIS status is not always a deal breaker.

Very	Somewhat	No	EIS?
23%	49%	15.3%	12.6%

Table 5 :How Important is EIS eligibility

We hear a lot also about both the Government and Brussels' contribution to funding start up companies. Is the process as straightforward and timely as they would have us believe or are there still things that could be done faster and better. Later investor comment suggests that there is. Our respondents reply to the question, have the companies in which you have invested, investigated or applied for Government or EU funding provided the following answers:

Graph 8 Relevant Public Funding Applications?



Contribution – R&D Tax Relief – 2020 Chartered Accountants

2020 are a London based firm of Chartered Accountants who specialise in helping SMEs grow and develop their businesses. They are particularly focussed on the technology sector.

Stephen Kelly is Director of the Practice based in the City of London.

R&D Tax Relief for SMEs

The Finance Act 2000 introduced a new definition of research and development (R&D) for tax purposes. The detailed provisions can be found in Section 69 and Schedules 19 & 20.

The two main tax effects of this legislation are as follows:

Research and Development Allowances (RDAs). These allow companies to write off immediately all capital expenditure on R&D against the profits of a trade. This is really a new name for Scientific Research Allowances (SRA), which have existed since 1945.

R&D Tax Relief and Credits for SMEs. Under these provisions smaller companies are allowed to boost the amount they deduct from profits for current spending on R&D from 100% to 150% for tax purposes. This is **R&D Tax Relief**. If the company is loss making it can surrender these losses for cash payments. These are **R&D Tax Credits**.

From April 2002 the Chancellor extended this regime to give extra relief to large companies and to those companies developing vaccines. However, the focus of this paper is the reliefs given to smaller companies.

Definition of R&D

This is the most difficult area of interpreting the legislation, as there will be a degree of subjectivity, no matter how tightly this is defined. The Act uses the definition of R&D contained in SSAP 13, as modified by guidelines. The Secretary of State for Trade and Industry published a helpful guidance paper in 2000 on the definition of R&D for tax purposes. Quoting from this:

"R&D is thus characterised by work which breaks new ground and the novelty of what is being created in an atmosphere of scientific or technological uncertainty, and if successful will result in the extension of scientific or technical knowledge (although it is recognised that R&D will not always be successful). R&D should be founded on the investigation and exploitation of a scientific principle. This may be in pursuit of the creation or development of, for example, new liquids, substances, materials, software, designs, products, processes, technology or knowledge. R&D may result in intangible as well as tangible outputs."

Who Qualifies?

Firstly, R&D tax relief is only available to companies, not to sole traders or partnerships. Secondly, the company must meet the definition of a small or medium-sized enterprise (SME) as per the Commission Recommendation 96/280/EC. Broadly, this states that the company, together with any companies of which it owns more than 25%, must have:

- Fewer than 250 employees;

- Either:
  -Turnover no greater than 40m Euros; or
  -Balance sheet total no greater than 27m Euros; and

- No more than 25% of the company can be owned by one or more enterprises not meeting this definition of an SME.

Qualifying Expenditure
The following are the key criteria for expenditure to be qualifying, as laid down by Schedule 20 of the Act:

The expenditure must be revenue in nature and deductible for a trade or would have been deductible for a trade if it existed and such trade it is intended will derive from the R&D activity.

- The expenditure must be at least £25,000 for a 12-month accounting period.

- The expenditure must be incurred after 1st April 2000.

- The R&D can be carried out by the company directly or by a third party on its behalf.

- The expenditure must be on staff costs, consumable stores or on sub-contracted R&D costs. If the R&D is sub-contracted special rules apply.

- Any intellectual property created as a result of the R&D must vest in the company. It should be noted that this could be in conjunction with other parties.

- Expenditure does not qualify if the company is contracted to carry out the R&D by another party.

- Subsidised expenditure does not qualify. This encompasses notified State aid for relevant projects (even if the aid is for non R&D expenditure on the project).

The Act defines staff costs as all cash payments, employer's Class 1 NICs, and pension payments but not benefits-in-kind. Staff costs for all relevant staff should be considered. If any staff member spends less than 20% of their time on relevant activities then their cost is ignored. Conversely, if they spend more than 80% of their time on relevant activities then 100% of their cost is allowed. Relevant staff is those directly involved in R&D activity. This excludes support staff.

How is Relief Given?
If a company, which is trading, makes qualifying R&D expenditure then it can, on making a claim, increase the cost of this expenditure from 100% to 150% as a deduction against its trading profits.

A separate election must be made if the company has not yet started to trade. This election must be made within two years after the end of the accounting period in which the expenditure was incurred.

If a company is loss making then it can claim R&D Tax Credits. To calculate the value of the credit the company must first calculate the value of its "surrenderable losses". These are the lower of:

- 150% of its qualifying R&D expenditure; and
- Its unrelieved trading losses for the period (ignoring losses brought back or carried forward to the period).

The value of the R&D Tax Credit is then the lower of:

- 16% of the surrenderable losses for the period; and
- The company's PAYE and NICs bill for the period.

The Inland Revenue will make payment of the R&D Tax Credit direct to the company.

Other Considerations

As with most other areas of tax legislation, there are specific anti-avoidance rules, particularly relating to combating artificially inflated claims.

There are also rules to prevent companies surrendering losses to other consortium members, under the provisions of section 402(3) of the Taxes Act 1988, where those consortium members would not meet the SME definition contained in this legislation.

Finally, it is not uncommon for companies to undertake joint R&D initiatives. Where this happens, the parties should consider their own position carefully. Where the two parties involved simply share the activities and the costs then each will normally be able to treat their share of the R&D costs as qualifying costs under this legislation. However, where there is a separate joint venture company, then they will need to consider who will ultimately own the intellectual property created by the R&D activity. This is the party to whom the benefits of R&D Tax Relief will accrue.[6]

[6] *The author has taken all reasonable care to ensure that the contents of this article are true, accurate and fair. However, neither the author nor 2020 Chartered Accountants can be held responsible for any loss occasioned to any party as a result of actions taken or not taken as a direct or indirect result of reading this article. There is no substitute for good quality tax advice and readers who are interested in acting on the contents of this article are advised to contact a Chartered Accountant.*

Survey - Two Year Investment Record

Company Performance

Now we are a little clearer about the type of person the Survey represents, we wanted to get a feel for their levels of activity over the last two years, what they have invested in, when their last investment was, how much was their average investment and so forth. This is hard data and no conclusions are drawn from it.

> *When we asked about Company Performance over the last two years 16% of the UK Business Angels responding to the survey, stated that none of their companies had met their financial targets with a further 24% saying that only the minority of their investments had performed well. Around another 38% reckon that only half of their investment companies have met financial targets.*

Write Offs

This is backed up by the admittance that 42.3% of Angel Investors have written off one or more of their investments over the last two years, (this contrasts sharply with the findings pertaining to sensitivity around EIS qualification of companies). The other 58% have not written off any of their investments, although whether this is due to out-performance of the investment or simply a 'wait it out' approach remains to be seen.

Investment Recency

Despite the downturn, investors have continued to show faith in the private company sector, with a significant number investing strongly in the last quarter of 2002, seemingly at odds with the general downbeat view on the market in 2003. 75% of Business Angels had made multiple investments over the two-year period.

1-3 Months	4-6 Months	7 Months – 1 Year	Over 1 Year Ago
35%	19%	15%	31%

Table 6 : Recency of Last Investment

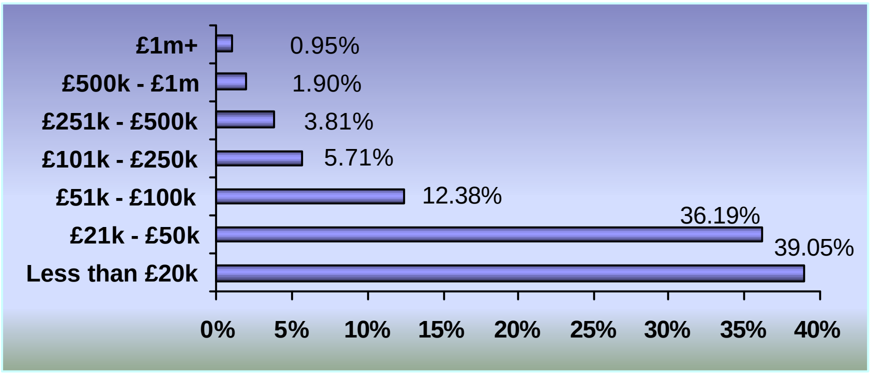
1-2 Companies	2-3 Companies	4-6 Companies	7 or More
24%	43%	21%	12%

Table 7 : Frequency of Investing 2000 to 2002

Average Investment Size for the Survey

The survey respondents had invested in around 338 companies between 2000 and the end of 2002, with the average amount invested per transaction of around £27,500.

Graph 9: Average Investment Size



Contribution - Employee Incentives Scheme - Olswang

Olswang is a full service law firm focusing primarily on clients in the media, communications and technology sectors. Nicky Griffin heads up their employee incentive practice and advises on the legal issues associated with providing share incentives for directors, consultants and third-party advisers Nicky's direct line is 020 7067 3402 and her email address is nicky.griffin@olswang.com

Employee Incentives - Potential Tax Traps

It is usually essential for an early stage company to be able to offer share incentives in order to recruit high quality executives. This is particularly the case where it is not possible to offer salaries and cash bonuses commensurate to equivalent roles within more well established organisations. In addition, share incentives, if appropriately structured, can act as a valuable tool for aligning the interests of the executives with those of the investor.

Unapproved Share Option Schemes

Until a few years ago early stage companies would have established an unapproved share option scheme. However, from a tax perspective this is now highly inefficient: executives are subject to income tax at 40% (plus an additional 1% employees national insurance from April 2003) and employers are subject to national insurance at 11.8% (increasing to 12.8% in April 2003) on the difference between the value of the shares on exercise of the option and the option price paid.

There is no mitigation for the length of time the option is held and business asset taper relief for capital gains tax ("CGT") purposes can only start to reduce any gain in value in the shares once the option is exercised. Many companies are still operating these schemes and if an investee company does still have such a scheme thought should be given to replacing it with the alternatives discussed below, particularly if there has been no significant change in the value of the company since options were granted, which unfortunately in the current climate is too often the case.

EMI Schemes

Today most early stage companies will hope to be able to grant options under an Enterprise Management Incentive ("EMI") scheme. EMI schemes were introduced by the Government in 2000 and offer substantial tax breaks for both employers and executives. The Government's aim in introducing the EMI scheme was to help "small, high-risk" companies attract and retain employees.

Unlike any other option arrangement, an EMI option is itself generally treated as a "business asset" for CGT purposes. This potentially enables an executive to reduce his/her tax charge from a 40% income tax charge which would otherwise crystallise on the exercise of an unapproved option to a 10% capital gains tax charge which will crystallise only on the sale of the underlying shares following exercise of the EMI option, provided that the period starting on the date of the grant of the option and ending on the date the shares are sold (i.e. following exercise) is 2 years or more.

However, a company whose shares are subject to EMI options must be a "qualifying company" within the EMI legislation. A company whose activities consist wholly or as to a substantial part (generally greater than 20% of all activities) in the receipt of royalties or licence fees attributable to the exploitation of intangible assets will not be a qualifying company unless the intangible asset being exploited was created by a company within the group. This will not always be the case, particularly where the intangible asset has been transferred to the company in question from a university research programme or even individual creators.

Flourishing Shares

A company that does not qualify to grant EMI options should look to issue its executives with what are known as "flourishing shares". These shares have limited rights on issue, but rights such as dividend rights, voting rights and rights to rank equally on a winding up etc. "flourish" in certain predetermined circumstances. These could be on an exit event such as a listing or sale or could be linked to the company's or the individual's performance. As the executive holds the shares from day one, on a subsequent disposal he/she should be able to benefit from business asset taper relief from the date of issue. Therefore, as with an EMI option, he/she has the potential to reduce his/her tax charge from 40% to 10%. Unlike unapproved options, the issue of the flourishing shares is unlikely to result in a national insurance charge for the employer.

As well as the tax benefits set out above a company can ensure by careful drafting of its articles that it only rewards success and does not allow those employees who leave the company or who do not perform well to benefit.

It is essential, however, that the rights of flourishing shares are set out in the company's articles of association prior to issue of the shares and this will require the company to give due thought and consideration to this issue up-front. A little forward planning in this area can reap significant dividends for both the company and its executives.

Survey - Forward Investment Intent

We asked what the view of the Angels was going forward specifically in terms of the overall UK Economy.

Your View on the Economy	Percentage
Improving Markedly	5%
Improving Slightly	30%
Static	36%
Worsening Slightly	18%
Worsening Markedly	11%

Table 8: 2003 View on the Economy in General

> *Nearly 76% of Angels surveyed stated that they would be investing about the same or more in 2003, with 21% planning on reducing their levels of investment, and a further 3% planning to put their purses and wallets away for the foreseeable future.*

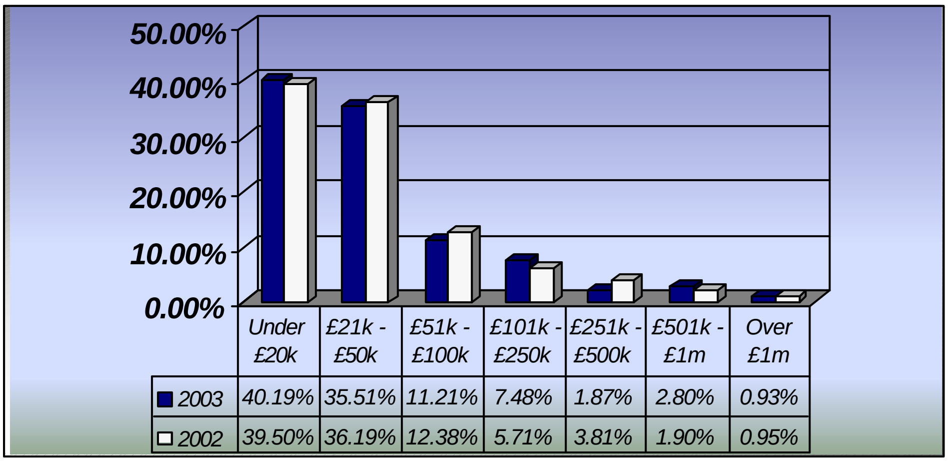
Management Involvement

In terms of looking after their money in a hands on fashion, there was a slight increase from last year's 21% to this year's 22% of those investors still planning on taking **no** active management interest in their investments; a fifth plan to participate fully in **all** their investments, and around 56% will be taking an active role in some of their investments.

Investment Size

After comparison with 2002 it can be seen that the general trend in 2003 is remarkably similar. The most significant areas look to be the planned increase in the £101K-£250K segment, which is balanced out by a similar fall in the £251K-£500K segment.

Graph 10: Forecast 2003 investment size



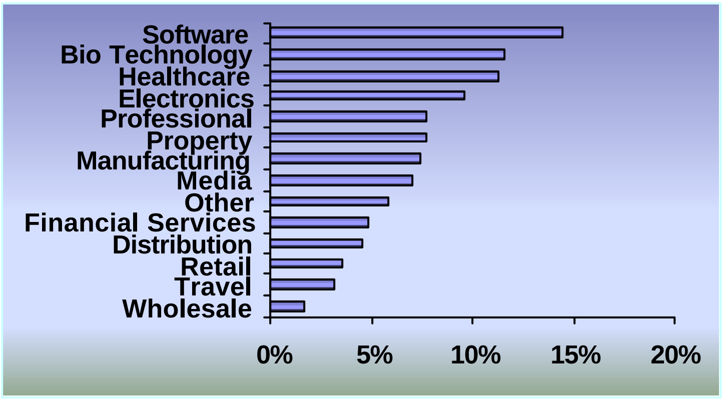
Hot Sectors for 2003

We then asked Business Angels to identify the sectors in which they would be most likely to invest in during 2003; the results of which are summarised in the chart below. Note that these are not necessarily in the same order as the top 5 sectors identified by the respondents as the most likely to be showing improvement over 2003. This may indicate that investors are likely to stick to what they know, over and above investing in a sector that they rate as a growth one but one that they perhaps do not understand as well.

The top 5 sectors voted by the respondents as most likely to show a marked improvement are in ranked order:

1. Healthcare
2. Bio-Technology
3. Software
4. Professional Services
5. Electronics

Graph 11: UK Business Angel Survey Hot Sectors.



Contribution – 2003 UK Economic Outlook- American Express Bank

We asked John Calverley, who has been Chief Economist and Strategist of American Express Private Bank since 1995 to offer his views on the UK market going into 2003 and to highlight some of the influences expected to impact on the UK from the US. John travels widely dealing with both investment issues and country risk analysis for the Bank.

The UK economy has weathered the last couple of years of world economic slowdown rather well. GDP grew 1.6% in 2001 and an estimated 2.2% in 2002. Not bad for an economy with a "trend" growth rate of about 2.5% p.a. and after growing an average 3% for the preceding 8 years. But the prospects for 2003 are uncertain. Will the US economy pick up again, lifting the rest of the world including the UK? Or are the full implications of the late 1990s stock bubble still to come through, as households in the US and UK and elsewhere cut their spending to try to make up their losses? And how will the UK's unsustainable housing boom resolve itself—with a whimper or a bang?

Most seasoned US forecasters expect a rebound in the US economy later in 2003. Policy settings are very supportive with interest rates of only 1.25% and yet another big tax cut planned by George W. Bush. And, historically, business spending nearly always does pick up about a year into an expansion.

However there are several worries. First, state and local budget cutting will partly offset the Federal stimulus. Secondly consumer spending may weaken. US employment growth has been stagnant in recent months while the boom in American house prices, which has supported heavy consumer borrowing, is coming to a halt.

This issue of slowing house price inflation is a theme to which we will return in the UK. When house prices rise, people borrow more money and some of it goes into spending. The result is a surge in consumer spending and an apparent fall in the savings rate (which is measured as simply income less spending, taking no account of how much borrowing is done). But if, in the following year, households borrow the *same* amount then the *growth* of consumer spending actually slows down. And if house prices stop rising altogether or actually fall, consumers will likely borrow less and spending can actually fall.

So, to return to the US, all the main signs are that the US will pick up but this does depend on the household savings rate staying the same or only moving up very slowly from its current level. And the current savings level is only about 4%, well below the normal 6-10% range. It also depends on business investment recovering. At present business is cautious, both because of the soft patch in sales and because of the threat of war and high oil prices.

In the UK the weakest parts of the economy in recent months have been manufacturing and finance but both should receive a boost from a US pick-up. However consumer spending, the mainstay of the economy in 2001-2 boosted by 'mortgage equity withdrawal' from the booming housing market, is probably now in a weakening trend. Data for the last months of 2002 already point to a slowdown in spending and, with house price inflation likely to slow to a crawl during 2003, consumers will pull in their horns. As in the US, the household savings rate is unduly low at present, close to 5.5% compared with an average of 8% in the last two decades, so again consumers could be a drag on the economy. The optimistic view would be that the savings rate could return to normal over a several year period, too slow to seriously damage the economy. Pessimists worry that it could happen in just a year or two, which could severely slow the economy.

So inevitably there is a range of possible outcomes and plenty of uncertainty.

"At American Express Bank we are forecasting a moderately positive result, a solid US recovery in 2003 and, for the UK, GDP growth of 2.2%. And we expect the Bank of England to keep rates at 4% for the first half of the year and then push them up by about ½% later on."

But there are downside risks too, if the US fails to pick up strongly or if UK house prices go off the boil suddenly. The Bank of England would likely then cut interest rates, good news for investors in government bonds but the stock market would probably swoon first.

Where does all this leave investors? Well there is no doubt that nearly 3 years of falling markets has left stock valuations much more attractive than before. Even so, valuations are still relatively high for the US and only fair rather than cheap, for the UK market. So the UK stock market is vulnerable if the US market falters again, or if the aftermath of the British housing boom brings a home-grown economic slowdown. Still, for the long-term investor, UK stocks now offer an attractive dividend yield and reasonable prospects for capital growth. Since nobody can forecast the markets ups and downs, investors should probably be as nervous about being *out* of the market as being *in* the market. At American Express Bank we are recommending cautious overweights in stock markets generally, including the UK.

Government bond yields, including UK gilts, will tend to sell off if we see a global economic recovery this year, as we expect. Nevertheless inflation is likely to remain fairly muted and the sell-off may be less than some expect, perhaps to the 4.5% range for US 10 year Treasuries and 5% for 10 year gilts. In this environment corporate bond spreads will likely narrow so corporate yields will be more stable overall and therefore relatively attractive. Given the economic uncertainties it will be important for investors to hold a mix of bonds and stocks.

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Survey - Business Angel Comments

We asked the question what should be done to simplify and/or improve the business of Business Angel Funding.

We make no comment on their quotes, and they are produced in full. The following comments and their inclusion into this report do not imply any agreement, shared view or otherwise with the author of the comment by c2Ventures, InvestorPulse, or any of the Report partners. Comments are re -produced in full, without editing save for the correction of small typographical or grammatical errors.

We have provided a selection of comments roughly categorised by type to make for easier reading, where the comment is highlighted, it indicates that there were one of more similar views expressed by the Angels surveyed.

What would help a company get funded?

'Clearly demonstrating who is going to pay for the product or service. I invest in companies who get cheques from customers, but need additional resources to satisfy customer demand'

'You should have an idea of the company's worth before you attempt to offer equity for investment'

'Greater Market Awareness'

'The provision of better support and training so that the management teams have more skill and are more credible'

'Mentoring of companies and availability of mentors to company management'

'Having better management who are committed delivering a return to the smaller share holders'

What could Government, Professionals and Public Bodies do to help?

'The removal of Capital Gains Tax by the Government for private investment into private companies'

'Fast track decisions on Gov Funding - Yes or No. Then a project and potential investors know where they stand'

'Less red tape'

'A standard way of buying shares in a start-up would help compared to the current system where each deal is a custom deal and is then changed completely by the next round of venture capital investors'

'Better tax breaks'

'Matched funds, better government support, easier exit, tax benefits'

'Less regulation pertaining to Angels and advisers'

'Simplify and shorten the process of potential Government funding'

'More government support for SME's'

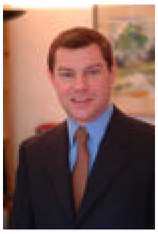
'Transaction costs in IPR based businesses (e.g. Biotech where I am a specialist) are so high that small start-up deals are becoming not worth the hassle. We need some simple agreements between lawyers (TO RUN THE PROCESS EFFICIENTLY) and not to kill the deal at first stage'

'Lifetime investment funds with tax free status rather than have pension/endowment/ISA accounts handled by fund managers. Therefore needs political will for a change'

'Devolved, easily accessible, low cost loans and grants for new technology and manufacturing companies in the start-up to pre-revenue stage. Very strong tax-exempt and bureaucracy exempt environment for new technology companies with less than 8 employees'

'Simpler more uniform access to money, and a removal of the FSA regulations governing the promotion of private business to individuals, in other words, letting business people make their own decisions over what they do with their discretionary income'

Contribution - Government Assistance for SMEs – Nigel Griffiths



Nigel Griffiths is Government Minister for Small Business and we asked him to outline what he thought were the significant milestones that the Government has achieved in supporting the UK entrepreneur and what more we could expect going forward into 2003.

He has not seen or had opportunity to comment on the Survey findings or advice offered by the Angels surveyed.

Over the last year the DTI and its agency the Small Business Service (SBS) have worked hard to make sure that the environment in Britain is right for small firms to achieve their maximum potential. The SME sector is worth over £1 trillion to UK Plc.

Small businesses by their very nature do not have access to the same resources as larger companies, which is why it is so crucial that there is access to quality professional advice and a variety of sources of finance. We are positively affecting ease of access to finance and its availability, at the same time as ensuring that we educate and support SME's through the process.

Access to sources of finance
In terms of developing a nationally recognisable connected network of Business Angels for companies to access, the SBS has provided pump-priming funding of £700,000 over three years to help establish the National Business Angels Network (NBAN).

Furthermore in 2003 the Government will complete the rollout of the nine Regional Venture Capital Funds (RVCF). This marks a major breakthrough in the risk capital market, because it will help to plug the 'equity gap' for small firms with growth potential.

Each RVCF is independently managed by commercial fund managers and provides capital of up to £500,000 to local SMEs with growth potential who have traditionally found it difficult to access the funds they need to expand and improve. Firms have already begun to benefit around the country.

Management support
To support the Entrepreneur and small business, we have introduced the investment readiness pilot scheme. Backed by over £1m of SBS money, six organisations across England will run projects to assess the most effective way for companies to attract new investment. The project managers will look for dynamic small businesses with high growth potential and explain to them all the different sources and types of private sector funding available to them. This ensures a consistent level of affordable support across the country

The Business Link network has advised more companies than ever, boosting profits and providing longer-term stability. We've helped 40,000 businesses to make better use of information technology and embrace e-commerce via the UK on-line service delivered through Business Link operators.

The SBS has also set up the £75m Business Incubation Fund, which provides suitable premises, business advice and other help such as financing options. This type of business incubation provides a supportive nurturing environment and encourages the creation of an entrepreneurial culture through fostering business

Start-ups. 75 per cent of the businesses that start in such incubation projects are still in business after 5 years, compared with only 33 per cent that do not have such support.

Government commitment to the SME

However, SMEs have been telling us that we need to simplify and focus the delivery of government support, so throughout last summer the SBS worked with a number of partners to develop and streamline policy on small business. The new policy framework, "*Small Business and Government – The Way Forward*" that we launched in December represents a significant step forward in tackling the barriers facing small firms and ensuring that policy makers in Whitehall take full account of the views of SMEs when drawing up policy. The strategy, which has the full support of both the PM and the Chancellor is a sign of the Government's commitment to making Britain the best place in the world to start and run a business.

Small Business Service: www.sbs.gov.uk
Business Link: www.businesslink.org

What could the advisors do to help companies?

'More angel investing with service firms to help with the due diligence'

More information sharing by professional advisers with the private investor community and investor groups'

'Developing certain templates (and standard assumptions/guidance on issues like IRR etc.) that would capture 80% of the information necessary leading to quicker decisions about "go or no-go" '

'The market needs the existence of a more prominent and coordinated information distribution service. There are currently too many diverse bodies confusing the "start-up" arena'. Current legal documents are far too diverse and cumbersome.

The development of standard subscription agreement terms and conditions.

What could the VC do to help?

'VC'S need to be more realistic and to act like VC's, not like banks'

'We need better liquidity for angels at rounds two and three. I am severely disillusioned by VC's attitude to Angels. They fail to understand that without angels they will have no second round opportunities. At the minimum second round funding should offer Angels an exit option'

'Venture capital companies (or govt fund run akin to a VC firm) which would syndicate with angels to fund businesses'

'Greater protection for existing angel investors in subsequent VC funding rounds'

Contribution – Sales and Marketing Focus– c2Ventures & GEIF

Paul Gardner has an MBA and the Diploma in Marketing, and has held Global Sales; Marketing and Customer Service responsibilities for a cross-section of listed and start up companies. He is currently Managing Director of c2Ventures, a leading Business Angel network based in London and the South East. Paul is the author of this report. Grant Hawthorne is an Accountant by profession and has a wide range of experience in hi-tech start-up funding, business development, consultancy, and project management gained from stints spent in South Africa, Canada UK and Ireland. He is currently Managing Director of the Great Eastern Investment Forum, a leading Business Angel network based in Cambridge.

Having received over 500 business plans in 2002 between our two organisations there is one constant area that shows ill preparation, or lack of appreciation b y management seeking funding, and that is marketing, sales generation and customer retention awareness.

I am sure we have both seen perfectly adequate business plans in every respect except for the fact that the company is able to articulate its sales and marketing strategy and plan in less than two pages. As Grant says, some companies seem to have no idea on how they are going to win the customer, or keep and serve them once obtained. So we ask the question, have start-up companies learnt their lesson from the last two years?

Recent research focused on the Cambridge based high tech and biotech start up companies conducted by The Great Eastern Investment Forum and the Cambridge office of Deloitte and Touche suggests not, and this certainly backs up anecdotal evidence.

The survey revealed that more than a quarter of early-stage companies spent over 90% of their funding on product development, with fewer than one in five companies spending more than half of funding on market development activities.

The reasonable conclusion; that start -up companies in the Cambridge area would rather spend their cash on product development than on building market share. Furthermore the research showed that companies seem unaware of how to bring their product and services to market, how to create market awareness and at what stage in the development cycle to commence market development activity.

This push to develop products and services rather than build market share was reinforced by findings that most CEOs questioned spent less than half of their time building market awareness, with non-executive directors playing a negligible role

An astonishing one in five companies completely disregards building market awareness until the product or service is ready to be launched.

Research findings also disclosed that rather than create 'next generation' products or services, for which there is a ready market in existence, 57% of companies surveyed are developing totally new products and services with unproven market potential.

There are huge risks attached to this fixation with product development to the exclusion of all else. Needless to say, start-up and early stage companies without a marketing and sales focus fare poorly in obtaining funding, because they are asking the Business Angel to fund something that has no possibility of a return for them, because there is no proven established need, market or customers for the product, and more importantly, no reference customers.

A lack of customers, and therefore revenues also impacts upon the valuation of a company. If there is no plan on how to make the figures forecast in the financials, (remember, lack of faith in the financials is a significant reason why Business Angels choose not to fund a business) then the Business Angel is also simply unable to calculate a valuation with any confidence. Even though revenue based valuations on their own simply do not do it, and are currently out of favour, most Angels still look to revenues as one part of their valuation process, and more importantly, as an indication that a company can succeed in the harsh 2003 environment.

Morgan Stanley Investment Bank (European Stock Selection - The Factors that Matter) gave the results of a recent exercise the bank conducted. It tested, over a 15-year period, the performance of shares based on a number of key fundamental ratios. Market value to sales, and enterprise value to sales ratios proved important in picking good stocks in depressed markets like the one we are currently experiencing. Business Angels know facts like this.

Lack of sales following on from an unfocused or poor marketing strategy clearly affects valuations in the public space just as it does in the private one, just examining the valuations of selected companies in the technology sectors whose sales have been hit recently shows this:

Sector	2000	2001	2002	q12003
Portal | Search Engine (Yahoo)	194x	14x	13.5x	11.4x
E-tail (Amazon)	17x	2.5	1.7x	1.98x
Transaction (e-bay)	71x	19.5x	24x	17.25x
Content (the451, FT.com)	24x	0.7x	0.4x	N/A
Solutions Outsourcing (Sapient)	29x	2.3x	2.2x	1.33X
Networking Solutions (Cisco)	17x	24x	6x	4.9x

Table 9; Sample ICT ratios[7]

So the message we would offer to new firms seeking funding is that you underestimate the importance of hard sales, reference customers, and a commercial marketing strategy at your peril. Lack of thought and direction in this area may well reflect management's core skills in technology and discomfort in the commercial discipline, but you need to have the customer acquisition and retention component in your plan, business and head too. Not to have this impacts on your ability to make a return on your Angel's investment, and also on the ability for you to get a valuation that means anything.

If young start ups can demonstrate that they have worked with their customers, taken their needs into account and clearly demonstrated an appetite for their products and services, they may yet find that venture capital investors and business angels are willing to open their cheque books and back ventures that otherwise would have them voting with their feet.

[7] Source – Observed Valuation Ranges Market Capitalisation / Revenues Bloomberg and Yahoo

In Closing – Bernard Halliwell – Managing Director – NBAN

Bernard has been managing director of the National Business Angels Network since 1999. He is also a director of EBAN, the pan-European business angels' organisation that promotes the use of informal equity in all international contexts, and also of the Business Angel Networks Association, the trade representative body that oversees the development of best practice in the UK.

This survey has set out to establish the state of business angels' thinking in the middle of one of the biggest investment turn-offs for seventy years. 'Great timing' might be an ironic response but it would be wrong. The informal investment market is one of the defining parts of a successful enterprise based economy. It has to work for UK plc's long-term health.

There is much folklore about how to do informal investment. Jon Moulton says it is right to be pessimistic about the outcomes of investments. He's right to remind us how risky business angel investing can be. Risk capital is used for risk purposes. It's important to keep a clear focus on the essential nature of the downsides but it's also important to keep a clear focus on the upsides. One quarter of business angel investments are reckoned to show returns of fifty per cent per annum or more; clearly the best investors know how to spot some very good bargains.

What else do we know? Well, where prudent and experienced investors negotiate well and take active interest in those investments, companies do better and are less likely to fail.

I did not invest in Enron, WorldCom, Tyco, Marconi or Vivendi. But had I invested, the sense of being powerless as those stories unfolded would have been overwhelming. My investment decision would have been based on flawed information. A business angel can get much closer to the people before he makes a decision and exercise more influence after. Looks sensible to me.

Business angel investing has the ability to move much closer to the mainstream. It is thought that around one smaller business in twenty from those already trading is capable of growth better than the average listed company. This is even truer when the strategic benefits of an investor's contacts and experience are added to the off balance sheet assets.

Jon says that a good business plan is not a good investment. That's true too. Many good entrepreneurs plan intuitively and know what to do and when to do it to make the most of their chance – it's just that their business plan document doesn't say it very well. Smart business angels know this and can sort the real deals from the glossy plans that look promising but go nowhere.

This survey has been valuable in getting an insight to the present mood of a large group of Angels, reason enough for National Business Angels to have backed it.

c2Ventures are to be congratulated in originating and promoting it. I hope we can all do something with the findings to make this market a better place for both investors and companies to do more deals more often.

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National Business Angels Network

NBAN is the DTI's chosen vehicle for moving informal investment capital into the mainstream. Its role is to bring together companies seeking investment with investors looking for the right opportunity through a network of skilled Associates. It is the voice of British Angel Capital and an influential part of the European Business Angel scene. www.bestmatch.co.uk

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