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Business angels – possible source of finance for the development of the company in conditions of sustainable development and corporate social responsibility

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***Abstract*— The aim of this paper is to present business angels as possible source of finance for the development of small innovative companies in the conditions of corporate social responsibility (CSR) and sustainable development. In the first part of this paper, we describe concept of corporate social responsibility and emphasize its importance. Later we define who is a business angel and explain why we believe that business angels are suitable type of finance for the development of small innovative socially responsible companies. We give three main arguments in order to support this idea.**

Keywords*— *source of finance, business angels, corporate social responsibility, sustainable development

I. Introduction

The term corporate social responsibility represents a concept focused on increasing the competitiveness and attractiveness of the entrepreneurship. The first efforts of responsible entrepreneurship can be identified in 19th century in activities of Robert Owen from Great Britain, Andrew Carnegie from USA, or Tomáš Baťa and Ján Baťa from prewar Czechoslovakia [1]. Businessmen became more interested in the concept of corporate social responsibility (CSR) in the middle of the last century [2]. Issues of corporate social responsibility and sustainable development are becoming more and more important at the time when humankind must solve problems like global warming, pollution of the environment, need of alternative source of energy and other problems concerning to our environment and society. It is important to start to think sustainable and on strategic level as these questions determine our future and thinking in short run is not sufficient.

World Business Council for Sustainable Development formulates its Vision 2050 as follows: In 2050, around 9 billion people live well, and within the limits of the planet [3]. In order to achieve this challenging vision, already present companies have to understand the need of corporate social responsibility and sustainable development and apply this idea in their entrepreneurships. Later development of such companies is determined by several factors and companies have to face some serious problems and one of the most serious is financing of the company in the early stage of life cycle. In this paper, we would like to propose business angels as one of the possible solution of this problem. We believe that connecting socially responsible companies with business angels might bring symbiotic co-operation favorable for both sides.

II. Importance of existence and development of the companies respecting CSR and sustainable development

The essence of the philosophy of the corporate sociable responsibility is to move from the perspective of the "profit-only" entrepreneurial efforts to the level of "triple-bottom-line" business which is based on social, environmental and economic pillar in order to achieve sustainable, transparent and responsible development. Sense of this philosophy is in respecting legal requirements and moreover in the identification and appropriate meeting needs of all stakeholders which are not required by law [2].

Economic aspect of corporate social responsibility relates to transparent business and good relations with stakeholders. It is evaluated by the impact on local, national and global economy. In the social sector, the company focuses on the approach to employees and the support of local communities what increases the standard of living, security, health, education and cultural development of citizens. Environmental area is oriented on recognition of impacts that businesses have on environment. An enterprise should carry out their activities in the way that keeps the burdening of animate and inanimate nature at minimum level [4].

Unfortunately the concept of corporate social responsibility is not very well developed yet in the terms of permanent changes. The main factor that discourages companies from integration of this concept into their strategy is initial increase of costs, lack of qualified workers in relation to the corporate social responsibility, weak government support and lack of knowledge of the market concerning to this concept. But despite of these disadvantages, companies should realize the importance of this concept and incorporate it into their strategies [2].

However, in our opinion, not only existence of companies which have applied principles of social responsibility is crucial, but also their development and growth if we want to reach sustainable development. Start-ups as innovative small newly created companies and their development are very actual topics in recent times and part of them have already understood the importance of protection of the environment, society and sustainable development. Even the core business of some of these companies is in the areas such as alternative sources of energy and so on. The problem is that start-ups (not only those which are socially responsible) are in the beginning of their life-cycle, they have to deal with several serious problems that cause a lot of them goes bankrupt. List of the most serious can be seen in Figure 1, which shows the results of a survey in which entrepreneurs from SME responded to the question, what are the most serious issues they have to deal with.

Access to finance was identified as the second most serious problem and the severity of the problem is still growing. Newly established enterprises are mostly in the first phase funded by equity of owner of the company, his friends and family. Later, however, these resources are becoming insufficient for further growth and development. Then there is a need to obtain a new source of capital.[1] In the past, this function was performed mostly banks, but the times have changed. The global crisis has caused that banks have very conservative approach now and access to bank loans is therefore much more difficult, especially for small start-ups. They often have innovative ideas, patents and well prepared business plan, but investing in them is considered to be risky because there are no historical data on the performance of the company and the owners often have no experience in business management. Therefore, they face the serious problem of access to finance. We believe that this kind of investors is one the possible solution for elimination of the problem of access to finance. Additionally they help companies solve also the fourth most serious problems with lack of skills.

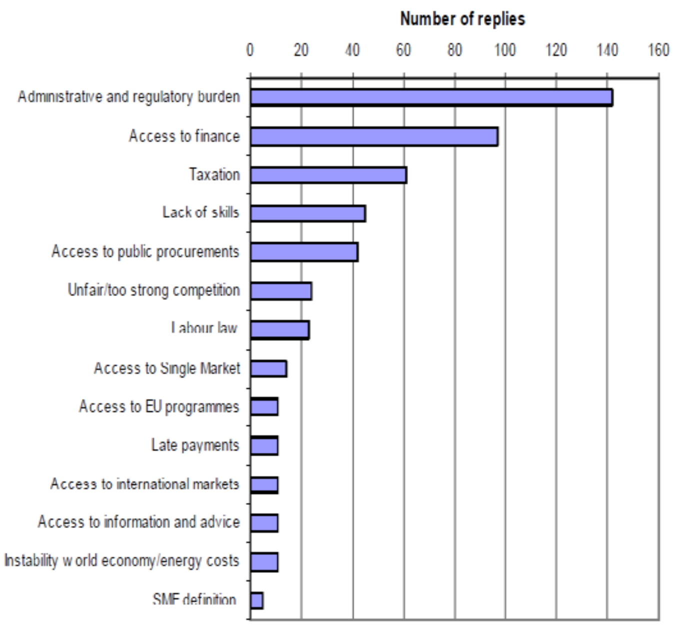

Figure 1 The most serious problems of SME [5]

[1] For further information concerning capital structure in Slovakia see [6]

These two contributions of business angels are valid for wide spectrum of start-ups. Moreover, they have some other specific attributes we will talk about that make them very suitable especially for development of socially responsible start-ups. In our opinion, co-operation of these two subjects could be favorable for both sides. That is the reason why we will pay attention to the business angels in this paper.

III. WHO IS A BUSINESS ANGEL?

Business angels are individuals who invest their available funds in businesses with high growth potential and offer them their rich experience in the same time. These individuals are mostly former successful entrepreneurs who already do not actively participate in the management of the company for various reasons and their main activity is investing of financial capital they have got by selling their companies or shares in companies [7].

European business angels network describes business angel as an investor possessing free capital which reclaims by investing in projects of other entrepreneurs in the early stages of business life cycle. The vast majority of business angels are men, from 35 to 65 years old, who have a successful career as an entrepreneur or manager. Investments of these individual investors ranging from € 25 000 to € 250 000. The investment should not exceed 25% of the total assets of the investor. In addition, the investor is willing to share his business management experience, special know-how and its network of contacts. Time capacity of this informal investor allows him to help the entrepreneur with the managing of the company at least one day a week [8].

As a hands-on investor (investor actively engaged in managing companies) ask for his investment return in the form of partial ownership in the company which secures him share on the profit and the opportunity to participate in corporate governance [9]. Business angel is not a investment collector, but mainly investor who wants to make profit on his investment through selling his stake in the company after certain period of time. However, unlike formal investors, gain is only one of many motives of investment [10].

IV. ARGUMENTS FOR FINANCING SOCIALLY RESPONSIBLE START-UPS BY BUSINESS ANGELS

The aim of this paper is to present business angels as possible source of finance for the development of small innovative companies in the conditions of corporate social responsibility (CSR) and sustainable development. In this chapter we list our three main arguments supporting this proposal.

A. Business angels solve the problem of access to finance

As we already said above, newly created companies are in the first phase funded mostly by equity of owner of the company, his friends and family. Later these sources become insufficient and company needs additional capital for financing of its growth and development. Capital provided by business angels fill the financing gap in the businesses which need smaller amount of capital (generally around € 150 000). This is the reason why we say that business angels form a bridge between the initial internal financing and formal venture capital, which can be used later [11].

The European Commission also points to this fact and claims in its report Benchmarking Business Angels that the importance of business angels in financing start-ups increases, since such investments are too small to be interesting for venture capital funds. Banks used to be a traditional provider of such capital, but as we have already said, their interest in providing loans to enterprises in the early stages of the life cycle has declined [12].

B. Participation of business angel in management of the company

Active engagement in managing companies is the main point that differ business angels from other sources of financial capital. When we compare business angels to other financial sources, there is much bigger co-operation between business angel and entrepreneur. For example in the case of bank loan, bank only provides money and passively waits for payments. Investors of venture capital funds play more important role in defining the direction of the company but involvement of business angel is still more significant. Table 1 shows some of the key differences between investment of business angel. As you can see, business angels emphasize and pay attention to participation in the managing of the company more than investors of venture capital fund and actively monitor the investment inside of the company. More information about venture capital is possible to find in [13].

This feature of financing by business angels might provide companies significant contribution and added value in comparison with other sources. One of the most problems starting companies have to deal with is lack of skills and business angels bring to the company their own experience. We believe that their help in managing company can help them to survive the early stage and grow and develop the business more than other sources of financing.

Also according to Slovak club of business angels is big advantage of these informal investors that fact that their investments are called „smart money“ what means that investor provides company not only financial capital, but also know-how in the area of management strategy, knowledge of specific segment, strategic contacts creating base for faster development of the company.

Table 1 Key difference between business angels and investors of venture capital funds [8]

Key difference	Business angel	Investor of venture capital fund
Person who decides about investment	Entrepreneur	Financial manager
Invested capital	Own capital	Fund’s capital
Investing in	Perspective companies in early stage	Middle-sized companies
Monitoring of investment	Active, inside of the company	Strategic
Demand on participation in management	Important	Less important

More than 40% of business angels agreed with the claim, that their engagement in management of the company and knowledge they transfer into the company are at least as important as money they invest [3].

C. Similar philosophy and motivation

Philosophy and motivation of business angels are in our opinion similar to socially responsible companies. It is typical for business angels that economic motives are not the only one motivator for these investors. Motives of business angels for investment can be divided into three main categories according to authors Sulivan and Miller [14]:

Economic motives – these are primary motives of investment, e.g. maximizing of the profit, maximizing of company’s value etc.

Hedonistic motives– motives connected with satisfying of psychical, such as feeling of self-realization, entertainment, feeling of satisfaction coming from gained successes, appreciation of other people etc.

Altruistic motives – motives connected with altruistic behavior, empathy. For example helping entrepreneurs they remind investor his own beginnings when he has been starting in the previous company.

Also according to the research of European business angel network from 2011, economic motives are not the only factors that motivate business angels. Other investment motives are especially need for personal fulfillment, the need to diversify its property portfolio, the need for self-employment, etc. [10].

Additionally, other point supporting the idea that philosophies of business angels and socially responsible companies are similar is classification of business angels made by Benjamin and Margulis which recognizes separate category called socially responsible private investor. Authors describe socially responsible private investors as investors who look for strong entrepreneurial personalities and require strong personal interaction. They prefer deals oriented to solving of social problems and are ready to accept less profitable offers. The huge amount of money they can invest is often gained through heritage [7].

Moreover, the term business devil emphasizes engagement of business angels to help entrepreneurs they invest in. Business devils are opposite to them. They are persons, who try to act like business angels and at first sight they give impression they really are business angels but their motives are different. Their motivator is the vision of easily earned money or position in the management of the company. Egoism is typical for them, on the opposite to the altruism of business angels. Business devils deliberately give false information about their abilities and capabilities in order to get attention and then the connection with the company. They are dangerous threaten for the company because they are not able or willing their obligations. Another common feature is to invest in companies in later stages of the life cycle, when the company is already well-positioned [15].

We find the similarity of philosophies of business angels and socially responsible entrepreneurs as important fundamentals of their co-operation which would be suitable to both sides. As we already mentioned, business angels enter management of the company so we consider consistent philosophies of investors and original owners as crucial condition for success. Similar way of thinking and attitudes may allow the company growth and maintain socially responsible approach at the same time. On the other hand, enter of new manager with different philosophy may cause disputes between him and original owners.

V. Conclusion

We are convinced that socially responsible approach to entrepreneurship is essential for sustainable development of our society. However not only existence of socially responsible companies is essential but also development of small innovative companies that are aware of need to protect our environment and society. These companies have to deal with several problems during early stage of their life cycle. One of the most serious problems is access to finance. We propose financing of their growth and development by business angels as one of the possible solutions for this problem. We see three main arguments supporting this proposal. First one is that business angels focus on investments in companies in this stage of life cycle. The next one is the fact that they provide except of money also know-how and contacts gained during their which may help accelerate the growth of the company or arise the chance of survive as lot of newly created companies go bankrupt during initial stage of life cycle. These two contributions are generally valid for the majority of investments made by business angels, but similar philosophy with socially responsible companies, the third argument, make co-operation of business angels with socially responsible entrepreneurs even more suitable than co-operation with other companies. This makes also business angels more interesting for responsible entrepreneurs from their point of view.

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