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The development of business angel networks in Latin American countries: the case of Chile

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This article analyses the recent development of business angel networks (BANs) in Chile, in order to understand the limitations of the current public policies to encourage informal venture capital and especially the BANs. We describe the evolution of this policy and apply a semi-structured interview to managers of Chilean BANs. The poor results in total investments in the case of Chilean BANs allow us to understand how government programmes exclusively oriented towards the supply of the informal venture capital market are insufficient to promote the dynamism of this industry. It is necessary to implement articulated programmes both from the supply and demand side, accompanied by the continuous evaluation of their results.

Keywords: investment readiness; informal venture capital; Chile; business angel networks

1. Introduction

Business angels, defined as ‘high net worth individuals who invest their own money, either alone or with others, directly in unquoted businesses in which there is no family connection’ (Mason and Harrison 2011, 5), have long been recognized as an important source of financing for businesses in their early stages overall, at their start-up and in their early growth stages.

Many authors point out the importance of business angels, not only for financing the initial stages of the development of businesses but also for the amounts and the number of ventures financed by them, which are significantly greater than in the formal venture capital market (Mason and Harrison 1993, 1996; Freear, Sohl, and Wetzel 1997). Business angel markets, however, are not developed in Latin American countries (Kantis and Federico 2012) and neither is the venture capital industry (LAVCA 2010). New businesses are basically financed by so-called ‘love money’ (friends and family), with scarce participation of other investors such as ‘business angels’ (Romaní, Atienza, and Amorós 2009). Public policies to promote informal venture capital are very recent in Latin America. In fact, in a pioneering country such as Chile, the creation of business angel networks (BANs), like a form of ‘informal venture capital’, has only been established as an objective of the country’s development strategy since 2006. This public effort, concentrated on the promotion of the capital supply, still shows weak results. Seven BANs were created with public support. Currently, only four networks are active, of which one has become private.

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In this context, our research questions are as follows. How were BANs developed in Chile? Why have they had such poor performance in Chile? What is lacking for the launch of the angel market?

Due to the invisibility of business angels, who act individually, and the lack of information on their activity and results, this article focuses on an analysis of the development of the BANs in Chile, as a visible part of the market, in order to understand the potential limitations of the current public policy to encourage informal venture capital and especially the angel networks. The article describes the evolution of this policy and analyses the results of semi-structured interviews conducted with the managers of the Chilean BANs in 2011.

The results allow us to understand how a government policy oriented exclusively towards encouraging the supply of informal venture capital is insufficient for promoting the dynamism of this market. As in the USA and Europe, Chile needs additional measures oriented towards promoting the demand for informal venture capital, in particular the 'investment readiness' of projects, as well as strengthening the supply by training investors and designing an institutional framework that considers the regional differences, which is more favourable for angel investing.

This article is divided into four parts: the literature review shows the importance of business angels in general and also, in Latin American countries, the governmental impetus to promote BANs and the existing evidence of their effectiveness. Afterwards, the case of Chile is presented, with special attention on the evolution of the public policies oriented towards the promotion of the informal venture capital market. The third part presents the methodology and the fourth part shows the results of the interviews with managers of BANs. Finally, in the conclusion, the policy implications of the results obtained are discussed.

2. Literature review

2.1. The importance of business angels in the funding of new ventures

Business angels are private individuals who invest their money directly in new and small unquoted companies with strong growth potential with which they have no family ties. It is an equity investment made directly by the private individuals, and for this reason this activity is known also as informal venture capital. The importance of informal venture capital is that it minimizes the first funding gap, also called the seed gap, which is between the financing from the 3Fs (founders, friends and family) and the venture capital funds, which do not tend to invest small amounts due to their high transaction costs (Mason and Harrison 1999). The seed gap is usually under US\$1 million in the USA, the UK and other countries. Business angels generally invest between US\$50,000 and US\$1,000,000 in the USA (Wetzel 1994). In the UK, the range is between 50,000 and 500,000 pounds (Mason and Harrison 2011).

The informal venture capital market is also significantly greater than the formal venture capital market, both in terms of the amount invested in the initial stages of the business as well as in the number of deals made. According to the pioneering works of Wetzel (1987), Freear et al. (1997) and Mason and Harrison (1993, 1996), angel investments are 2–5 times greater than venture capital investments and they finance from 30 to 40 times as many ventures.

From 2002 to 2007, the US angel market experienced a modest increase in total dollars invested, but after 2008–2009, it has experienced a huge decline. During the same period of time, the venture capital industry has had a similar trend, although the

decline in venture capital investing did not start until 2009 (Sohl 2010). As a result of the current market movements – basically, the recession – the size of the angel market and venture capital market are virtually identical in 2009 in terms of dollars invested. However, the angel market has consistently invested in more than 10 times the number of deals as their venture capital counterparts (Sohl 2012a, 19). Similarly, the UK market experienced a downturn similar to that in the US market during the global recession (Mason and Harrison 2010), although on a smaller scale, since the size of the UK angel market according to Sohl (2012a) is approximately 5% of the size of the US angel market.

The total angel investments in 2011 in the USA were US\$22.5 billion (an increase of 12.1% over 2010) and 66,230 entrepreneurial ventures received angel funding (an increase of 7.3% over 2010). A total of 318,480 individuals were identified as active investors (20% more than 2010) (Sohl 2012b). In the UK, the angel investment activity of the BANs in 2009–2010 was £50.5 million. The networks had 4555 member angels at the end of 2010 (Mason and Harrison 2011). In Europe as a whole, it is estimated that there were 75,000 angels investing €4 billion in 2008 (EBAN 2009). In Australia, the angel market is smaller than in the USA but larger than the UK market. Angels invested US\$1.4 billion in more than 5000 companies (Gettler 2010). There are also the experiences of countries such as Sweden, Denmark and Italy among others, where scholars measured the market size and scale, showing its importance as a main funding resource for the early stages of ventures (Avdeitchikova 2008; IBAN 2010).

In addition to money, business angels provide their know-how, abilities, experience and networks to the investee businesses (Harrison and Mason 1992; Mason and Harrison 1995, 1996, 2011). For this reason, the money they provide is also called ‘intelligent capital’ (Aernoudt 1999, 2005).

Finally, angel investment is also important because it contributes to job creation. Sohl (2012b) estimated that there were 165,600 new jobs in the USA in 2011, which means 2.5 jobs per angel investor.

2.2. Importance of business angels in Latin American countries

Latin American countries are no different than other economies in terms of funding gaps. These economies present large imbalances in their financial markets and information asymmetries, resulting in financial gaps concerning new business funding. In Chile, for example, Romaní et al. (2009) showed the existence of financing gaps in the early stages, both in the country as well as in its different regions. These authors show that new businesses are basically financed by so-called ‘love money’ (friends and family), with scarce participation of other investors such as ‘business angels’ (Romaní et al. 2009).

According to these authors, on average an opportunity entrepreneur in Chile needs \$18,000 to start a business and is able to gather approximately \$4200 from family and friends, and would, therefore, have an initial financing gap of approximately \$13,800. Considering that the entrepreneur might have access to government subsidies through seed capital from the Technical Training Service, ‘Servicio de Cooperación Técnica’ (Sercotec), the maximum amount that could be received is \$2000. That would still, therefore, leave a financing gap of \$11,800. This situation roughly exemplifies the importance of business angels, considering that they invest smaller amounts compared to formal venture capital investors. In the case of Chile, angel investments range from 25,000 to 2 million dollars, depending on the type of business and its financing needs.

Pereiro (2001) estimated the initial investment and sources of capital for 170 entrepreneurs in Argentina. He found that the initial investment of 43% of entrepreneurs was between US\$10,000 and US\$99,000; 88% of the entrepreneurs used their own savings to start a business, 27% used family funds and only 5% were funded by angel investors. Unfortunately, information is not available for the rest of the countries of Latin America. However, according to the World Economic Forum (2012), 1 of the 10 most problematic factors for doing business in countries such as Argentina, Brazil, Chile, Colombia, Mexico and Peru is the access to financing. In their early stages, businesses are generally financed by the 3Fs. There are government subsidies, but these resources are very limited. Banks do not lend to entrepreneurs when they are starting their businesses. In the case of Chile, there is empirical evidence showing that banks do not lend money to entrepreneurs and generally grant credit to medium and large companies that are already established (Atienza, Romaní, and Aroca 2006; Atienza 2009, 2012).

It is also important to take into consideration that in these countries, formal venture capital is still quite incipient and is basically oriented towards financing the later stages in the life cycle of an enterprise, not the early stages (LAVCA 2010). Therefore, the financing gap in the early stages is a crucial problem, which makes angel investment in these countries important.

Also, angel investors are important not only because they shorten or bridge the financing gap in the early stages, but also because they get involved in the business. That is, they invest not only money but also time, in which they advise and guide entrepreneurs in technical and managerial aspects of how to manage an enterprise, so this money is also considered to be intelligent money (Aernoudt 1999, 2005). This is also important in Latin American countries where one of the problems faced by new companies is the sustainability of their businesses over time. The data from the Global Entrepreneurship Monitor (GEM) 2011 report shows that the rate of entrepreneurial activity in its early stages in Latin American countries is higher than the rate of established entrepreneurs, with more than three and a half years of activity (see Kelley, Singer, and Herrington 2012). This evidences the vulnerability of these businesses over time.

On the other hand, in recent years, entrepreneurial activity in its early stages in Latin American countries has increased (Amorós and Poblete 2012). Currently, there are many organizations trying to encourage entrepreneurial activity in various Latin American countries. In Buenos Aires, Palermo Valley, founded in 2008 via Twitter, is a non-profit organization that connects the Argentine community with the high-tech business community, both within Latin America and beyond. According to Essinger (2012), 'today Buenos Aires is bubbling away with activity, with many interesting tech start-ups and established companies, and a top notch talent pool. Furthermore, Buenos Aires is providing help in the form of subsidies and business coaching'.

Also in Brazil, the government has introduced many incentives to attract business from across the world. Through the 'Lei do Bom' (Good Law), the government offers tax incentives to companies focusing on technological innovation. From 2006 to date, many technological parks have been created with the objective of promoting technological innovation that has been financed by their respective federal states, with various fiscal incentives for research and development.

Chile has not remained behind. In 2010, the Chilean government launched the StartUp Chile programme, with the objective of bringing entrepreneurs from all parts of Chile to set up their businesses in the country. All these measures have contributed to the emergence of new entrepreneurs, oriented towards the technological sector with growth potential.

In this context, angel financing takes on much more importance and becomes a key aspect in the financing of the early stages of a new business. Countries such as Brazil, Chile and Colombia are therefore driving the formation of groups of angels so that entrepreneurs have more alternatives for financing the early stages of their enterprises.

2.3. Public policy for the development of business angels

The first government interventions to encourage informal venture capital activity came to light in early studies carried out by Wetzel (1981, 1983, 1987) in the USA, Tymes and Krasner (1983), and Riding and Short (1987a, 1987b) in Canada, Harrison and Mason (1988), Mason and Harrison (1992, 1993) in the UK and Landstrom (1992, 1993) in Sweden. Those studies showed the potential of the informal venture capital market and its importance in financing the initial stages of new businesses, and also some results of the activity: many business angels did not find sufficient opportunities to invest due to the lack of communication with the entrepreneurs. On the other hand, in the UK, the USA and Canada, there was a decline in the availability of formal venture capital. The venture capital funds stopped investing in the initial stages of new businesses and oriented themselves towards later stages (Mason and Harrison 1993). This evidence gave rise to the first programmes for the formation of networks of angels. Networks tried to match investors who were looking where to invest with entrepreneurs who were seeking financing, and to reduce the existing communication problem.

The UK was one of the first countries to implement a pilot programme in 1992. In Europe, the creation of BANs traces back to 1997, where a study of viability was performed in which, among other measures, the creation of a pilot programme of BANs was proposed (ESBAN 2006). The BANs are groups of private investors who have a common objective: participation in new entrepreneurial projects. The network concept arose from the need of business angels to find a channel for evaluating investment projects, share experiences and professionalize this activity. Angel networks are constituted, therefore, as a meeting point of investors and entrepreneurs.

The European pilot programme intended to reduce the fear that many entrepreneurs have in seeking new financing in private capital and to be a model for organizing the informal venture capital sector. The networks were proposed as a means for activating potential business angels, increasing the transparency of the market and reducing the asymmetry of information. Six years after the pilot programme, there were 282 BANs, led by the UK (101), followed by France (40), Germany (40), Sweden (28), Italy (12), Spain (11) and others (50) (EBAN 2004). The European BAN – EBAN – was created in 1998. EBAN is a non-profit association that acts as a network of networks in Europe, with the objective of leading and representing this sector and increasing the visibility of the value added by ‘informal’ private investment. The BANs have some advantages: these networks are the principal channel of communication between entrepreneurs and investors, they bring together a heterogeneous group of angels with different experience, know-how and investment capacity, they increase the network of contacts and investment opportunities and they reduce the transaction costs of a project. Other advantages of BANs are their greater capacity for satisfying investors’ preference to invest locally, and greater visibility of the activity without necessarily revealing their members (EBAN 2009).¹

In Latin America, the creation of BANs started at the beginning of the 21st century. Chile was one of the pioneering countries in establishing a line of financing for the creation of Angel Investor Networks in 2006. However, in countries such as Brazil, the

networks continued to be private, without government intervention, the same as in Argentina, where the so-called Angel Investors Clubs were created. In recent years, the Colombian government has created a policy for the development of the formal and informal venture capital market, one of the results of which has been the formation of some angel networks in that country.

2.4. The effectiveness of programmes for the formation of angel investor networks: evidence from the literature

Government interventions to encourage the informal venture capital market have basically taken place in Europe after it has been realized that it is a fundamental part of the entrepreneurial ecosystem. The first interventions to encourage informal venture capital took place at the beginning of the 1990s in the UK, followed by the other countries of the European Union in the mid- and late 1990s and by Eastern European countries in the early twenty-first century (Mason 2009). Studies on the effectiveness of these policies are scarce; the principal contributions in this regard are evaluations made in the UK (Mason and Harrison 1999, 2002) and in Belgium (Collewaert, Manigart, and Aernoudt 2010).

In Latin America, the first intervention of this type took place in Chile in 2006. In Brazil and Argentina, the angel networks or clubs emerged in the early twenty-first century by private initiative, while in Colombia, it is known that some angel investor networks were also being formed by private initiative, and in 2012, the government created a programme to drive the formation of BANs. It is not known whether there is an evaluation of the impact of these programmes in Latin America, so in this section, the effectiveness of this type of programme will be described in light of the European experience, where the few evaluations performed have had mixed results.

Harrison and Mason (1996) showed that the result of the pilot programme launched in the UK in 1992 was positive in various aspects such as: mobilization of resources; number of investments; education of entrepreneurs, investors and intermediaries; and the generation of awareness of investment via equity. They also concluded that its impact in terms of the cost-per-job was favourable compared with other forms of small and medium enterprise (SME) assistance. Collewaert et al. (2010) also positively evaluated the government's programme to support BANs in Flanders, Belgium, in terms of added value and the creation of jobs by BAN-backed companies, and the indirect effects achieved, such as education and training, and post-financing. Despite the positive evaluations of these programmes, there is evidence that their impact has been limited (Mason 2009). Mason and Harrison (1999) show that most of the investors think that BANs have not provided them with a superior quality of deal and the main reason for that, according to these authors, is that BANs do not have enough critical mass of investors and investment opportunities. Also, the authors link this situation with the lack of resources that the BANs may have to improve their activities and offer better services because the BANs are non-profit organizations with a local or regional focus. In that sense, questions emerge regarding the sustainability of the BANs.

In that regard, Knyphausen-Aufseß and Westphal (2008), building on the studies by Wetzel and Freear (1996), Blatt and Riding (1996), Mason and Harrison (1996) and Liu (2000) affirm that many BANs in North America, Canada and Europe have not had the expected success in bringing entrepreneurs and investors together and offering services that actually provide a real benefit to users. Moreover, even though many European networks have implemented different ways to generate income based on the services offered, they have had serious problems in financing these services and depended

heavily on government subsidies. Indeed, there is no clear evidence of their sustainability without government support (Knyphausen-Aufseß and Westphal 2008).

On the other hand, it is also important to recognize the emergence of BANs operated by the private sector, created on a commercial basis. These BANs, in addition to generating deal flow for their investors, take the lead in the negotiation and due diligence process, charge for these services and so have high transaction costs. Mason and Harrison (1997) did an evaluation of both private and public networks, concluding that the BANs from the private sector are oriented towards another segment of the market, different from the BANs created with government subsidies. Their investments are greater in volume and they invest in later stages. They therefore use different business models that enable them to sustain themselves commercially over time. According to these authors, the support of the public sector is still considered to be essential in creating BANs, especially in countries where this activity is starting up. However, it is recommended to seek an adequate business model that enables their sustainability over time. In this sense, a strong alliance with the Entrepreneurship Centres of Universities could reduce the costs of the networks' activities. These centres could do the market study for the entrepreneurs and would evaluate the business opportunity, while the BANs would basically be concerned with performing the match and achieving the effectiveness of the agreements between investors and entrepreneurs.

3. Chile case study

In order to analyse the performance of the BANs in Chile, interviews were held, from October to December 2011, with managers of four BANs, including a BAN that discontinued its activities. It was not possible to interview three BANs: two of them declined to participate, and the other is inactive and it was not possible to find its former manager.

The interview was structured in three parts. The first was dedicated to the activity performed by the BANs: source of financing, projects financed, rejection rate, sectors of investment, geographic scope and sources of information used to select business. The second part included questions on the investors: the number of partners and their experience as investors or entrepreneurs. In the third part, managers were asked about the challenges and limitations that BANs face.

The results were analysed using descriptive analysis, and for the open questions, we used content analysis by thematic categories (Krippendorff 1980; Neuendorff 2002).

The main limitation of this study is that we were only able to interview the managers of the BANs. It would have been interesting to interview the business angels also but, unfortunately, it was not possible to get information about them because the BANs regarded this as confidential and the investors desired to remain anonymous.

In the next two sections, we present the background of the Chilean case in terms of recent public policy and the evolution of the BANs.

3.1. Programmes to support informal venture capital

The Production Development Corporation, '*Corporación de Fomento de la Producción*' (CORFO), created in 1939, is a Chilean state agency responsible for driving national productive activities. In 2005, CORFO created Innova Chile in order to promote innovation and technology transfer activities. Through this institution, the government made the first public intervention to encourage informal venture capital in Chile. In 2006, a line of

financing called ‘support for business angels networks’ was created with the objective of ‘increasing the investment opportunities of non-institutional investors, who are so important in the early phases of the creation of businesses, and to provide new alternatives for access to capital by entrepreneurs and small and mid-sized companies, in order to develop innovative businesses with high growth potential’ (CORFO 2006, 5). In contrast to the experience of Europe (Mason and Harrison 2001; Roure and San José 2005; Mason 2009) and Asia (Botelho 2005), where the support for the formation of angel networks sought to reduce the equity gap, in Chile the objective of this policy was to strengthen innovative entrepreneurs.

In its initial form, this programme provided support for the organization, formalization and operation of BANs in ranges of investments of between 10 and 250 million Chilean *pesos* (US\$20,000 to US\$500,000), co-financing of up to 80% of the total amount required as a non-reimbursable subsidy, with a maximum limit of 180 million Chilean *pesos* (US\$360,000) that can be requested over three years. The applicants could be individuals, foundations, corporations and investment companies that have their own legal identity and must obtain the commitment of at least 20 potential investors, with total assets of more than 7000 million Chilean *pesos* (14 million dollars) (CORFO 2006). This programme enabled the creation of seven BANs, whose evolution will be discussed below.

This first government intervention was focused directly on the supply of informal venture capital. There were no specific measures on the demand side for supporting the development of informal venture capital. There was a strong investment in the creation and strengthening of business incubators throughout the country and in the support for the pre-investment and initial development of innovative ventures with the support of seed capital to energize entrepreneurship and increase innovative capacity in Chile. In 2010, with the entry of the new government, many programmes were eliminated but others were created, always with the objective of energizing entrepreneurship and innovative capacity in the country. So there arose programmes such as StartUp Chile, Global Connection and Support for the Entrepreneurial Environment and a new line of financing called Flexibly Assigned Seed Subsidy (*Subsidio Semilla de Asignación Flexible* – (SSAF)), among others.

The SSAF is a co-investment program that ‘through the creation of a fund enables applicants to offer Chilean entrepreneurs financing and incubation services according to today’s demands and timing’ (CORFO 2010, 9). This programme could be considered a new state intervention with the objective of promoting the participation of private investors because it involves the constitution of a fund with up to 75% of its support from the state and 25% from private investors in order to make equity investments in small amounts in entrepreneurs’ projects (see the basis for the SSAF programme). It is known that in May 2012, two funds have been established under this programme and are in the process of initiating activities.

As can be seen, the concrete measures for encouraging informal venture capital in Chile come only on the supply side (the BANs programme and, recently, the SSAF programme). On the demand side, no direct policies for developing the informal venture capital have been initiated.

3.2. *Origin and evolution of BANs in Chile*

The informal venture capital market started in Chile at the beginning of the twenty-first century and was based on private initiatives in which private universities had a prominent

role (Romaní et al. 2009). In 2004, *Universidad Adolfo Ibáñez*, in conjunction with its business incubator Octantis and a group of informal investors created the first BAN under the name '*Red de Inversionistas Ángeles de Chile*'. This network also had the support of a World Bank project, with the objective of matching investors and entrepreneurs. That year, the business incubator Genera UC of the *Pontificia Universidad Católica de Chile* created the Business Angels Club to invest in its projects. Within a few months, the two networks had attracted investors, established regulations and procedures and made actual investments of close to a million and a half US dollars.

Subsequently, as part of the programme 'Support of Angel Capitalists Network' (CORFO 2006), the original *Red de Inversionistas Ángeles de Chile* changed their statutes and transformed into 'Southern Angels' in 2006. A year later, two more projects of BANs were approved: one submitted by the School of Business and Economics of the *Universidad de Chile*, called '*Ángeles de Chile, Red de Inversionistas Ángeles*', and another submitted by the private company Incured S.A., '*Red de Capitalistas Ángeles Incured*'. At the end of 2007 there were three BANs in Chile financed by CORFO's Innova Chile programme. All were located in the capital of Chile, Santiago. Two of the BANs were linked to universities. The exception was Incured S.A.

In August 2008, Innova Chile modified the conditions to apply for the programme 'Support for Angel Capitalists Networks'. The operating period for the BANs was extended from three to six years, the co-financing was modified and the minimum number of potential investors that the BAN required was eliminated (CORFO 2008). These modifications attracted two more BAN projects. In December 2008, the BAN '*Red Ángeles DICTUC*', which originated at the Genera UC incubator of the *Universidad Católica*, and '*Chile Global Angels*' of the *Fundación Chile* were approved. One year later, in 2009, the first regional BAN called '*Ángeles del Sur*' was created, with the support of three incubators in the Region of Bío-Bío and with co-financing from Innova Bío Bío.² In 2010, the BAN '*Proyecta Chile*' was created, after new modifications to the programme related to the number of potential committed investors (a minimum of 10) and in the co-financing conditions. So, by December 2010, there were six BANs in Chile, supported by Innova Chile, located in the country's capital, and one regional BAN, supported by Innova Bío Bío, located in Concepción (Southern Chile).

According to information provided by Innova Chile and '*Ángeles del Sur*', these 7 BANs had over 200 investor members in total and in which Innova Chile invested close to US\$2 million. By December 2010, almost 300 projects had been presented in venture forums of which 11.5%³ were financed, with an average investment per project of US \$284,500 (Tables 1 and 2).

'Southern Angels' BAN ended the period of support from Innova Chile and continues to operate privately. It is the oldest BAN in the informal venture capital market and, according to information on its website (www.southernangels.cl, accessed January 27 2012), its members have invested US\$6.5 million in 20 projects, with an average of US\$325,000 per project. In 2010, this BAN entered a process of transition towards a new business model. In 2011, it was constituted as a private group supporting two areas of business: the BAN and the consulting work in the area of innovation and entrepreneurship, with a Latin American scope in its initial stage. According to its president, this new group intends to make entrepreneurship a sustainable private business, focused on enterprises that have the growth potential and willingness to put in the necessary degree of effort required to be attractive to private investors.

'Incured S.A.' BAN also ended its period with Innova Chile and ceased its activities in 2010. The '*Ángeles de Chile*' BAN is currently inactive. '*Ángeles del Sur*', the only

Table 1. BANs supported by Innova Chile and Innova Bío Bío (December 2010).

BANs	Start year	Number of members	Innova contribution (US\$)
Southern Angels	2006	70	460,000
Incured S.A.	2007	35	316,218
Ángeles de Chile	2008	30	359,820
Ángeles DICTUC	2008	30	252,000
Chile Global Angels	2009	18	220,000
Proyecta Chile	2010	10	120,000
Ángeles del Sur	2009	17	N/A

Source: Innova Chile, CORFO and 'Ángeles del Sur' BAN.

Note: N/A = not available.

regional BAN, is also inactive, according to information received from its manager. Therefore, in May 2012, there were only four active BANs in Chile. Three of them are linked to co-financing from Innova Chile and the other has become a private BAN, and all are headquartered in the capital of Chile, Santiago. Currently there is no evidence of the existence of more private BANs in the Chilean market.

4. Results and Discussion

4.1. Activity of the BANs

Three of the four BANs interviewed received financing from Innova Chile and the other from Innova Bío Bío. Two BANs continue with that financing; one is trying to self-finance its activities privately; the other stated that for the moment the BAN is inactive, having not made any investments in its two years of operation and public support was not renewed. At this time, the BAN did not have a way to finance its operations, so it had to suspend its activities.

The managers of the BANs stated that they mainly consult the business incubators, entrepreneurship centres and announcements on their web pages in order to attract investment projects. According to Innova Chile, 58 projects were presented in venture forums, of which only 20% came from incubators (Table 3). The rest of the projects were presented directly to the BAN. This result is striking due to the effort made by the government to promote incubators to serve as a source of projects for the BANs. The low percentage of projects that attracted funding, just 14%, is also striking (Table 3). This figure coincides with the statements of the managers of the BANs interviewed, according to whom the rate of rejection of projects ranges between 80% and 85%. The

Table 2. Consolidated data (December 2010).

	Total
Number of investors	193
Number of enterprises presented to the rounds	296
Number of enterprises financed	34
% Enterprises financed/presented	11.5
Total amount invested (US\$)	9,670,000
Average investment (US\$)	284,426
Total contribution from Innova Chile (US\$)	1,728,036
Total amount invested/contribution from Innova Chile (million US\$)	5.6

Source: Innova Chile, CORFO.

Table 3. Origin of the ventures.

Origin of the ventures	Submitted to venture forums (a)	Raised capital (b)	(a)/(b) (%)
Website of the BANs	46	5	11
Incubators	12	3	25
Total	58	8	14

Source: Innova Chile, October 2010 (data for Incured S.A., Ángeles de Chile and Chile Global Angels).

main reasons for rejection relate mainly to aspects of ‘investment readiness’, such as the preparation of the project and the capabilities of the entrepreneurial team. These reasons include: ‘do not meet the BAN’s standards’, ‘the entrepreneurial team is not very capable’, ‘does not fit with what investors are seeking’, ‘lack of agreement between the investor and the entrepreneur’, ‘the projects do not have a business model or a commercial strategy; they lack management’.

In Chile, there is a generalized complaint about the quality of the projects that reach the BANs (Álvarez 2011). There is still no awareness among entrepreneurs in the country of the importance of equity funding, which is key to reducing the percentage of rejections and strengthening the formal and informal venture capital market. Although there are many workshops organized by business incubators and entrepreneurship centres to improve the presentation of projects, these efforts have been insufficient for projects to attract investment. The entrepreneurs need to be aware of and know what the business angel is interested in and focuses on (Mason 2009). This necessity has become evident in countries where this activity has been carried out for a longer time, such as in the UK, where ‘investment readiness’ programmes were implemented more than 10 years ago in order to improve the quality of projects and their presentation and so that they conform to the investors’ requirements (Mason and Harrison 2001). These types of programmes also extend to other countries in the European Union, such as Ireland, Germany, Hungary, the Czech Republic, Spain and France (European Commission 2006). In Chile, for example, the private organization Endeavour only supports high-impact entrepreneurs,⁴ through mentoring and networks, with long selection processes, but without fully developing all the dimensions of ‘investment readiness’.

The Chilean BANs have not defined a precise sectorial orientation. Two BANs indicated their interest in investing in all sectors, and the other one is oriented towards the information technologies sector. Their geographic scope is also limited. Even though two BANs state that they have a national scope, only one recognized the possibility of investing in regions of the country other than the capital. All the BANs have made investments in the Santiago Metropolitan Region, where their offices are located, and two BANs also invested in other regions, Valparaíso, next to the Santiago Metropolitan Region, and Aysén, in Southern Chile. This result corroborates that business angels invest in their home regions (EBAN 2009). Despite the development of information and communications technologies, distance is still a significant factor for investing (Mason 2009). This trend is reinforced by the Chilean geography, a country nearly 4000 kilometres long from north to south, and with limited development of transportation infrastructure. Other regional limitations mark the importance of decentralizing some pro-entrepreneurship programmes and policies (Amorós, Felzensztein, and Gimmon 2013). This fact manifests the importance of promoting new BANs outside the Santiago Metropolitan Region, where the country’s principal export activities are located and where there are hardly any possibilities for finding equity funding.

4.2. *Characteristics of investors*

The three active networks interviewed have an average of 25 investors, of which only 1 is a woman. This near total predominance of men among the participants in the networks also occurs in more developed countries (Harrison and Mason 2007). The principal source of information for the selection of BANs members is the group of partners itself. In one case where the BAN had been started in the Faculty of Engineering of a university, alumni were attracted as investors.

The background of the members of the BANs is very heterogeneous. In one of the BANs, 80% of its members had experience as venture capitalists. Another two BANs stated that between 60% and 70% of their members had been investors in the stock market. In contrast, one BAN pointed out that none of its members had experience as investors but had the wealth to be able to invest. This result shows that in Chile, the learning curve of business angels is still in its initial stage. Therefore, policies that favour the creation of BANs are not enough. It is also necessary to strengthen the abilities of their members, since the angel investment process requires having the capacity to deal intelligently with the 'central mysteries' of venture investment, namely pricing, structuring and exiting (Freear, Sohl, and Wetzel 2002). According to San José, Roure, and Aernoudt (2005), a new form of intervention oriented towards solving the problem of a lack of adequate understanding of the investment process by potential business angels (which many times incapacitates them from taking advantage of all the investment opportunities they are presented with) is the creation of business angels schools or angel academies. These would serve as the framework for the exchange of experiences and tighten the bonds of collaboration among them.

The managers also revealed that on average, two-thirds of the members of the BANs have been entrepreneurs, 17% worked in financial institutions and 5% in public organizations. Nevertheless, having this experience is not sufficient for being a business angel. The result is even more worrying when it is observed that there are members of the networks who have never created an enterprise and others who come from the public sector. These data again provide evidence for the need to implement training and education programmes for business angels.

4.3. *Challenges of the BANs and of the informal venture capital market*

The questionnaire included open-ended questions about the principal challenges for embedding the informal venture capital market in Chile. The principal challenges identified by the managers of the BANs have to do with the sustainability of the BAN, the 'investment readiness', the training of the investors, the lack of fiscal incentives and the creation of an organization that represents the networks (Table 4).

One of the objectives of the Innova Chile programme was to support the sustainability of the BANs. For that, the programme financed their activities over a period of three years, which could be extended for three more years based on the goals achieved. However, according to the manager of one of the BANs, the objectives that Innova Chile required for extending the financing period do not conform to the reality of entrepreneurial activity in the country. The entrepreneurs do not present good projects, the rejection rate is high and it is difficult to reach the targets set for the number of projects financed, which weakens the sustainability of the BANs. Also, the cost of preparing projects is high and often is not supported by the financing from Innova Chile. Presently, three of the seven BANs created have discontinued their activity, which could be because the design of the programme did not take into account the problem of

Table 4. Principal challenges of BANs in Chile.

Categories	Selected phrases
Sustainability of the BAN	‘Consolidate the operational and business model of the BAN’ ‘Obtain business models for self-financing of the BANs’
Investment readiness	‘Increase and sophisticate the entrepreneurs who deal with the investors’ ‘Have more cases of success’ ‘That the entrepreneurs arrive with better plans to implement their projects’
Train the investors	‘Sophisticate the investors and staff of the networks in order to carry out successful processes’ ‘That the investors have better project strategies in order to diversify the risk’ ‘Obtain some type of certification of investors’ ‘There is a lack of a risk culture in investors’
Incentives	‘Obtain real tools that facilitate investment’ ‘A tax incentive is needed for business angels’ ‘Give incentives for investment by individuals’ ‘Some tax incentive for investors and the ventures in which they invest’ ‘Tax benefits for angel investment, in order to reduce investors’ risk’
Institutional representation	‘Establishment of a trade union that watches over the activities that are necessary (education, dissemination, lobbying, etc.)’

Source: Authors from interviews.

‘investment readiness’ existing in Chile when setting the goals. This situation highlights the need to supplement the programmes oriented towards strengthening the financing supply with others that improve the ‘investment readiness’ of the projects and that also include the cost of the interaction between investors and the potential entrepreneurs in the preparation and selection of projects, just as has been done in other countries where informal venture capital is more developed and also where the population has higher levels of qualification. Nevertheless, the implementation of these programmes is not enough, as demonstrated by the experience in other countries (Mason and Kwok 2010); their evaluation and continuous monitoring is necessary (Lerner 2010).

Furthermore, the challenge of training the members of the BANs must be faced. The administrators of the BANs are aware of the importance of their members having knowledge of the investment process, an aspect that is ignored by the programme to support the creation of BANs. There is abundant evidence on how the lack of adequate understanding of the investment process inhibits the activity of business angels and prevents them from taking advantage of existing opportunities (Freear et al. 2002; Mason and Harrison 2002; San José et al. 2005). This has prompted many countries to introduce new forms of intervention through the creation of schools or academies of business angels (San José et al. 2005). In September 2010, after four years of research, the Ready for Equity Academy was created in Hungary to prepare business angels – and also entrepreneurs and professionals – in the informal venture capital market of more than 11 European countries (EBAN 2011). In Chile, there is an urgent need to implement initiatives that prepare not only entrepreneurs but also investors.

In addition to training entrepreneurs and investors, another of the pending challenges for the development of BANs, identified by their managers, is the establishment of the

appropriate incentives for investment. Fiscal incentives are one of the forms most used by policymakers to stimulate the informal venture capital market (OECD 2011). Through these incentives, private individuals get tax relief for specific types of investments in specified types of business. There are different schemes for increasing the investors' supply and the amount invested (Mason 2009). Countries such as the USA (Lipper and Sommer 2002), the UK, France, Ireland, Holland, Italy and Japan (OECD 2011) have adopted these fiscal measures. However, there is controversy on the effect of fiscal incentives (Carpentier and Suret 2007). Paul, Whitmann, and Johnston (2003) point out that in Scotland, the tax advantage is the last motivation cited for becoming a business angel. In Canada, Farrell (2000) found that fiscal incentives do not act as motivation for investors. In contrast, in the UK, an evaluation of the fiscal incentive programmes has found a positive impact (Mason and Harrison 2002; Boyns et al. 2003) and a high sensitivity of investors to the level of taxes (Mason and Harrison 1999, 2000). These incentives also present certain disadvantages, such as the attraction of 'dumb money' – passive investors who do not provide active support to the companies invested in or who do not have the necessary competencies and whose results depend mainly on the state of the economy (Mason 2009).

In Chile, there are fiscal incentives for formal venture capital, but not for individual investors or members of the networks. There is a Capital Market Reform project that includes the incorporation of fiscal incentives for business angels, but it has not yet been approved. A system of tax incentives adapted to the country's reality and that really achieves increased angel investment is one of the great challenges for the Chilean government. It must not be forgotten, in any case, that increasing the supply of financing through fiscal incentives has an effect neither on the problem that investors have in finding appropriate investment opportunities nor in the training of the investors themselves.

Finally, the managers of the BANs consider that the creation of an organization to represent their activity is another of the pending challenges. In Chile, the BANs have been created to do the matching between entrepreneurs and investors, but there is no national organization that groups and represents them. There is no Chilean association of BANs that watches over the interest of all the networks and the private individuals that want to be part of that association. In May 2010, the Latin American Association of BANs was created, with the mission of promoting investment in the early stage of ventures through the development of BANs that contribute to the strengthening of an entrepreneurial culture for economic development, the generation of employment and the creation of wealth in the countries of the region (OECD 2011). This initiative could serve as an example for the creation of a Chilean association that provides the informal venture capital market with the appropriate representation and promotes collaboration among BANs.

5. Conclusions and implications

The informal venture capital market in Chile is in its initial stage. The activity of BANs exists, but is still incipient and precarious. Since 2006, seven BANs have been created in Chile, all publicly supported and all of them located in Santiago. Currently, only four networks are active, of which one became private and has a Latin American scope.

Interviews with the managers reveal that the sustainability of the BANs still depends on complementary policies oriented towards improving the 'investment readiness' of entrepreneurs, the training and instruction of investors, the establishment of fiscal incentives and the strengthening of the entrepreneurial ecosystem. Contrary to what has occurred in countries such as the USA, the UK and some European countries, where informal venture capital activity has been carried out for a longer time and policies have

evolved towards a more integral focus that includes the development of the supply and demand for capital and its institutional framework, public programmes in Chile continue to be oriented basically towards strengthening the supply of capital, without taking into account the deficiencies in the demand or the design of a legal and tax framework that contributes to strengthening the supply and making it more sustainable.

The conditions established by the government for renewing financing from Innova Chile have not taken into account the difficulties the BANs face in finding attractive projects. As has occurred in other countries, it was thought that the supply of informal venture capital would be enough to promote the informal venture capital market. The poor results of the Chilean experience indicate that it is time for 'investment readiness' to become one of the main foci of the policies oriented towards the development of informal venture capital. This type of policy is even more relevant in Chile than in more developed countries due to the lower training of entrepreneurs and the scarce development of an equity funding culture. In this sense, the implementation of programmes such as Investment Ready or Ready for Equity is recommended in order to improve deals, increase the investments made by the angels and reduce the percentage of failures. At the same time, support programmes must include the training of angels, who in the majority of cases only have the capacity to invest but do not know the investment process. Both types of programmes, from the supply and demand side, are necessary but not sufficient, and must be accompanied by processes of continuous evaluation of their results in order to adapt the programmes to the national market's own characteristics.

An aspect that has special relevance and that has hardly been considered in the promotion of informal venture capital in Chile is its regional dimension. Because of the north-south elongation of the country and the marked differences in economic structure and population density, it is essential that this heterogeneity and the problems of scale in the peripheral regions, which are also those with the greatest exporting orientation, are recognized in the design of future programmes. It would be appropriate for the programmes to promote the supply of informal venture capital to be based on functional areas within the country in order to align their programmes and resolve the problem of the scale of the local markets. At the same time, the programmes of 'investment readiness' and training for investors take on special importance in the most peripheral regions, where the levels of training are lower and where it has not yet been possible to consolidate any BANs.

Despite the controversy over the efficiency of fiscal incentives programmes to promote the activity of informal investors, there is evidence that some of these programs have positive results when they are studied before being implemented and their impact can be monitored and evaluated. In the case of Chile, where there are already proposals for fiscal incentives for angel investment, it is appropriate to evaluate their design – taking into account the country's characteristics – in order to avoid the attraction of 'dumb money' and to establish mechanisms to evaluate their impact.

Finally, it is appropriate to develop an entrepreneurship ecosystem with the participation of diverse actors, both public and private, in which government, universities and large companies can be involved. The Chilean government has made great efforts in the last five years to create a series of support programmes to encourage entrepreneurship. However, these programmes have been discontinuous. The changes in the government's priorities and the constant implementation of new programmes, without evaluating the impact of the previous programmes, generates uncertainty and mistrust in entrepreneurs. In the last three years, the focus of the new government has been on encouraging entrepreneurship and innovation. Examples of the effort to create a

culture of entrepreneurship in Chile are programmes such as Global Connection, Support for the Entrepreneurial Environment and StartUp Chile. The StartUp Chile, implemented in 2010, aims to attract early stage, high-potential entrepreneurs to bootstrap their start-ups in Chile, using it as a platform to go global (www.startupchile.org). Nevertheless, the existence of a set of programmes isolated from each other is not sufficient. The creation of an environment favourable for entrepreneurship and the investment of venture capital require a set of articulated programmes that supplement the supply and demand sides of investment with fiscal incentives and that are subject to processes of continuous evaluation and adaptation.

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Notes

1. However, there are also a small number of cross-border BANs (EBAN 2011).
2. Innova Bío Bío is the Technological Innovation Fund Committee of the Region of Bío Bío, a pioneering regional institution, born in 2001 as a result of an agreement between the regional government, the Ministry of the Economy and CORFO, and is oriented towards promoting innovation and the transfer of technological capacities in the Region of Bío Bío. It operates independently from Innova Chile. It is important to point out that this is the only region in all of Chile that has an Innova Committee. The other 14 regions are governed by the dispositions of Innova Chile.
3. It is important to point out that as of that date the Proyecto Chile and Ángeles del Sur networks did not make any investment.
4. For Endeavour, a high-impact entrepreneur is one with an internationally scalable project and with a global vision.

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