Return Flight

The tech crash left Germany's 'business angels' wary about investing. Now the country is trying to lure them back to the market.

By Mary Lisbeth D'Amico

MUNICH—Cornelius Boersch remembers when it was easy to be an angel.

During the height of the tech boom, he was one of a host of "business angels" who stepped forward to mentor start-ups, investing in the fledgling companies and passing on their business expertise. In 1999, he recalls, he made deals while teeing off on the golf course. His mobile phone would ring, and a friend would ask him to co-invest in a technology company. "If I heard there were a lot of other 'good names' going in, I usually went right in, too," says Mr. Boersch, the chairman of chip broker ACG AG.

Then the tech bubble burst, many of his deals "went sour"—and Mr. Boersch, like most of Germany's angels, pulled back heavily on his new investments. It was a staggering blow for an investor class that was just getting off the ground. Now many angels find themselves in the same position as Mr. Boersch and his old clique: Many of his angel acquaintances "don't have the funds anymore," Mr. Boersch says, and are leery of jumping into deals.

But the angels are getting a hand from venture-capital groups and the government, who think a healthy community of angels is key to nurturing innovative new businesses. Both government-sponsored and private groups are working to organize and expand Germany's angel class, creating databases of the investors and encouraging angels and VC firms to coordinate their investments and pinpoint promising start-ups.

Men Who Would Be Angels

"Angels" support young companies with private capital and know-how. Below are results of a 2002 survey of 232 business angels in Germany.

Average Investment
- Up to €500,000 ....75%
- €500,000–€1 million 17%
- Above €1 million 8%
- Average €500,000

Percentage Investing in These Business Phases
- Pre-start-up or seed money 38%
- Start-up 45%
- Early stage 25%
- Expansion stage 16%
- Bridge financing....3%
- Management buy-outs or buy-ins 3%

Snapshot of the Angels
- Gender ....95% men
- Average age....48
- Estimated average assets ....€2.7 million
- Average number of investments 3.3

Industry Experience
- Services industry 44%
- Information technology 40%
- Mechanical and plant engineering 30%
- Trade....24%
- Telecommunications 21%
- Electronics 20%

Investment Focus
- Information technology 52%
- Life sciences....22%
- Service industries 17%

Source: University of Applied Sciences and Arts, Hannover. Study conducted on behalf of the Technology Investment Association of the Deutsche Ausgleichsbank, a German government bank.

The hope: "Angels will become more professional, and more entrepreneurs will join in, eventually creating as strong a group as we have in the U.S.," predicts David Amis, author of a just-released book on German business angels entitled "Winning Angels."

Falling Angels

A decade ago, the term "business angel" was unknown in Germany. Then the high-tech and biotech industries took off, luring thousands of investors who wanted to shepherd firms in cutting-edge fields that offered potentially huge returns. During the height of the boom, from 1998 to 2000, 46 regional networks sprang up that allowed angels to regularly meet, exchange ideas and assess companies for co-investment, according to the Business Angels Netzwerk Deutschland e.V., or BAND, an organization sponsored partly by the German government that promotes angel investing.

The shrinking rolls of many of these networks reflect the reduced activity of angels since the tech collapse. **Munich Business Angels** AG, for example, now has only 26 members, down from 65 in 2000. The Business Angels Agency Ruhr now numbers 60 people as members, one-third lower than its peak of 90. Numbers are harder to pinpoint for the many angels not involved in networks. Although government estimates put the pool of active angels at around 40,000—out of an estimated potential pool of 270,000 high-net-worth individuals—many investors believe there are only several thousand active angels out there.

And the remaining angels are clearly more reluctant to invest. While the Munich Business Angels made 14 investments in 2000, for example, last year they made only one. A number of angel organizations are even discussing the idea of putting together formalized funds for angels to minimize their risk in investing.

"Angels have become very cautious," says Hans-Dieter Kleinhueckelskoten, a former consultant and business angel in Essen, Germany. "They have lost money in the stock market, in real-estate investments or from insolvencies" of their portfolio companies.

Tax changes in Germany have made investing even less attractive. Previously, those who took a stake of less than 25% in a company could sell their investment tax-free. But tax authorities have edged that limit down, first to 10% and now to 1%.

Another reason for angels' hesitancy: They're concerned that the companies they back won't find additional funds. The venture-capital industry has retreated from the market, with only €556 million invested in seed and start-up financings last year, compared with €1.2 billion in 2001, according to the German Venture Capital Association. "Follow-on financings via institutional VCs are hardly taking place," says Curt Winnen, chairman of Munich Business Angels. "Business angels are investing very cautiously, or only when they are in the position to finance a second round into that company using just business angels."

The good news is that those investors who remain are much more serious about the business of being an angel, say market participants. Because there are far fewer easy pickings these days, angels now spend more time doing due diligence on possible investments and understand that they must put more time and commitment into a company. Gone from the scene, for example, are consultants who sought to pick up a stake in a company in exchange for providing consulting services. Also absent are "dentists" looking for quick return on investment.

Indeed, some angels are eager to jump back into the fray. The market has been so punishing, they say, that prices are low and only the most determined and experienced people are stepping forward to start businesses. "I'm looking seriously for investments I can work on," says business angel Holger Morbitzer, a former telecommunications engineer based in Pulheim, Germany. "This is a fantastic time to invest."

Some public and private groups are trying to get more angels to join networks. BAND, for example, has set up an Internet exchange and a central database of angels. It will also exhibit for the second time at this year's CeBIT trade fair in Hannover, partly with the goal of reaching business angels or those who want to become one. **BrainsToVentures** AG, a company that offers a range of services for business angels, organizes twice-yearly conferences for business angels in Germany and Switzerland. "We are trying to build a more formalized community," says partner Jan Bomholt. Last year, the privately held company took in €1 million in revenue from membership fees and sponsorship, and became profitable in October 2002.

Not everyone believes the market needs to be formalized, however—particularly those angels who are already well connected. One such angel is Florian Langenscheidt, board member with the family-owned Langenscheidt Publishing Group, who has his own angel investment vehicle, **Translantic Ventures** AG. He has an informal, active circle of some 35 individuals whom he calls on when he needs co-investors. "My interest is in the companies and management; how the angels are organized is of less interest to me," he says.

Many investors say they shy away from participating in organized angel networks for fear that that the government will target them for tax inquiries. "Politicians must work to reduce that anxiety so more people will 'out' themselves as angels," says Mr. Morbitzer. (Over the past year, VCs and angels have been lobbying heavily to lighten the tax burden on investors, but the government hasn't budged.)

Flocking Together

Those angels still in the market are getting some help from venture-capital firms. In the past, angels' interests have often been at odds with those of venture investors. Angels tend to be more patient with start-ups, sticking around for the long haul; VCs, which have institutional investors seeking returns as of a specific date, tend to want quicker results. Although angels often depended on VCs to give their companies later-round funding, there wasn't much cooperation between the two groups.

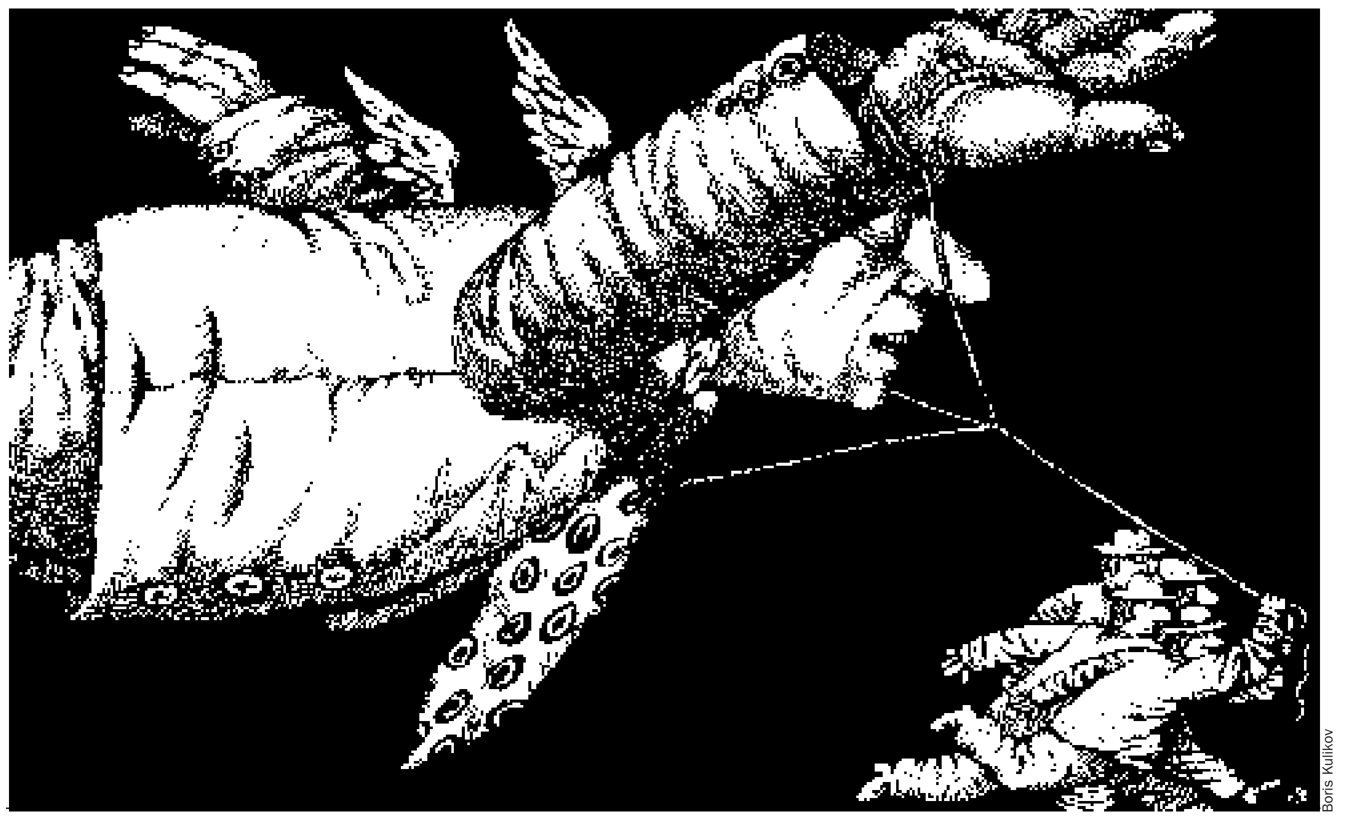
Now, with good companies hard to find, "VCs want feedback from experienced angels" about what start-ups could be worthy investments, says Mr. Morbitzer. In return, VCs can help angels by being upfront about their investment plans.

Last fall, Munich-based investor VC **Wellington Partners** announced an agreement with the Munich Business Angels to share information about deals and co-invest. Deutsche Venture Capital (DVC), a firm with offices in Berlin and Munich, co-sponsored Mr. Amis's book on business angels and in January struck an agreement with BrainsToVentures that gives DVC access to the company's database of 250 angels as well as a look at the deals the angels are working on. In exchange, DVC will act as a sponsor for BrainsToVentures' investor conferences.

One of the goals of the agreement is to give the angels and DVC a chance to get to know each other, possibly leading to greater cooperation on investments. "VCs are looking for ambitious, motivated people to co-invest," says Holger Heims, managing partner with DVC. "We want people who are financially and personally involved."

DVC also hopes to find new angels in Germany's *Mittelstand*, its network of small to medium-size private companies. "We must have a broader base of angels if we want to invest down the road," says Mr. Heims. Without angels to nurture start-ups along, "there is only a narrow flow of good companies making it to the stage where they are eligible for venture capital."

The German government also sees the value in cultivating angels. Although the government has drastically reduced its generous financial support of start-ups over the past two years, it has introduced some new incentives to bring business angels on board as investors.


Boris Kulikov

'Angels have become very cautious,' says one former business angel. 'They have lost money in the stock market' and elsewhere.

The Technologie-Beteiligungs-Gesellschaft, an agency that provides financial support to start-ups, launched a program in 2001 to provide €150,000 loans to seed-stage companies, which includes paying for a "company coach"—an adviser often drawn from the angel class—for six months. The agency also gives start-ups referrals to business angels, and last year co-sponsored the most extensive study of business angels in Germany to date.

And even though it has slashed its support in recent years, the government remains an active sponsor of start-ups—making them a safer bet for investors. When a business angel or VC funds a young company, the TBG takes a matching stake, which is paid back by the start-up. The TBG also gives investors a further incentive to invest by covering half of their losses in the event of a company failure for up to five years.

Mr. Amis, the author, believes the government or a trade organization should help investors further by setting out rules on how VCs and angels should interact with each other.

"Germans expect their government to have a positive and sometimes intrusive role," he says. "A structured approach to angel investing is possible here, one that would make all parties more successful."

Ms. D'Amico is a writer based near Munich who frequently covers technology and venture capital.