POLITECNICO DI TORINO

Department of Management and Production Engineering

Master of Science Thesis

Business Angels:
Review in literature and a case study

Supervisor

Prof. Elisa Ughetto

Candidate

Khamdamov Otabek

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Abstract

Financing of a new innovative venture(startup) is the most important milestone for an establishment and further development. There are different financial institutions that are available for entrepreneurs to fill their financial needs. However, they have different attitude about investments and approach differently to the investment process. For instance, business angels with crowdfunding are financiers of early stage development with small amounts of invested capital, whereas venture capitalists, banks, government funds and other financial entities invest larger amounts in later stages.

Nowadays, business angels are gaining more and more attention because, firstly they are considered, as main source of finance to fill the early stage equity gap which is result of the shift of venture capitalists to later stages and secondly because angels are have capability to offer more than only funds.

On this thesis work the author will try shed light on characteristics and investment process of providers of capital for newborn innovative ventures(startups), focusing more on business angel financing. The work talks about business angels' objectives, characteristics, investment process, invested amounts and invested stages of the development. The thesis also shows invested industries, value building mechanisms offered by business angels. Moreover, it discusses about business angel networks and groups and actions have been taken by governments to improve business angel market. The work also studies Islamic finance and its instruments as an alternative way of financing of enterprises and finally it analyzes a co-fund "Yoshlar Akademiyasi" that is an organized way of bringing government's capital and angels' capital to invest in prospective business projects in Uzbekistan.

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1.Introduction

It is highly considered that innovative small enterprises are very important factor in determining economic growth, productivity, and prosperity of a country. One can observe that over the past some years innovation and new product development shifted from money rich large corporations to small newborn start-ups. This shift has changed the concept of Entrepreneurial finance and enrich it with new entrants such as business angel financing, crowdfunding. By Entrepreneurial finance, it is meant the alternative sources of financing of a new venture. The objective of this literature review is to shed light to the early stage financing of a venture that is seeking for a proper financial institution to fill its equity gap in its lifecycle development with particular focus on Business Angel financing and some new trends of this concept that emerged these days.

The main constraint for Europe's poor performance in starting up and nurturing technology-based ventures is financial one. The recent European Business Panel study showed that "The access to finance remains one of the major business constraints as almost all European businesses feel that national government and/or the European Union (EU) could do more to help small enterprises to get access to finance" (EC, 2003, p. 41). Over the years the Equity Gap of early financing was filled by Venture Capital funds. However, as they specialize more on intermediate and later stages to reduce risk associated with uncertainties in early development, the new institutions: Buisness Angels and Crowd Funding are appeared to fill the financial gap in the early stages of an enterprise. Business angels crate value in a life cycle of an enterprise by providing not only monetary support but also expertise, knowledge, and contacts in an exchange for an equity stake in the business they invest in.

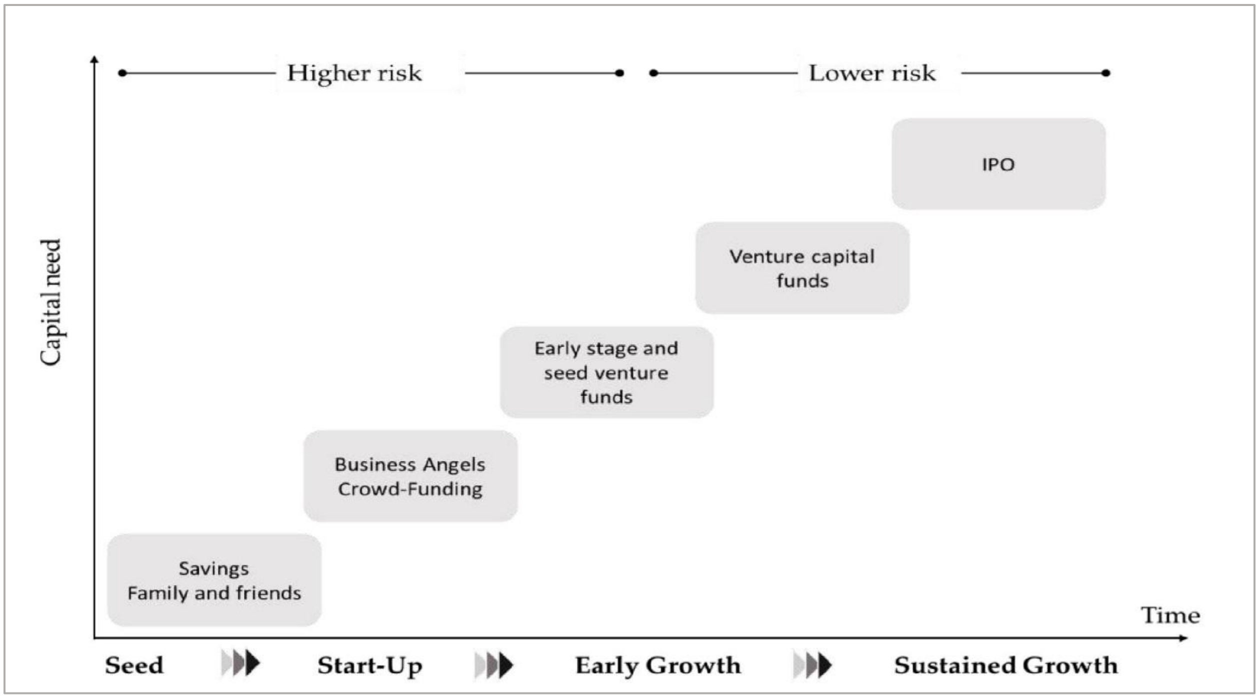


Figure 1.The Chain of Financing (Deffain and Sudolska,2014)

As shown in "Figure 1-The chain of financing", Business angels mainly focus on Start-Up and Early Growth between savings of family and friends on one side and venture capital funds on the other side.

On the following work, the author will try to open up investment process and behavioral differences of business angels relative to other actors of investment market, impact of angel investments on local and country economy, why some sectors of industries are more attractive for business angel investments than others , levers of government interventions to improve angel market and finally will try to talk about a new concept that emerged in the business angel market and analyze as a case study a business angel network that started to operate in Uzbekistan.

2. Entrepreneurial Finance, Innovation, Economic Growth

In this specific paragraph, it is provided an overview of Entrepreneurial Finance, highlighted the main actors involved in and their impact on an economy and in an innovation rate of a country as whole. Moreover, I will try to define their characteristic differences, segment the chain of financing, and assess value building mechanisms they offer and what motives they pursue from investments.

2.1 Entrepreneurial Finance

Entrepreneurship is the process of designing, launching, and running a new venture. While entrepreneurial finance is the study of how to allocate financial resources in the new venture. “The goal of entrepreneurial finance is to understand how managers of entrepreneurial firms can make better financial decisions and solve the funding gap and how managers of financial institutions which are interested in these firms can make better investment decisions” (Ughetto Elisa, Corporate governance and finance, 2019 Politecnico di Torino).

The main actors of entrepreneurial finance, on the one hand, are new ventures(startups) that are actively searching for a financial institution for a financial support, on the other hand, are financial institutions such as Business Angels, Crowd-funding, Venture Capitalists which are ready to support the survivance and further development of the venture for a specific return.

Although the objective of these financial institutions is the financial support with a return, they focus on different stages of the chain of finance as shown in Figure 1, offer different value building mechanisms and have different motivations for an investment. On the following paragraph, it is provided an overview of the actors of entrepreneurial finance and highlights their impact on an innovation rate and a country’s economy.

2.1.1 Startups

The term start-up has to be defined yet but some scholars and entrepreneurs characterize it as , ”A startup is a company working to solve a problem where the solution is not obvious and success is not guaranteed “(Neil Blumenthal, entrepreneur), ”A startup is a young company founded by one or more entrepreneurs to develop a unique product or service and bring it to market”(Amy Fontinelle , Investopedia, Mar 3,2020).

In general, a start-up can be described as a scalable venture with the main purpose of bringing a product to market with some objectives.

Moreover, A startup could be a young venture with a lifetime of 1-2 years or, yet it could be 5 years old but still considered as a startup, so one could not relate startup to a specific time frame. The main characteristics that could be related to a startup are: startup does not have well developed organizational structure even some cases it may not have employees but only owner, it does not have target set of costumers or a target market, it has only a product or a service that is on its an alpha phase which means the product has to be defined and developed.

Depending on pursue startups could be categorized into different categories.

"Table 1 – Main types of Startups "(Corporate governance and finance, 2019 Ughetto Elisa, Politecnico di Torino)

Startups	Objectives	Characteristics	Examples
Lifestyle	Work to live passion	Known market segment, usually not innovative.	Blogger, web designer and so on
Small Business Startups	Feed the family	Not designed for scale, financed by own savings, small business loans	Restaurants, Woodworker, bakery and so on
Buyable Startups	Born to be sold to large companies	Be scaled to a certain amount, and then to be sold	Web and mobile app startups: Google, Amazon.
Scalable Startups	Change the world	Created developed and then publicly traded or acquired	Apple
Large Company Startups	Not to be way behind customers taste and market trend	Creation of disruptive innovation	BMW Startup Garage program
Social Startups	Make the world a better place	Pursue social purpose	Certified, Helperbit

Table 1.Main types of startups

To sum up, a startup is young unbaked venture that is subjected to easy fails.

2.1.2 Finance Providers

There are number of ways for financing a venture. However, an entrepreneur must know the stage of the development of his venture. Because only in that case it is most probably that he will find the most appropriate one. Because pecking order theory of finance says that the stream of financial resources differs according to the stages of development of the venture.

First, we must list financing options that are available for the entrepreneur and then define which one can be used in the particular stage of the development.

In general, financing of a new venture can be carried out with help of two sources of finance: internal finance is a fund of founders, friends and family, or external finance is a fund acquired from outside entities such as: business angels, venture capitalists, banks, non-financial companies and others.

"It is proposed that external finance is more costly due to capital market frictions" (Stiglitz and Weiss, 1981). "Once the internal sources are exhausted, debt will be preferred to outside equity and a new equity will be issued only as a last resort"(Myers and Majluf, 1984).

Moreover, the literature review on who funds young innovative startups suggests that "Innovative startups evolve through the financial development cycle"(A. Bozkaya & B. Van Pottelsberghe De La Potterie (2008) page 5.) that consists of following stages: seed, start-up, early growth and establishment and uses different financing options in each stage.

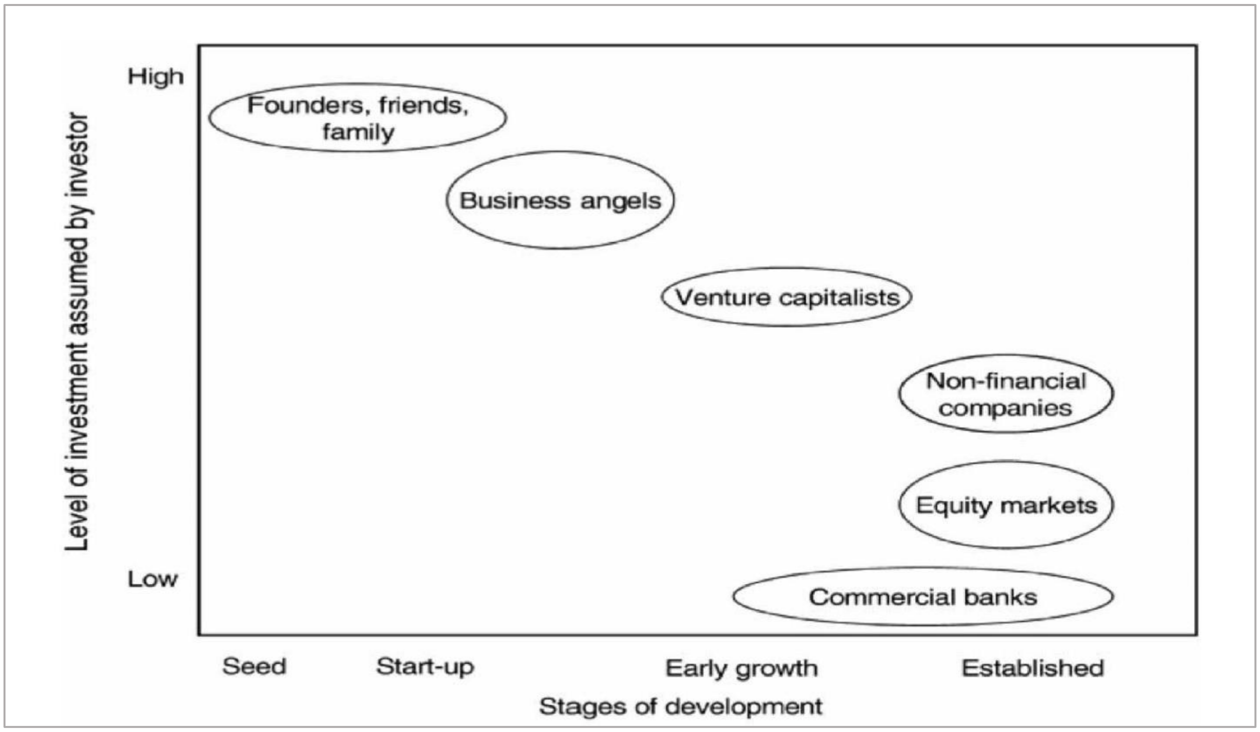


Figure 2.The financial development cycle (A. Bozkaya,Van Pottelsberghe De La Potte ,2008)

In the seed and early startup phases, it is very difficult to obtain external finance due to some issues that will be discussed later on this paragraph, as a rule on these stages, the entrepreneur heavily depend on internal finance. Bergerand Udell(1998) comments that "The evidence accumulated in the last two decades shows that the most available source of initial capital to the innovative entrepreneur is his/her personal savings" The bank of England in 2001 concluded that "Innovative startups heavily depend on internal funds at the seed and startup phases".

In addition, the survey conducted by Bozkaya and Pottelsberghe in 2008 concluded that almost 82% interviewed innovative young startups rely on personal funds as the primary source of finance on seed and early startup stages. The Table 3 "The Capital base of small firms" shows the results of the survey.

Source of Finance	Seed	Start-up	Early Growth	Development
	% of Cases during the Stage of			development
Internal Funds				
Personal funds of founder	82	48	28	17
Family and friends	35	18	12	7
Retained earnings	0	0	5	7
External Debt-Finance				
Commercial bank loans	8	28	40	36
Government sponsored funds	20	33	17	14
Non-financial institutions	1	8	9	10
Other debt finance	1	2	3	5
External Equity-finance				
Business Angel finance	10	20	17	5
Venture Capital	13	26	30	21
Other equity-finance funds	2	2	3	4

Table 2.The Capital base of small firms (Bozkaya and Pottelsberghe ,2008)

It is worth to mention that as the business develops, internal finance plays diminishing role and its capital structure constitutes more external finance until replaced by retained earnings (Figure-3).

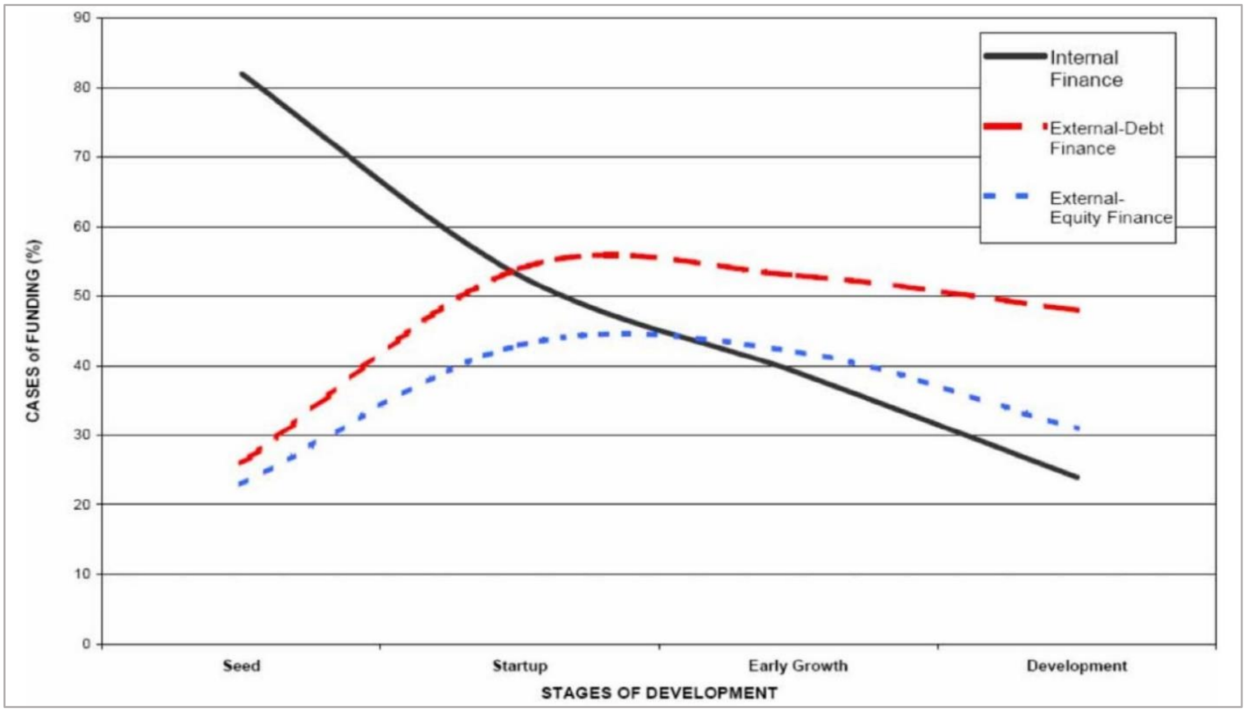


Figure 3.Internal and external source of finance, during the stages of development (A. Bozkaya and B. Van Pottelsberghe De La Potterie, 2008)

Before going into the discussion of external financing participants, we must define some issues that were mentioned above.

Many academic literatures showed that entrepreneurs encounter difficulties to finance their business in stages of the development, but it is mostly seen in the early stages. It is due to risks associated with their business and being unable to deliver proper information to be sufficient to get favor of investors.

As Portfolio theorem suggests, there are 2 parameters that constitute risk:

Systematic risk, “which is a function of market condition or specifically, an uncertainty of gaining a competitive advantage” (Barney 1989;Fiet 1991,1995).Fiet and Porter(1991) comments “Mainly new enterprises are subjected to more market risk than established business simply because they have not yet entered the market”.

Unsystematic risk, which is the firm specific and could be considered as business related knowledge and skills of a management team.

Moreover, the weak debt financing on the early stages is due to lack of tangible assets for collaterals to borrow bank loan, lack of credit history, lack of market information on innovative products while weak early stage equity finance is due to limited government policies to promote investment, limited reliable information, sometimes eagerness of VCs for quick exit, unwillingness to take risk and high return expectations. Finally, many companies tend to avoid the separation of ownership and control as long as possible.

All above listed factors combined determine the characteristics of investors and divide them into categories along stages of development of business life cycle as it was shown in Figure -1.

Moreover, apart from focusing on different stages of the chain of finance, investors offer different value building mechanisms and pursue different objectives. Let us first discuss about three external equity finance providers (Table-3): crowdfunding, business angels and venture capitalists since they are major suppliers of funds on seed, startup and later growth stages as shown on Figure-1.

	Crowdfunding	Buisness Angels	Venture Capitalists
Background	Individuals with no investment experience	Entrepreneurs or managers	Professional investors
Investment Approach	Individual contribution	Individual contribution	Invest investors (limited partner) financial resources
Investment Stage	Seed, Early start-up phases	Seed, Early start-up phases	Later stages
Deal Flow	Open call through the internet	Individual meetings, friends, or Buisness Angel Networks	Social networks, individual meetings, and others.
Due Diligence	Minimal Individuals relay on each other	Minimal mainly relay on previous experience or networks of individuals experience	Extensive Performed by VC
Geographic Outreach	No limit through the internet	Local investment	No limit
Post-Investment contribution	Feedback for a product/service	Contacts and Experience	Strategic coaching while seating on a board seat
Return on investment and motivation for investment	Company stake, some sort of reward	Company stake, personal motivation	Company stake

Table 3.Three external equity finance investors and their characteristics

As for debt financing of ventures, "commercial banks are the main supplier of funds to small businesses" (Berger and Udell, 1998) on early growth and establishment stages. Moreover, there exists other alternative sources on these stages such as: government's funds through loan guarantee programs, public grants , and support programs as like the Italian government's program to tackle Covid-19 emergency for companies under financial distress and others.

2.2 Innovation and economic development

Invention is an act of developing a solution to a specific problem. Whereas innovation can be defined as the "Economic exploitation of an invention and society moves from invention to innovation when an invention is marketed and bought". (Marco Cantamessa and Francesca Montagna, 2016 Politecnico di Torino).

Economic development is economic growth of a country or a community that leads to improvements in the welfare.

The famous economist Freeman (1982) states that "Innovation is critical for sustainable economic growth, for the improvement of quality of life, for the long-term conservation of resources and for the improvement of the environment".

The economic development of a country highly depends on its creativity and ability to innovate. Moreover, the presence of large and highly innovative companies constitutes the wealth of the specific region even within country. Take as an example, USA and European Union both are highly innovative with expenditure on R&D 511.11 billion of US$(2.744% of GDP) and 379 billion of US$ (1.64% of GDP) respectively. If one considers specific region within a country the best example could be California state of US the most innovative state 39139 of patents registered has GDP $2.2 trillion in 2013 hosts the highest number of High-Tech companies and startups(*to compare GDP of Italy $2.1 trillion in 2013). Germany has highest innovation output rate in European Union (Innovation Union progress at country level, European Commission, 2014) and its GDP per capita is one of the highest in European Union 44.976$(United Nations,2017).

In fact, all examples demonstrate that there is direct relationship between innovation and economic development of a country because innovation pushes country's economy by

- Creating new products and industries
- Creating new job positions and improving efficiency of existing ones
- Exploring country's competitive advantage and boosting export potential

2.3 Conclusion

To conclude, all discussions so far were to come up to conclusion that innovation is the very essential determinant of the development of entire economies and their competitive positioning. That is why innovative start-ups, new ventures with radical innovative ideas are often called the Engines of Growth and the entrepreneurial finance is the mechanism that actives that Engine.

3.Buisness Angels

Business angels are important for an economic growth and reducing unemployment rate. As, it was mentioned above angels constitute the largest portion of funding after family and friends for new ventures. It is considered that business angels are very important in providing risk capital and business experience for newborn companies, which increases the potential of survivance and development of them.

Moreover some authors also consider that "the supply of startup and early stage finance become more dependent on business angels" (European commission, Fostering Business angels) who compensate market failure "Equity Gap" on these stages . This is due to inability of venture capitalists to provide risky finance for small ventures in early stages and their shift from early stages to later ones to reduce risks associated with investments.

Statistics of European commission on impact of angel investment on employment showed that a company's number of employees tripled in just 3 years after business angel investment.

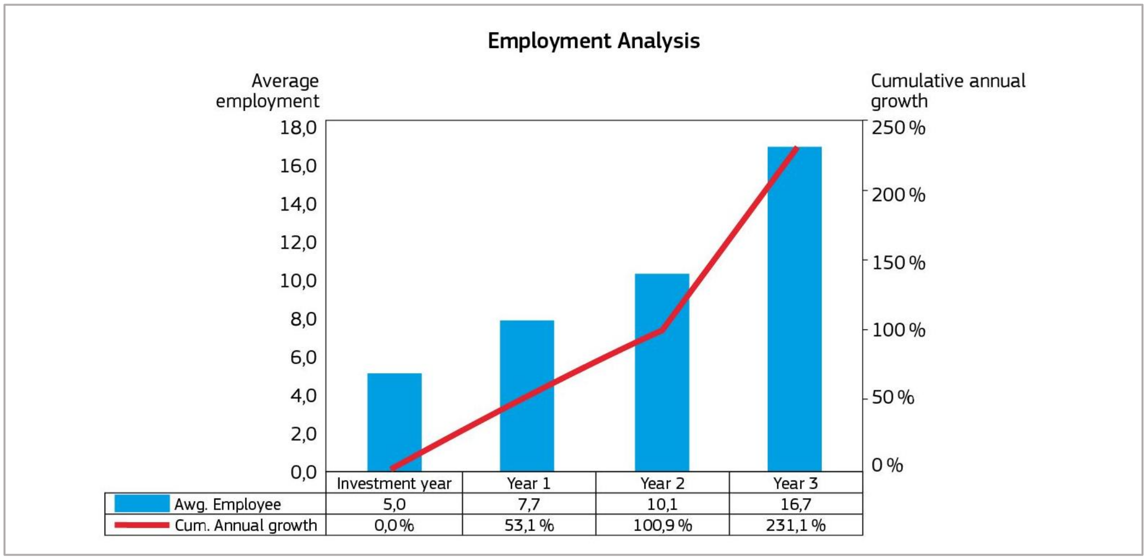


Figure 4.Impact of business angel investment on employment (EBAN and Business Angels CRECER+)

Moreover, the report of European Private Equity and Venture Capital Association showed that the total amount of early stage investment in 2013 was 7.5 billion euros in which 5.5 billion was contributed by business angels, 73% of all contributed capital on the stage. They invested in 33 430 business and crated 184170 job positions.

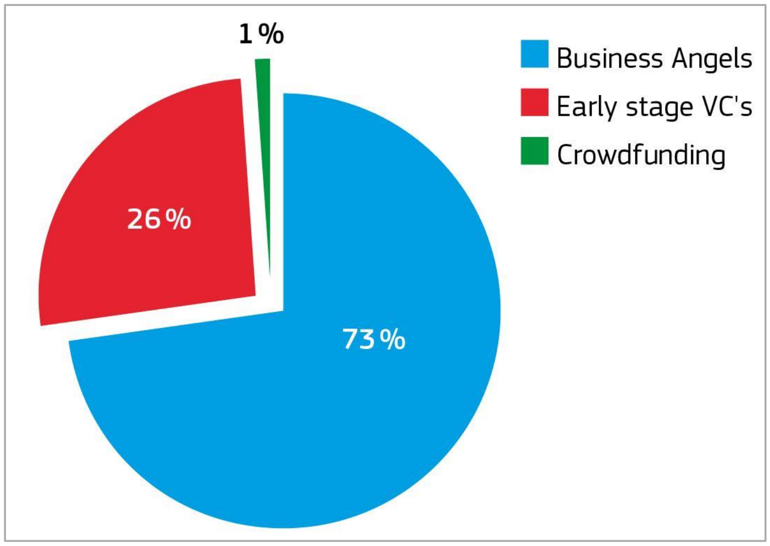


Figure 5.Early stage investments in 2013 (EVCA and EBAN statistics 2014)

While, in US angels invested 24 billion dollars in 64000 startups in 2016 (Laura Huang, Andy Wu, 2017).

3.1 Definition and Characteristics

The term Buisness Angels comes from private investors providing the seed capital needed to launch a new musical scene on Broadway in New York. In return, they received part of the financial outcome from the scenes. The term first was used by William Wetzel to describe investors 1978 who supported new entrepreneurs to develop their businesses.

3.1.1 Age

Business angels are middle aged private investors who provide financing and support to unlisted businesses. In general, the average age for business angels varies from 40 to 60 years old (Markku Maula, Erkko Autio, Pia Arenius,2005). The study of Laura Huang (University of Pennsylvania) and Andy Wu (Harvard Business School) carried out on 1659 US angels concluded that the 32% of investors were between the ages of 50 to 60 and 30% were between ages of 61 to 70.

3.1.2 Wealth

As a rule, business angels are quite wealthy people with a high continued secure income (Markku Maula, Erkko Autio, Pia Arenius,2005) who invests on average 10% of the wealth as an investor. A high level of a secure continued income allows them to make risky investments without being afraid of consequences and to sustain economic loses. One of the surveys that consist of 74 buisness angel respondents conducted by Colin M. Mason and Richard T. in 2002 showed that in UK 71% of total respondents had net worth more than £500000 and 62% of them were millionaires. In terms of income, 12% had £250000 or more, 43% were in the £100000±£249000 range with a further 39% in the £50000±£99000 range. Moreover, sometimes apart from high income, they might reinvest funds from sale or cashflow of their own buisness.

3.1.3 Background

In general, a typical business angel has a secondary education and professional experience. Moreover, literature review also suggests that the informal investment is a male dominated activity. The survey of Laura Huang and Andy Wu on 1659 American angels showed that 77.9% were male.

Most of the business angles have experience in senior management of large corporations, companies or are involved in a business activity in their careers. In addition, the literature review also suggests that, some of the angels are founders or co-founders of a business venture.

3.1.4 Motivation for an investment

There are different motives for business angels' investment apart from financial income. The survey carried out by Pierre Marro and Luuk Borg for European Commission showed that an angel investment is more concentrated to benefit society and the economy rather than enrichment and personal motives. Although, financial income plays a crucial role for an angel investor, most of the angels are motivated to be involved in prosperity of someone or personal motivations such as stay involved with business, to be active in retirement or at least to have fun with money.

3.1.5 Investment amounts

As for the invested amounts. It has already been said that mainly business angels fill the gap between the owner's own capital, family and friends and early venture capital investment with an average investment amount of $20000-$100000(Ughetto Elisa, 2019). For example, one of the Russian BAN "Moscow Seed Fund "reported that in 2014 the four most active investors on their network were ready to invest from $25000- to $500000. It is worth to mention that the research of Pierre Marro and Luuk Borg showed invested amounts by European business angels are country specific and varies widely across borders. The results on Figure-6 shows that Germany, Austria, and Benelux business angels invest relatively more than other countries of the Union. I dare to suggest that it is due to fiscal policies introduced and GDP per capita of each country. Since the research of Laszlo Szerb, Siri Terjesen, Gabor Rappai suggests that "economic prosperity of individuals, high level of entrepreneurship education and government support are factors of informal investment".

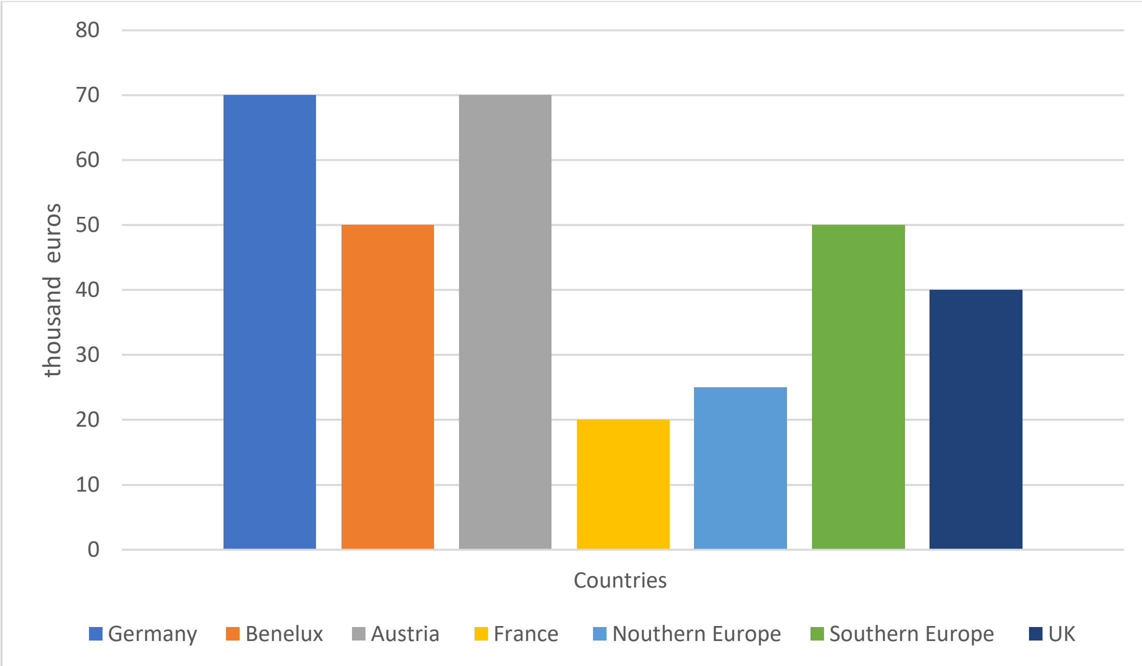


Figure 6.Median size of investment (European commission)

3.1.6 Other forms of support

In general, apart from financial support, buisness angels offer different forms of strategic, networking, monitoring and control support thanks to their prior entrepreneurial and managerial experience for a new business at the seed, start-up, and early growth stages. To be as efficient as possible at support they usually invest in those industry sectors that they have some experience. It worth to mention that non-financial supports diminish over time as the business becomes more mature and self-sustain. Some literature also put forward that there is so called a lead business angel who frequently involved in the day to day business and keeps in touch in weekly basis rather than monthly or quarterly basis as usual angels do.

The non-monetary contributions offered by BAs:

1.Strategic support – relaying on their current or prior entrepreneurial or managerial experience, BAs play major role in the decision-making of the company.

2.Networking - BAs are very helpful in building suppliers and customers network; in addition, they could be useful to attract new investment stages for subsequent funding and help with marketing, administrative and legal issues.

3.Supervision - To protect their investments, they contribute their knowledge and expertise to avoid mistakes in the corporate governance of the company.

4. Other benefits – co-working spaces, hiring people, office facilities and others.

3.1.7 Time spend on angel activities

In general, time spent on engaging with invested firms depend on the number of portfolio firms. The report of European commission on business angels says “Business angels with one firm in their portfolio report spending 39 hours per month on their business angle activities, this increases to 58 hours per month for those with 6 to 10 firms in their portfolio and up to 79 hours for business angles with more than 10 firms”.

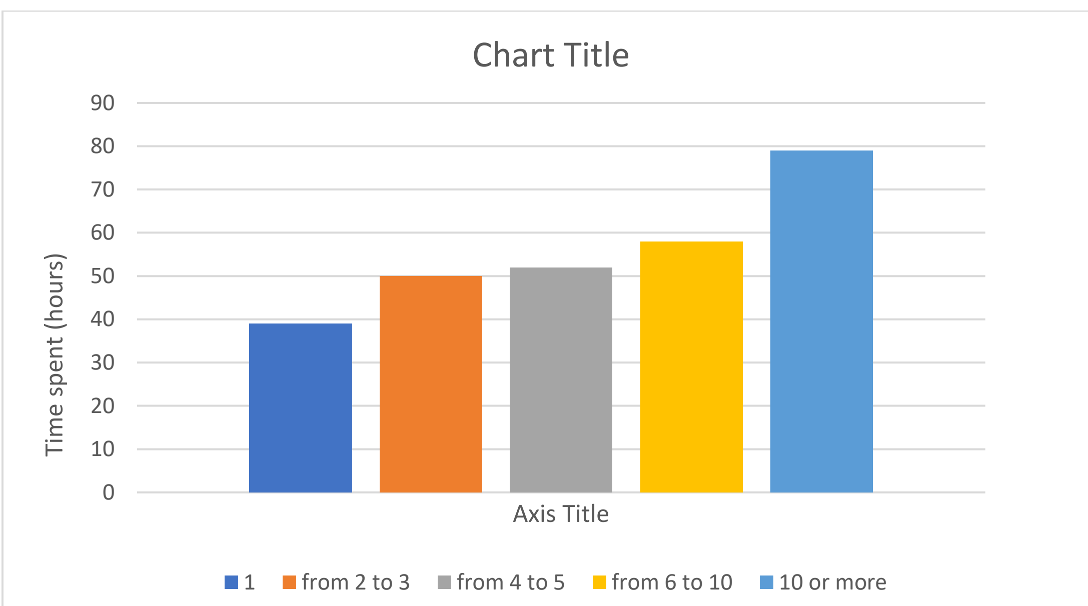


Figure 7.Time spent on BA activities by number of firms in investment portfolio (Report for European commission)

3.2 Deal Flow

The most important prerequisite for the financial success of a business angel investment is a careful selection of a project for an investment. Business angels approach the selection of projects very carefully and rely primarily on information of business angel networks, existing contacts, family, conferences and business gathering, incubators, local banks because it is unknown which of the project has a chance to turn into the first-class innovative company, or which one will fail. It was reported in 2016 by The European Trade Association for Buisness Angels that every 100 buisness plans received only 7 get funded.

The procedure for analyzing and selecting projects can vary greatly depending on the sector of the business, the preferences and country of origin of the business angel, the invested amounts, and others. But the literature review suggests that there are some investment pre-requisites that are common for many BAs.

3.2.1 Sector of investment:

Nowadays, ICT industry is predominantly preferred by business angels specifically software services such as cloud-based software, e-commerce, and of course mobile applications. Among non-ICT industries, biotech and life sciences and manufacturing are most favored ones.

However, a sector is not a prima interest of angel investors they rather invest in the entrepreneur and team and then to a good idea. In addition, sometimes they want to diversify their portfolio of investments among different sectors as a part of strategy and may invest in industries that brings benefit to society rather than economic wealth to an investor such as: social impact investing.

So, the sector is not an aim of angels but is an option. Due to, ICT sector is growing very fast, needs less investment amounts compare to other sectors and there are a lot of good investments ideas, it predominates over other sectors in deals amount.

The pie chart (Figure 4) represents sectoral distribution and investment amounts on percentages on each sector by European business angels.

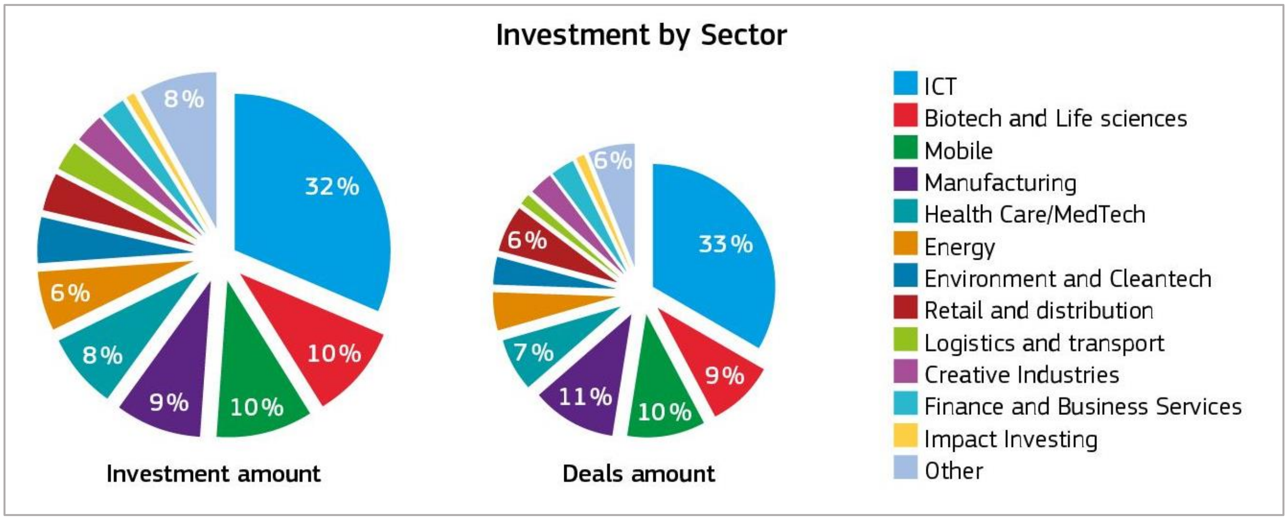


Figure 8.Sectoral distribution in 2015 by investment amount and number of deals. (European Commission Fostering business angle activities in support of SME growth,2015)

3.2.2 Development stage:

Almost all research carried out has highlighted that the business angel investment is the seed and early stage investment because of their character and attitude toward investments. As an evidence European Early Stage Market Statistic suggests Figure 9, that shows in European countries, seed, early and startup stages receive the most of angel investments.

The reasons for this:

1. “Usually BAs use massively tax breaks” (Ughetto Elisa, 2019) to increase return on investment. Many countries such as UK, France, Germany, other European countries and Central Asian countries such as Uzbekistan offer different tax incentives for the seed and the early stage investments to attract funds that lack

because other entities like VC, professional investors don't want to invest due to high risks.

2. As, I mentioned above some angels prefer to be actively involved in the development of the business from the beginning till a successful venture and take excitement from being a part of it. Moreover, they have strong commitment of being a leader and invest into companies that need very much help. In addition, these stages are a good university to study investment work, and some inexperienced business angels can learn more about the investment process itself.

3. Investment in these stages is associated with high risks but also with very high return and with lower sums of investment that is favorable by angels.

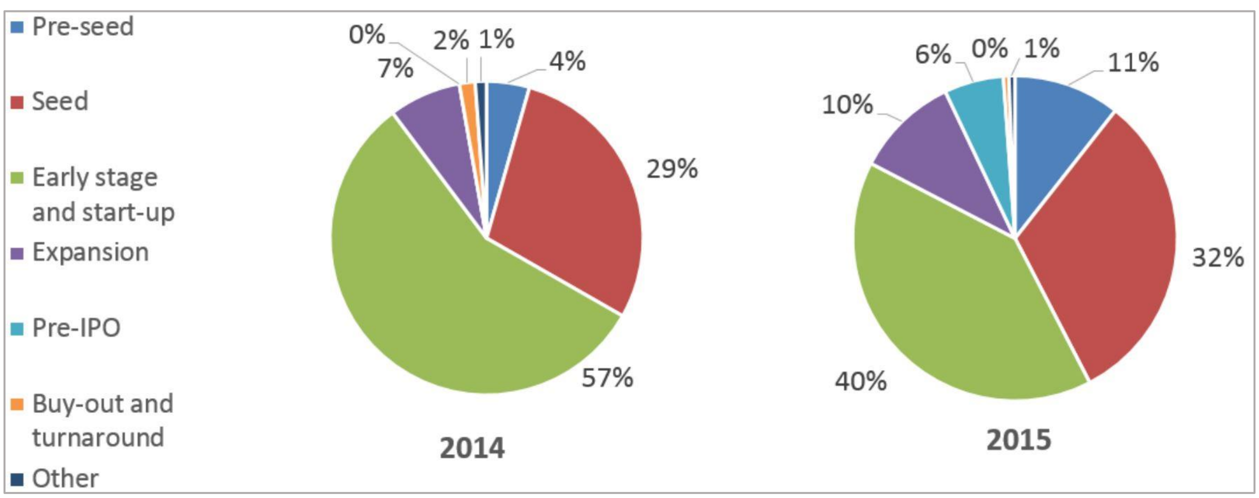


Figure 9.Investments by investee's development stage 2014-2015(European Early Stage Market Statistics, 2015)

3.2.3 Location of the investment:

The literature review and some statistics suggest that the buisness angel investment is most likely to be a local investment within one hour of travel from the investor's residence. However, some business angels are represented their readiness for long distance investments and even cross border investments in case of suitable legal and fiscal policies that facilitate it.

The main reasons that favor angels for local investments are: (1) Most angels choose local investment opportunities that are one hour drive distance because they want to be actively involved in the management and strategic decision making process of the company; (2) Moreover, most them tend to co-invest with other BAs to form syndicates through local personal contacts so co-investment most likely to occur in the locally environment; (3) A long distant investment leads to high search, negotiation and monitoring cost that reduces return on investment; (4) Experienced BAs tend to invest locally since they have well developed local personal networks through which easy access to potential opportunities guaranteed; (5) Since the relationship between two parties build on mutual trust BAs favor entrepreneurs that they have known prior or that operate in the businesses that are familiar to angels and this more likely to occur locally;

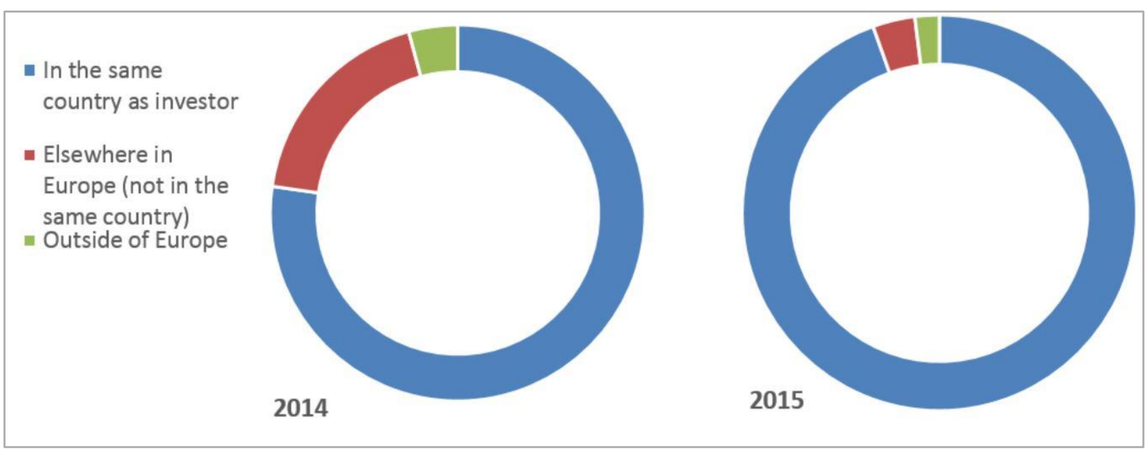


Figure 10.Investment by Location 2014-2015(European Early Stage Market Statistics, 2015)

So far, we have discussed some common elements of the many BAs for their decision-making process. In fact, there is a conventional Funding Funnel that consists of three stages (pre-screening, screening, due diligence) of evaluation of the businesses after which the successful gets funded.

3.2.4 Funding Funnel

Pre-screening is the initial stage in a search for competitive projects. The main sources of information about them are their descriptions received by the investor. On general, the investors search for projects through venture capital investment and buisness associations, personal contacts, banks, or buisness angel networks. The general criteria for a decision making during the pre-screening phase is based on the followings:

1. General impression of the proposal: the idea(concept), geographic location, industry, innovativeness of the proposal (traditional local non-innovative services are the main candidates for the rejection), competitiveness of the product or service, investor's opportunity fit, market potential and a social impact.
2. The investment amount: some angels are more reluctant to reject because of a high invest amount needed.
3. The investment stage: The business could be in its too early stage.
4. The market size: it must be big enough.
5. Quality of a buisness plan
6. IP protection and reliable technology

The procedure for analyzing one project in the pre-screening phase takes little time, and decision is based mainly on angels' own knowledge and experience or in case of BAN on the decision of the crowd. Usually at this step approximately 70%-90% of the projects are rejected.

Screening is the second stage of evaluations and BAs on this stage are more concentrated to evaluate the entrepreneurial team and chemistry between BAs and entrepreneurs. Usually entrepreneurs are given 10-20 minutes to pitch their projects and then answer to some questions. After, only successful projects have the chance to present their project in detail which usually takes approximately an hour. On this stage evaluation is based on the followings and about 87% projects are rejected:

1. Organizational plan: the organizational structure, educational and professional background of the team and age of each member.
2. The entrepreneur: educational and professional experience, age, management capabilities, passion to the project.
3. The buisness model and product evaluation: value proposition, customer relationship, customer segment, resource and capabilities, potential channels of distribution, growth prospects, brief description of the product or service, product attributes and competitive advantage of the product, minimum viable product and the test results of its use.
4. Financial evaluation: break-even analysis, liquidity analysis, preliminary cash flow analysis, projected sales, the cost and pricing model.
5. Marketing Plan: market analysis and market segmentation analysis, potential clients (may be invited on pitch day), potential competitors, product positioning, potential market growth and expansion plan, expected market share.
6. Operational plan: activities carried out and stake holders involved in.
7. Presentation evaluation: Quality of the presentation, pitch and preliminary buisness plan.

Due diligence is a process of "thorough examination" of a project by gathering additional information on the project and validation of it. The stage can last for several months and ends with a final decision to start investments or abandon them. The evaluation is concentrated on the followings:

1. In-depth evolution of the business model, growth potential, brief financial evaluation of the project and systematic risk assessment.
2. Understand the technological side of the project, the competitive advantages of the proposed technology, technological risk assessment.
3. The site visits to see properties such as: office, laboratory, production equipment, prototype of the product.
4. Meetings with team members to assess unsystematic risk: The basic principle of business angel investing is that investments are made primarily in the team, and only secondarily in the tangible and intangible assets associated with the project. Therefore, during the analysis of the project, the investor will be interested in the personality of the founder himself and the team. The team of the innovative company being created should contain specialists in every aspect of the project's life such as: research and production activities, management, marketing and product promotion, finance, and reporting. During the stage, a business angel finds out detailed information about each member of the team such as: previous experience in business, experience of success and failure, integrity, dedication to work, strategic vision of the members, professional knowledge and competence, ability to lead and work in the team. The report provided by Directorate European Commission in 2017 says that the most important factors to invest for a project are:

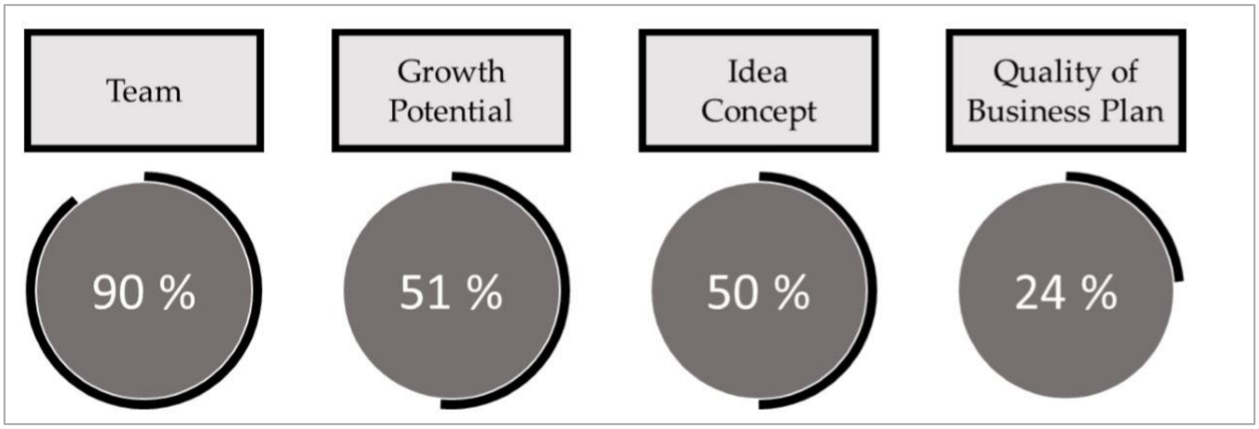


Figure 11.The most important factors to invest (Directorate European Commission in 2017)

Since the business angels mostly do not deal with established companies and products like venture capitalists, but with ideas or prototypes that are in their development phase so the financial indicators are not yet available and can be predicted with only a small degree of accuracy.

Therefore, the due diligence is not as sophisticated and advanced as the one conducted by venture capitalists, nevertheless angels try to assess as good as possible the prospects of the business, the market, the management and the financial indicators of the project. During the due diligence, some experts may be invited to analysis of the project from the technological side.

At the due diligence stage, an active business angel can provide an entrepreneur with great assistance in the process of formalizing an idea in the form of a clear business project, and therefore the initial business proposal can be significantly revised. This is done to attract future financial investment stages.

The final meeting is last stage before investment done. In case of an affirmative decision, the joint work begins with the formation of a business plan.

Even in the event of a refusal to invest, the final meeting with a business angel is very useful for applicants, since during it the investor can give the company a lot of valuable advice and guidance regarding its future strategy and actions.

3.3 Contracting

Usually business angels must deal with several risks. From opportunism that may arise from asymmetry of information or moral hazard a situation when agents put less afford than expected, till economic cost associated with taking higher risk by the entrepreneur due to using other persons money.

Nevertheless, business angels have developed number of strategies to manage these risks. For instance: milestone-based compensation, hands on monitoring through directly involvement in invested ventures, designing an incentive system to induce desired behavior, requiring that agents invest their own funds as a demonstration of their good faith, adjusting expected rate of return depending on risks associated with project and specifying rights and obligations in contracts (Peter Kelly , Michael Hay, 2003).

In this paragraph of the work, I would try to discuss some factors of the deal flow that influences on negotiating a contract.

Usually BAs use incomplete contractual terms and do not force tight rights and obligations instead give more freedom of action to entrepreneurs. This is due to: First, angels pay more attention on trust (the interpersonal relationship between them and entrepreneurs) than market. “Trust between parties is very essential and appears to be an important transactional lubricant for business angels to invest” (Peter Kelly, Michael Hay, 2003). Second, BAs choose active involvement in the post-investment management of the venture rather than introducing tight contractual terms for controlling the behavior of the entrepreneur. So, Van Osnabrugge (2000) puts forward the idea that BAs work with “incomplete contracts” and they look to active involvement to manage risks. Third, “angels typically try to invest in companies in which smaller number of shareholders including management hold relatively sizable individual equity stake” (Sapienza and Gupta 1994). Forth, angels unlike venture capitalists do not pursue only capital gain but also other motivations such as, creating job positions or just personal satisfaction from being involved. Fifth, BAs search for an opportunity from trusted personals or organizations such BANs, banks, friends and other.

However, sometimes BAs use tight contractual terms, behaving more like as VCs. This behavior difference is due to: First, The high level of industry relevant experience. Peter Kelly and Michael Hay commented “business angels with an extensive base of relevant industry experience spell out more clearly their rights and obligations”. Second, tight contractual terms are more used in case of syndicates than individual investor. “Syndicate deals can become quite complex in nature as each participant in the syndicate seeks to make their mark on the content of the contractual deal” (Landstrom,1998). Third, tight contractual terms are exerted when BAs bear most cost from behavioral bias. Peter Kelly and Michael Hay “tighter contracts are struck by business angels that retain larger equity stakes in the business in which they choose to invest”.

So, in a word, the behavior characteristics of business angels consist of monitoring and being involved in start-up management, that means a formal contractual term are not a paramount interest. However, sometimes it could be that angels also put forward tighter contractual terms.

3.4 Duration of investment

The review showed that the investment period varies widely. Some describes angel investors as patient investors who invest from 5 to 10 years. Some describes as a short period investor who invests from 3 to 5 years and gives emphasis on the creation of financial benefit by looking at the growth and successful exit. The review also suggests that there is tendency between the level of experience and the period of investment. Experienced business angles invest in a longer timeframe than less experienced or inexperienced angels. This may be due to less experienced angels cannot consider beforehand all issues linked with an exit. On contrary, experienced angels already have some experience about legal, monetary issues that attached to an exit. Moreover, there exists a correlation between motives of investment and investment timeframe. For instance, if the motive is not a financial one, rather it is social impact one, than it may take longer time to see the results, so an angel invests in a longer time frame.

3.5 Return on investment

The research conducted by Colin Mason, Richard Harrison and Tiago Botelho concluded that "Around half of all investments fail and only a small minority generate significant return ". Another author Shane claimed that " the returns on investments made by angels are not very high and the typical angel investment does not perform as well as the typical investment in other asset classes".

Nevertheless, we can observe in the market successful investments that generate significant amounts, this can be associated with deep due diligence and a little luck. Also, the respondents of research of Pierre Marro and Luuk Borg agreed that on average European business angles expects cash-on-cash return of 30%.

In general, there are two possible indicators of the future return on investment. As the research conducted by Harrison and Mason puts forward: first, "moderate performing investments have longest holding period to exit" ; second, in general "long distance investments have higher return than short distance investments" because the investor imposes tougher requirements to compensate information asymmetry.

3.6 Exit

There are wide variety of exit options available for business angels. For example, initial public offering (IPO), buyouts by managers (MBO), takeover by other firms (M&A), buyout by financial institutions (IBO) and others. However, often business angels have no clear idea about the future exit and time frame of the investment. This may be partly due to their character and way of thinking; they are concentrated more on "to begin" rather than "to end". Mostly angels believe that "good investment will always find exits". One of the popular UK entrepreneurs, angel investor Luke Johnson (2012) stated that "If the business works you will find the choice of exit". Johnson also states, "It is off-putting to the entrepreneur who is passionate about their business to be asked about the exit in their first conversation with a prospective investor". Moreover, the survey conducted by Horrison, Masson and Botelho showed that most interviewed angels gave less priority to options with an exit strategy. Only one of the 30 angels in the study took an exit-centric approach to investing.

Although there are number of ways as it was listed above, it can be concluded that the most probable exit option nowadays is M&A. According to Johnson and Sohl (2012) that examined 636 IPOs in the USA 268 of these firms were VC backed while 37 had been backed by angels and 52 were backed by both angels and VC. May and Simmons comment "an IPO as an exit strategy is a rare event". In addition, the number of IPOs has been in decline in the US since 1990s (Weild and Kim, 2010). In European exchange, there have been fewer than 400 IPOs per annum (Mason). All these statistics and comments show that IPO is not so preferable event for an exit. According to a recent trend the most likely strategy for an exit of business angels is an acquisition by a large company. As an example, we can list acquisition of Cisco, Dell, Apple, GrubHub, IBM, HP, Google, Intel, Oracle, Facebook, Microsoft, Nasdaq, PayPal, Siemens and many others.

3.7 Government intervention in the angel market

In the past years, governments of countries and regions begin paying more attention on angel activities. Since the character and the orientation of investments carried out by angels are very essential to boost innovative environment and an economy as well as to reduce unemployment rate on short period of time with the most cost-efficient way. Because, unlike other participants of investment market, angels invest in business opportunities that have fast cycle time, requires comparably less investment amounts in early stages and that in fast growing industries such as: IT, Mobile etc. Moreover, some researchers put forward that "governments bear very low cost associated with this type of intervention" (Aermoudt , EBAN 1999; Mason and Harrison 1999).

There are different possible instruments to stimulate the buisness angel market such as, tax incentives, co-investment schemes, creation of buisness angel networks, training programs, equity guarantees and other.

3.7.1 Tax incentives

Tax incentives are quite important to consider for governments since, they influence the risk taking and decision-making process of the investors. For instance, exemption of capital gains from taxes or tax deduction for losses could support investors invest more since, tax incentives reduce marginal cost of investing.

The report of European Commission (2015) says that across the EU-28 and OECD countries there are 46 tax incentives designed to promote venture capital and business angel investment. In the report it is also commented that the most popular forms of incentive are tax credits for invested amounts and tax exemptions on the return (current or capital) generated by investment. The report also demonstrates, top five schemes that offers income tax relief, capital gains tax exemption, loss relief, capital gains tax deferral relief. The schemes: Seed Enterprise Investment Scheme (UK), Enterprise Investment scheme (UK), Madelin tax reduction (France), Social Investment Tax relief (UK), Venture capital trust (UK), Invest-venture capital grant.

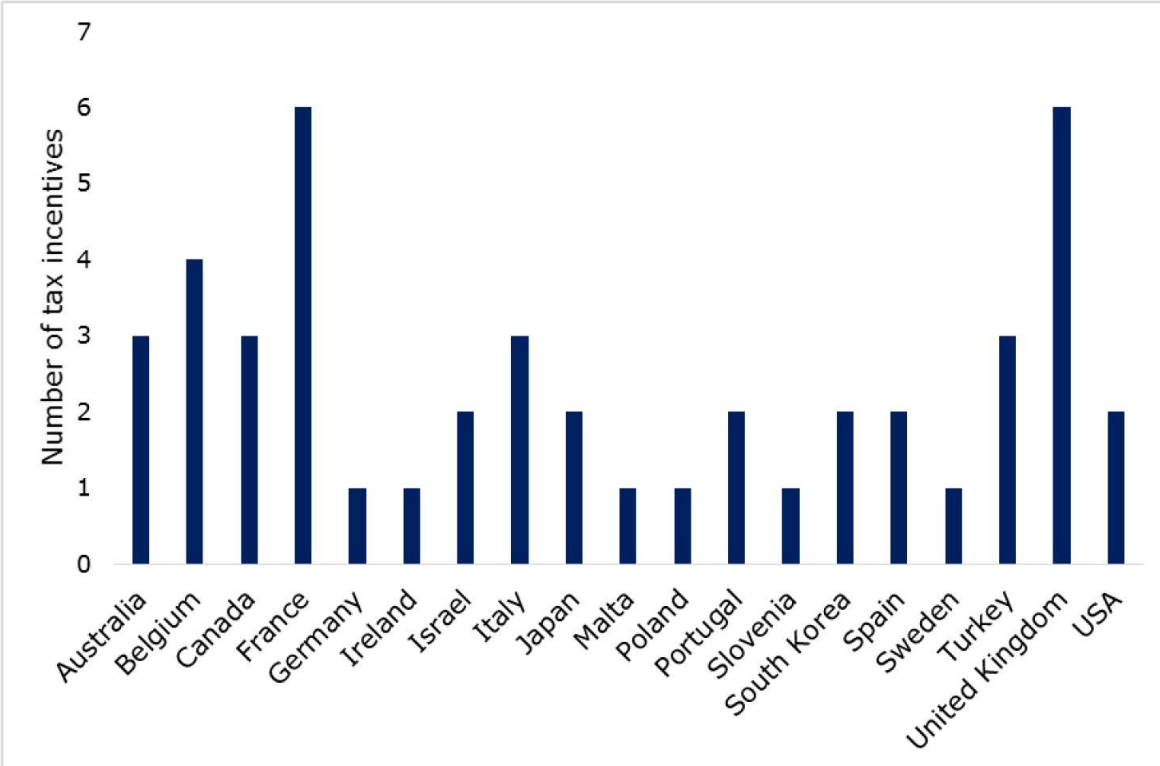


Figure 12.Number of tax incentives (The report of European commission,2015)

3.7.2 Co-investment funds

The study carried out for European commission on young venture and startup funding showed that there are number of co-investment funds organized across European Union and each uses different regimes of operation to attract business angels for co-investing.

For example, Germany based "INVEST-Zuschuss fur Wagniskapital" is a co-investment fund between business angels and public that gives member angels guaranteed subsidies for purchase of shares and eliminates capital gain tax in an exit.

France based "Acui-invest" co-investment fund amid to attract specialized funds and business angels' capital on the early stages of a company and allow co-investors to share risks and costs associated with the investee company.

Italy based " Ingenium Funds" is a co-investment fund financed by public, regional and buisness angel funds to foster the growth of innovative activities and investment attractiveness of the Emilia Romagna Region. Co-investment scheme carried out according to the pari-passu rule with public contribution of 70% in the first round and 50% in the second round.

3.7.3 Educational programs

UK based "Introduction to Angel Investing" is an education program for new or inexperienced investors, managed by UK Business Angel Association.

Apart from all that were mentioned above, there are other suggested instruments that could be deployed by governments to improve the market. For example, governments could set up the laws that decrease information asymmetry and improves transparency of the deal flow that in turn leads to trustful environment between parties involved in the market.

3.8 Buisness Angel Network/Groups and Syndicates

3.8.1 Business angel networks

The first business angel networks (BANs) appeared in the US in the 1980's and widely speared into Europe in the 1990's and 2000's. The emergence of BANs brought great changes into business angel market by making it visible through events, newspapers, and media and by giving more liberal character to angels' activities. It is said that "BANs greatly contributed to raise awareness on angel financing and to increase angel investment activity which has facilitated financing issues for young companies" (San Jose, Roure and Aernoundt, 2005,Mason and Harrison, 2002). The Figure-13 below illustrates the growth of BANs per year from 1999 until 2013.

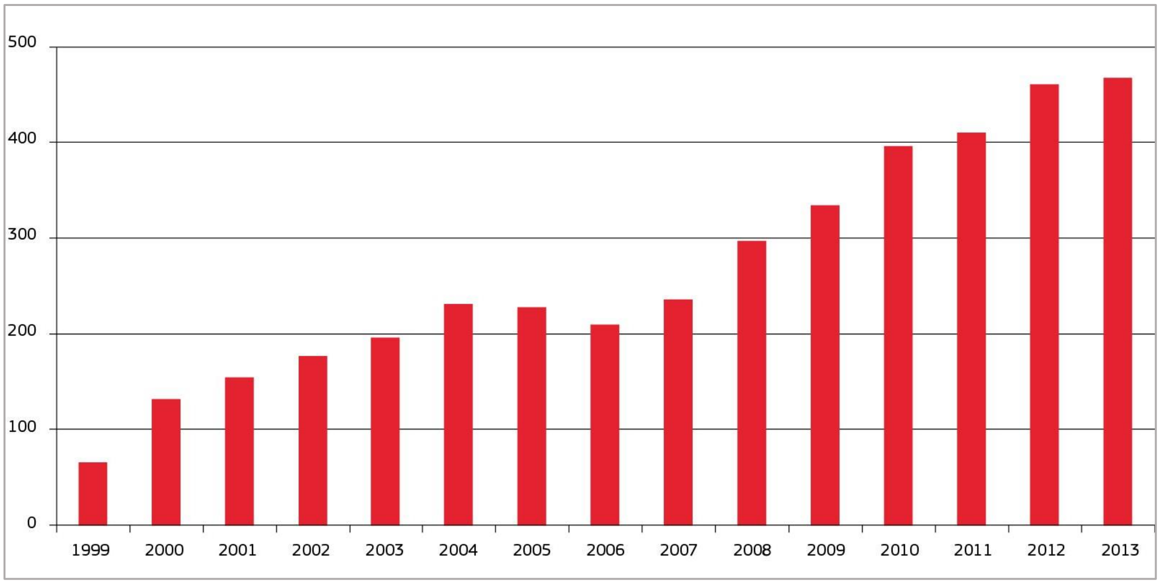


Figure 13.Growth of number of BANs (EBAN Statistics 2014)

So, what is Buisness Angel Network? “An angel network is an organized way of bringing individual non-professional investors(angels) together and match them with entrepreneurs seeking funding” (Ughetto Elisa, 2019). Business Angel Networks tend to be profit or non-profit organizations which usually organized and supported by public sector to boost local economic development and job creation. Sometimes, they could act as intermediaries, an entity that facilitates first meeting between parties and leaves them on their own or an entity that actively supports every aspect of the venture from its early stage till its maturity. BANs typically a group of 10 to 150 individual angel investors (European commission, 2015). Usually a network benefits member by maintaining them with information about new investment opportunities and enabling them to execute large sum deals that an individual investor cannot. Moreover, they reduce execution time of due diligence for an individual investor. In general, BANs perform two types of activities (European commission, 2015):

- Promotion of deal flow among members. Network manager and analysts screen and share interesting investment opportunities with member investors.
- Representation of interest of members angels to outside stakeholders.

Additional activities performed by business angel networks:

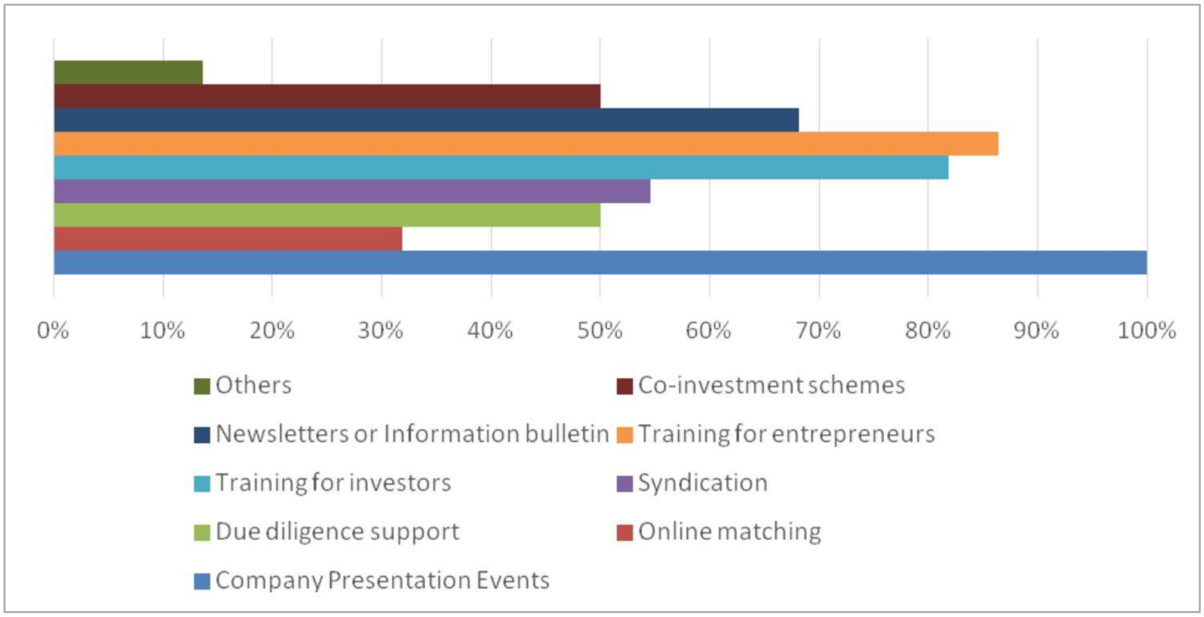


Figure 14.Activities performed by BANs (EBAN Statistics, 2015)

There are wide variety of income models available for BANs. The report provided by EBAN represents followings:

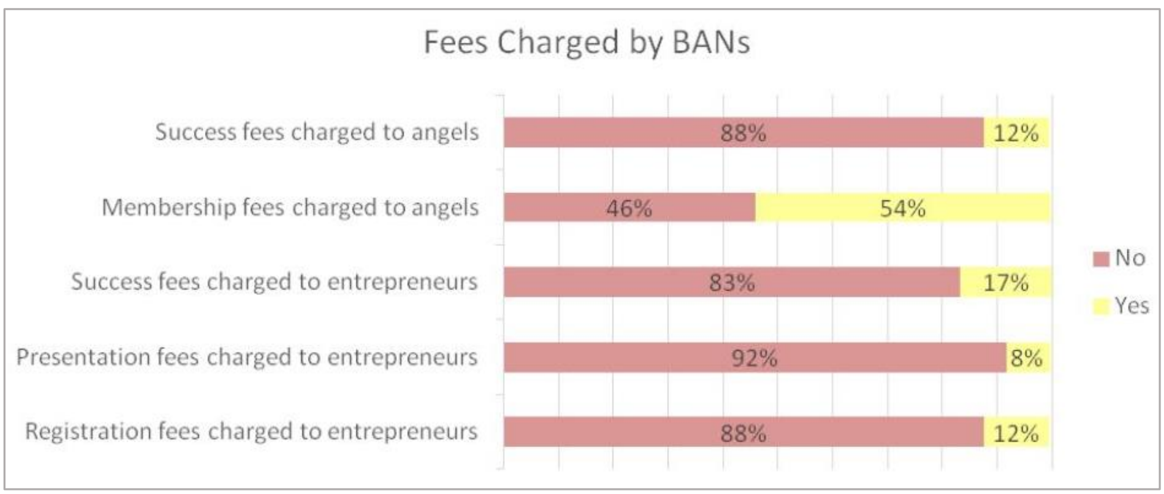


Figure 15.Fees charged by BANs (EBAN Statistics, 2015)

3.8.2 Business angel groups

Another important transformation of the angel market in the U.S occurred in 1990's and later in other parts of the world when appeared new trend called business angel groups. “Business angel group is a group of likeminded angels that pool their resource to make one or more investment based on shared philosophy” (Ughetto Elisa,2019).

Literature review showed that some authors such as, Mason, Harrison, Robson and Botelho mentioned in their work that BAGs lead to number of benefits for the market itself and participants. The authors mention followings:

- Collective evolution of the projects leads to economies of scale and development of routines as well as shares experience. In addition, they facilitated learning process for new angels.
- Collective investment practice reduces risks for an individual angel.
- They invest rather large amounts of money than individual angels which means a great possibility to invest in several successive rounds and in long-distance opportunities, which is very essential for new entrepreneurs who need several rounds of investments or who operate in less angel concentrated regions.
- They took away barriers to some investors who due to the lack of time or skills, would rather invest in other assets than equities of young innovative ventures.
- Due to gathering knowledge and expertise among members, they can add more value to investee companies than individual investors do and attract more capital from professional investors.

The activities performed by BAGs varies depending on the requests of the member investors and their level of involvement into the investment process. However, based on the literature review followings can be proposed:

1.Investment related activities:

- Deal sourcing: each member contributes by identifying new opportunities and put hands on collective actions developed by a group gatekeeper to increase deal flow.
- Deal screening: gatekeeper identifies and eliminates proposals that are not a good fit for group criteria in his own and then careful analysis of the proposal begins with other members.
- Investment evaluation and negotiation: in the evaluation phase careful evaluation of the proposal takes place with members and some field expertise. Several meetings are held to get to know an entrepreneur and its team, to evaluate financial and other aspects of the proposal.
- Post-investment monitoring of portfolio companies until exist.

2.Angel group activities:

- Member recruitment and relationship management.
- Managing the membership.
- Building and maintaining network culture.
- Developing a suitable ongoing training program for the members.
- Public relations.
- Advertisement of the group.
- Syndication with other financial investment institutions

Since, angel groups collectively have more knowledge base and tend to invest higher amounts of funds compare to individual investors, they invest in later stages of development, use more complex contractual terms and approach more professional to monitoring the project before and after investment. Usually groups charges membership fees to angel members and success fees to entrepreneurs. Typical membership fee is between €250 and €700.

3.8.3 Syndicates

Syndicate is a new format of working together of different private investors. Usually syndicates consist of private investors who invest together and share risks and reward of investing. Nowadays, it also becoming trendy that business angles co-invest with venture capitalists and government agencies to form syndicates. The main difference of syndicate from networks and groups of business angels is that it is a composition of fixed group of people who regularly invest together over a time (Fostering angel activity European commission, 2015).

Benefits of being involved in syndicate:

- Diversified portfolio.
- Pooling of economic resources to invest in several companies and rounds or in large deals.
- Skills, contacts, and experience sharing.

4.Islamic Finance

On this paragraph of the work, the author will try to give a general overview of financing in the context of Islam. Although, Islamic finance is not so wide spread as conventional finance and constitutes a little portion of global financial assets 2.5 trillion in 2018 and projected to grow in 2024 to $3.472 trillion (Islamic Finance Development Report 2019), its growth even in the financial crises and conceptually different prospective to finance, makes it attractive as a subject of studies and as a financing option for enterprises.

Although Islamic finance dates back to many hundred years, the modern industry started to develop in 1975 with the establishment of the Islamic Development bank. Many scholars and the field experts believe that Islamic finance has a great future, but it needs proper regulatory and supportive ecosystem. Because unlike conventional, Islamic finance must obey not only the laws of the country but also the laws of Islam

(Shariah). At present there are 44 countries with Islamic finance regulation (Islamic Finance Development Report).The most advanced countries in Islamic finance are Malaysia, Bahrain, UAE, Indonesia, Saudi Arabia, Jordan, Pakistan, Kuwait, Oman, Qatar, Iran, and others Muslim majority countries.

Among Muslim minority countries UK is the leader in Islamic finance. UK introduced Murabaha (Credit financing) in 1980 and in the early 2000s developed a work programme to change tax treatment to ensure that Islamic and conventional finance transactions with an equivalent purpose resulted in equivalent tax bill. The report of British Ambassador Robin Ord-Smith shows that there were 20 banks that offer Islamic finance services, 4 professional institutes and 70 universities and business schools that offer Islamic finance qualification in 2015 in the country. Not only UK but also other countries such as, US, Germany, France, Australia, Switzerland, India, Nigeria are good examples where Islamic financing institutions are developing very fast.

4.1 Industry

The potential of Islamic finance is assessed through the following five sectors:

1. Islamic banks.
2. Takaful (Islamic Insurance).
3. Other Islamic Institutions (investment companies, microfinance institutions, etc.).
4. Sukuk (Islamic bonds).
5. Islamic Funds.

Distribution of Global Islamic Financial Assets					
	Sector	***Share of Financial assets***	***Size (billion)***	***Number of Institutions***	***Number of countries involved***
1	***Islamic Banking***	70%	1,760$	520	72
2	***Sukuk***	18%	470$	2887 Sukuk outstanding	27
3	***Other Islamic Financial Institutions***	6%	140$	592	54
4	***Islamic Funds***	4%	108$	1701 Outstanding	28
5	***Takaful***	2%	46$	335 Operators	47
6	***Total***	100%	2,524$		

Table 4. Distribution of Global Islamic Financial Assets (IFDR 2019)

The leading trio of the industry Iran, Saudi Arabia, and Malaysia account 65% of the Global Islamic finance assets. Malaysia is the world's largest issuer of Sukuk amounting 219$ billion, while Saudi Arabia leads Takaful sector with total assets of 15$ billion and Iran leads banking sector with 488$ billion. It also worth to mention that Malaysia was the first issuer of Green Sukuk in 2017 followed by Indonesia which raised 1,25$ billion in 2018 and recently Saudi Arabia that raised 1,3$ billion. Moreover, Malaysia recently has launched a crowdfunding platform which fully complies with Shariah. Among Muslim minority countries UK is the first Western country that issued Sukuk, to date a total of 68 Sukuk have been listed on London stock exchange that worth 51$ billion.

4.2 Origin of Islamic Finance

Before going to discuss Islamic Finance and financial instruments, the author wants to give a brief introduction to the laws that govern Islamic Finance.

Islam is an Arabic word meaning "submission". From prospective of religion, it means "Submission to God". All activities carried out by human being including trade and finance in Islam have to conform with Shariah, the laws that govern live of an individual.

The primary source of Shariah is the Holy Qur'an and the Sunnah practices (sayings and teachings) of Holy Prophet(pbuh). The secondary source of Shariah are Ijma'a(consensus) and Qiyas(analogy). Both Ijma'a and Qiyas are based on Ijtihad meaning "independent reasoning" (Oxford dictionary of Islamic studies), the mental effort of scholars having juristic expertise to find solutions to emerging problems and issues. Qiyas, the deduction of legal prescriptions from the Holy Qur'an and the Sunnah by analogic reasoning (Oxford dictionary of Islamic studies).

4.3 Islamic Finance principles

The basic principles of Islamic finance are that it is an asset-based financing and there is a risk sharing. So, it is required that "All financial assets must be based on real assets (not necessarily gold or silver) and business activity and the time factor in business transactions has value only through the pricing of goods and their usufructs" (Understanding Islamic Finance, Muhammad Ayub p.13). So, unlike conventional finance, Islamic Finance sees money as just a medium of exchange and it has no value until it is associated with real assets and inventories. Moreover, Islamic finance considers that the fund providers should always share both risk and reward with users of the fund.

4.4 The basic prohibitions

There are prohibitions that come in the Holy Qur'an and the Sunnah, which cannot be excluded by human. Therefore, all human activities as well as financial instruments must avoid them.

The basic prohibitions: Riba in conventional finance known as interest or usuary, Gharar is an excessive uncertainty in transactions or subject matters, Maisir and Qimar (gambling) are speculative transactions, and finally any transactions, goods, activities involving Haram(forbidden).

4.4.1 Riba

The Holy Qur'an and the Sunnah treat Riba as the sin and not only the lenders but also borrowers as well as any other involved third parties commit sin by paying, receiving, or giving a hand in interest involved business. "Riba can be anything over and above the principal of loans and debts and covers all forms of "interest" on commercial or personal debt." (Understanding Islamic Finance, Muhammad Ayub).

Conceptually interest bearing is as an act of exploitation of economically weak by the strong and injustice toward him. Moreover, usually the interest is fixed and certain while the return on the business uncertain therefore, it is unfair toward the borrower of the fund. Hence, Islamic Banking sector and other Islamic finance institutions are doing business based on profit and loss sharing instead of interest rate based. Let us consider interest bearing loan from a conventional bank, the amount to be paid increases as time passes, on contrary in Islamic finance once the amount is agreed, it remains fixed. Therefore, even if the borrower is not able to pay on time, the lender cannot ask for an additional payment as a profit.

4.4.2 Gharar

Gharar is an excessive uncertainty in a subject matter or transactions. For instance, the sale of items not in possession or agreeing to a contract without concrete material terms."Gharar is the sale of a thing which is not present at hand or the sale of a thing whose consequence is not known or sale involving hazard in which one does not know whether it will come to be or not. The sale of a fish in water, or a bird in the air" (Understanding Islamic Finance, Muhammad Ayub p.47).

4.4.3 Maisir or Qimar (speculative transactions)

Maisir or Qimar both refer to games of chance. Nowadays the most widespread example of Qimar are lotteries and hedge funds. Qimar in literature means "receipt of money, benefit or usufruct at the cost of others having entitlement to that money or benefit by resorting to chance" while Maisir as described by scholar Muhammad Ayub means "wishing something valuable with ease and without equivalent compensation". It is also worth to mention that Islamic finance uses different mode of insurance called Takaful because conventional insurance contains both Riba and Maisir. Riba contains because of funds are invested in interest-bearing securities while Maisir contains because of the payment of the insured sum depends on pure chance.

4.4.4 Haram

Unlike some conventional financial institutions, Islamic financial institutions care about the nature of the activity the funds are required. They cannot finance or give other type of help for activities, goods, services that involve Haram. Haram is used to refer anything that is forbidden by God. Some Haram goods or activities are illegal drugs, alcohol, pork or its products, casino, pornography, tobacco, and others.

4.5 Instruments of Islamic Finance

In Islamic finance, there are clear principles for the financing party. According to these principles, it should be clear for what purpose the funding is being carried out. If the purpose is to provide unconditional financial assistance to the other party, then it will be in the form of an interest-free loan, in that case the financing party does not expect any income. But if the purpose is commercial one, then it must be in the form of profit and loss sharing and, in both cases, activities involved have to comply with the laws of Shariah.

The most well-known modes of Islamic financing are:

- Mudarabah is an equity-based partnership in which one party provides capital while the other party provides entrepreneurial skills to the partnership. The losses if any are borne by the provider of capital while profits are shared between parties according to pre-agreed ratio.
- Musharakah is another equity-based partnership in which parties coinvest and manage the business. The losses if any are borne according to financial contribution while profits are shared between parties according to pre-agreed ratio. This type of partnership can have different forms and can be used in different sectors. For instance, Diminishing Musharakah can be used for housing, auto financing, plant and machinery financing and other type of fixed assets acquisitions. The bank buys the asset from third party and rents to the client at cost plus mark-up on installment bases and thus the share of the bank in the asset is reimbursed with the passage of time and after full compensation the client becomes an owner of the asset.
- Murabaha (Credit Financing) is a mode of finance where financial institutions such as banks purchase an asset and on-sells to client with cost plus certain mark-up for profit. The main feature is the bank discloses his profit and actual cost of the asset.
- Ijarah (Leasing) is a mode of financing in which ownership remains with the lessor and its usufruct (the right to use) transferred to the lessee in exchange for rental payments that incorporates profit.

- Sukuk is a securitization of a relevant asset, when the ownership of the asset is sold to large number of investors in the form of financial instruments such as bonds.

4.5.1 Shirkah (Partnership)

In this paragraph, the author will try to shed light on two partnership agreements Mudarabah and Mushakarah that are based on the concept of Shirkah. “Shirkah is a type of business partnership under Islamic Financial law. In which, two or more persons agree to jointly enter into a financial enterprise whose profits will be divided between them” (islamicmarkets.com).

The concept Shirkah dates back to pre-Islamic periods and was used by Arabs to carry out business activities. There are different variants of Shirkah but for the purpose of our discussion, I want to discuss Shirkatul’aqd. “Shirkatul’aqd is a partnership effected by a mutual contract in which the partners conduct a joint business with the objective of earning profit and to share it on a pre-agreed ratio and bear the loss, if any to the extent of the investment of the partners” (islamicmarkets.com). Both Mudarabah and Musharakah are variants of Shirkatul’aqd that are adopted by Islamic financial institutions to respond modern financial needs of their customers. Both types of partnership can be used by individuals as well as legal persons or corporate bodies. However, as any legal contractual relationship, both Mudarabah and Musharakah require all conditions that are necessary for a valid contract, such as mutual assent, valid offer and acceptance, adequate consideration, legality of subject matter and others, and of course the business has to comply with the laws of Shariah.

4.5.1.1 Mudarabah

Mudarabah is a specific type of partnership in which one party provides funds(capital) and other party manages the business within the partnership. The provider of capital called “Rab ul Mal” and the manager is called “Mudarib”.

According to, Mudarabah agreement the actual profit accrued is distributed among parties according to a pre-agreed ratio whereas the losses, if any, are fully borne by Rab ul Mal if unless from the side of Mudarib is not detected breach of terms of the contract, negligence, misconduct or illegal behavior. Moreover, it is not allowed to fix certain rate of return to partners.

The decision-making process and the management are fully under responsibility of Mudarib until there is need to perform an unusual or a unique practice. Mudarib has no right to demand a salary or a bonus for the performed management practice other than agreed share of the profit.

Although, each party has the right to end the Mudarabah by notifying the other party, it is also possibly that parties agree not to terminate the agreement till a certain period to prevent risks associated with opportunistic behavior. In case of termination of the Mudarabah all assets of the business with profit accrued shall be distributed between parties according to the pre-agreed ration.

4.5.1.2 Musharakah

Musharakah is derived from Arabic and means “to share”. In the business, Musharakah is a partnership agreement between two or more parties. The partners co-invest in the common business (venture) and actively participate in the management of the business.

According to the agreement, the actual profit accrued is shared according to a pre-agreed ratio between parties. Whereas the loss is borne by investors according to the financial contribution. For instance, the partner that contributed 10% of the total capital, will suffer 10% of the loss. Moreover, like Mudarabah case it is not allowed to agree on a fixed amount of returns to any partner.

Although, the main principle of a Musharakah agreement is that each party has the right to participate in the management of the business, the parties also could agree on that one or more partners would not participates in the management. However, in this case the share of the profit of the active party can exceed his financial contribution while the share of the profit of the passive partner cannot.

Sometimes, a Mudarib (an entrepreneur) also wants to invest in the business, if so one can unify Musharakah and Mudarabah. In this case, the manager may require a certain amount of share of the profit for his investment, as well as certain amount of share of the profit for his business management activities. Parties can agree any profit distribution ratio, the only condition is, the share of the profit of the passive partner cannot exceed his financial contribution while the loss borne according to their financial contribution.

Musharakah agreement can be terminated as the Mudarabah by notifying the other party. Thus, if one or more of the partners want to leave the buisness, they could sell their share of the buisness to other partners at a mutual agreed price or they could sell their share to a third-party investor.

4.5.1.3 Musharakah and Mudarabah as mode of financing

Both forms of partnership can be used as a financing instrument in trade and industry. However, it must be clarified before the use, which is the most appropriate one. For example, they can be used for project financing, securitization of an asset, financing of a single transaction, financing of the working capital, to finance housing, in a road construction, to finance service sectors such as IT, medicine, architecture, law and others. It is worth to mention that modern Islamic banking system, Islamic funds and non-banking Islamic financial institutions use these arrangements to operate and finance their clients.

Since Project financing is more relevant for the purpose of our discussion, I want to talk a bit more about it. Both forms of agreement can be used for project financing, but parties should know which of them is the most suitable. If the financier wants to finance the whole project and does not want to participate in the management than

Mudarabah is the best solution. Whereas, if investment comes from both sides, Musharakah or combination of Musharakah and Mudarabah could be adopted.

In practice financial institutions do not want to stay as a partner for a long period of time, in this case, as it was discussed earlier they can sell their share in the business to other partner or third parties. If the sale of the share is not feasible at once, the financier can divide it into smaller units and each unit can be sold in suitable time. As units are sold, the share of the financier in the business reduces and when all units are sold, the financier comes out the business.

4.5.2 Murabahah (Credit Financing)

Murabahah (Credit Financing) is a mode of financing in which financial institutions such as banks purchase a commodity and on-sells to client with cost plus certain mark-up for profit. The main distinguished feature is that the bank discloses his profit and actual cost of the commodity. Once, the price of the commodity is agreed, it does not be changed even if the purchaser fails to deliver the payment on time. The payment by the purchaser may be at spot or it may be subsequent date as agreed between parties. Shariah considers that Mark-up is legal because, it is a charge in a trade transaction that are subjected to risks.

As, it is described Murabahah by its nature is a sale arrangement of a commodity and from Shariah point of view, sale of a commodity should comply with the certain rules. The rules that govern sale can be found on the work of Mufti Muhammad Taqi Usmani, An Introduction to Islamic Finance.

Nowadays, Islamic banks use this practice a lot to finance their clients to purchase commodities. However, it should be noted that Murabahah was not a financing mechanism initially, but just particular type of sale. Due to some difficulties associated with the use of Musharakah and Mudarabah, modern Islamic financial institutions adopted Murabahah as a mode of financing. With Mudarabah agreement, any type of commodities which may be subject matter of sale can be sold and purchased. But all rules of sale have to be followed and the subject matter has to comply with Shariah laws.

In practice, this type of financing carries some risks. For instance, sometimes the client may withdraw to buy the commodity after the financier has bought it or he may make the payment deliberately late etc. To prevent these behavioral biases, the fund providers usually take some actions:

1. They appoint client as an agent to purchase the commodities.
2. They try to sell the commodity as soon as it is purchased.
3. Fund providers may introduce penalties for late delivery of the payment, but all penalties strictly go to charitable purposes only, not as a profit since any excess amount charged apart from agreed upon is considered as Riba.
4. They ask the client to sign promise to purchase the commodity.
5. They may ask to furnish a guarantee from third party.

4.5.3 Ijarah (Leasing)

Ijarah as described by a scholar Muhammad Ayub "Ijarah is a contract of a known and proposed usufruct of specified assets for a specified time period against a specified and lawful return or consideration for the service or return for the benefit proposed to be taken, or for the effort or work proposed to be expended".

In a word, Ijarah is the transfer of usufruct of the owned asset for an exchange of specific rental payments during specific period. The subject matter of Ijarah should be a real asset that does not change its state from the use. For example, the goods that cannot be used without consuming cannot be subject matter of Ijarah. Thus fuel, money, food, cotton, candles, and other related goods cannot be a subject matter of Ijarah.

There are 17 basic rules that govern Ijarah contract and they can be found on the work of Mufti Muhammad Taqi Usamni, An Introduction to Islamic finance, page 111.

In Ijarah the owner of the capital is subjected to some risks such as:

1. He will assume the full risk of the corpus of the leased asset. He is responsible to repair in case of the asset failure during the lease period if it is not fond misuse or negligence of the lessee.
2. Ijarah can be canceled in case of the leased asset loses it usufruct during the lease period if it is not fond misuse or negligence of the lessee.
3. The client may make deliberately late payments.

Actions taken by fund providers to reduce risks:

1. Like Murabahah, the lessee is appointed as an agent of the lessor and responsible for the maintenance of the asset during lease period.
2. Like Murabahah the lessor can introduce penalties for late delivery of the rent and use penalties for charitable purposes only not as income.

4.5.4 Sukuk

As described before Sukuk is a securitization of an asset, when the ownership is transferred for a majority for a specified period in the form of financial instruments. Sukuk can be issued by governments, banks, corporations, or other financial institutions. There are several types of Sukuk, Musharakah Sukuk, Mudarabah Sukuk, Istsna'a Sukuk, Salam Sukuk, but the most popular one is Ijarah Sukuk.

4.5.4.1 Ijarah Sukuk

Ijarah Sukuk structure is based on Ijarah (Leasing). In practice, the originator (the owner of an asset) enters into a sale and purchase agreement with SPV(Special Purpose Vehicle) to which originator agrees to sell the asset, and SPV agrees to purchase the asset from the Originator.

SPV issues Sukuk certificates to investors (holders of Sukuk). Each certificate represents an undivided ownership interest in the asset. The capital raised (Principal Amount) from issuance of the Sukuk is used to finance the purchase of the asset from the Originator. The SPV after purchasing the asset, leases it back to the Originator under a Ijarah (leasing) agreement for specified rental payments for the specified period. The rental payments could be fixed or floating depending on an agreement between parties. Each rental payment is used to pay periodic distribution amount to investors.

The Ijarah continue until mature date and at the date of maturity, SPV will sell the asset and the Originator will buy it back at an exercise price which is equal to the principal amount plus any accrued, negotiated upon. Then, SPV distributes dissolution amount to each investor using the exercise price.

Ijarah Sukuk are tradeable in a secondary market.

4.5.4.2 Mudarabah Sukuk

Mudarabah Sukuk structure is based on Mudarabah partnership agreement. In practice, this type of Sukuk structure is used when it is not possible to identify any tangible assets. The originator an entity which is searching for capital enters into Mudarabah contract with SPV an entity which is providing capital and parties become partners within the partnership agreement. The originator will act as a manager and provides entrepreneurial skills while SPV will act as a silent partner and provides capital only.

The SPV issues Sukuk certificates to investors and acts as trustee of investors within Mudarabah business. The capital raised (Principal Amount) from issuance of Sukuk certificates is used by SPV to finance the Mudarabah agreement. The income generated by the business distribute according to a pre-agreed ratio between the Originator and SPV. Then SPV pays periodic return to investors from profits it has received within Mudarabah Agreement.

Mudarabah agreement continues until maturity date when the Mudurabah enterprise would be dissolved in accordance with terms of the agreement. The assets of the Mudarabah enterprise would be liquidated and the proceeds would be applied accordingly first, reimbursement of initial capital contributed (Principal Amount) by SPV; second, distribution of any remaining dissolution returns between SPV and Originator according to the pre-agreed ratio. SPV then pays dissolution returns to the investors redeeming the Sukuk certificates.

Mudarabah Sukuk are tradeable in a secondary market.

4.6 Conclusion

To conclude, in the paragraph the author has tried to give just brief description of the Islamic finance paying more attention on the partnership agreements Musharakah and Mudarabah. This try has been done to demonstrate that although currently there are wide variety of options for entrepreneurs to finance their projects in conventional way, they can also use one of the most suitable Islamic finance instruments as an alternative.

5.Case

Uzbekistan is forgoing great changes in terms of entrepreneurship activity. According to statistics provided by Ministry of Economy of Uzbekistan in 2017, the share of small business and private entrepreneurship in GDP was 53.3%.

In 2017, 78.3% of the country's employed population is engaged in small business, compared to 49.7% in 2000.

The share of small business in the country's total export was 27%, in import 50%, and in investment 32%.

Government is introducing number of fiscal policies to improve entrepreneurial environment and different study programs to support entrepreneurial culture in the country.

For instance, the single tax rate of 5 % for the goods and services sold; loans from public banks at low interest rates or in case of commercial bank financed businesses 50% reimbursement of accrued interest on loans; entrepreneurship training courses for entrepreneurs across the country; provision of land plots for rent at a zero rate for a period of 5 years and others.

Despite the progress and the government intervention on the market, entrepreneurs prefer traditional non-innovative buisness activities and the country is very far behind from many countries on innovativeness.

The reasons blamed for are, the lack of proper information about innovative projects, high risks associated with them and the importantly current entrepreneurs have got used to deal with traditional non-innovative projects.

To deal with these problems the government is trying to increase awareness of entrepreneurs about new innovative business opportunities, to reduce the risks associated with this type of business and to create a layer of young entrepreneurs that are concentrated on innovative projects.

There are several projects that are focused on eliminating above listed problems and one of them is co-investment fund " Yoshlar Akademiyasi".

Key facts

- Fund Name: Yoshlar Akademiyasi
- Type of fund: Co-investment in equity
- Period of Investment: since 2017
- Geographic scope: Uzbekistan
- Target sector: High-tech
- Organizations involved: Ministry of Innovative Development of the Republic of Uzbekistan

Description

Yoshlar Akademiyasi non-profit governmental co-fund was created in 2017 to foster innovative entrepreneurial activity of young population of the country and to create a network of angel investors who will co-invest with public companies. The aim of the fund is, financial and expertise support of young entrepreneurs under age of 40, by actively participating in the whole lifecycle of their business projects.

There are four platforms of the co-fund:

- Idea's generator – a platform that consists of specialists aimed to create a solution to a specific given problem.
- Startups – a platform that consist of young entrepreneurs, whose realization of business ideas under working process.
- Business angels - 50 current or previous entrepreneurs that have at least a year of successive entrepreneurial experience in the field of high-tech.
- Academics - a platform of 275 volunteer-scientists who contributed significantly to the development of high-tech industries in Uzbekistan.

Non-monetary contributions offered by the fund to entrepreneurs:

- Full technological and expertise support for R&D and IP registration.
- Support in preparation of business plans.
- Strategic support with field experts and group of angel investors.
- Support to build suppliers and customer network.
- Support in bringing new products to a production.
- Carry out advertisement campaigns of new products through broadcasting on the fund's TV channel and newspapers.
- Study programs to improve managerial abilities of the entrepreneurs.

- Organization of events with field specialists to exchange knowledge.

Benefits for angel investors from co-investment in addition to the financial return on their investments:

- Mitigation of risks due to co-investment with the government capital.
- Depending on the level of the involvement, privilege for an import of a new equipment as well as tax reductions to build their own businesses.

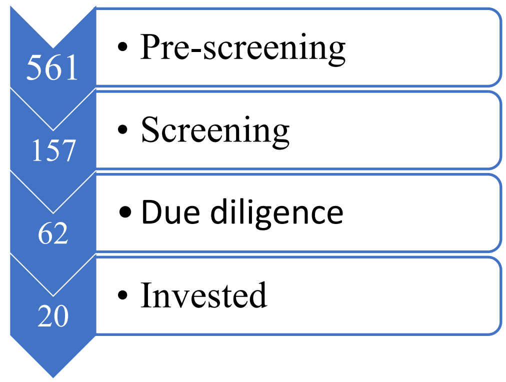
Deployment method

Successful startups are mainly financed due to co-investment of business angels and legal entities, companies with state share of 50% or more that donates each year their 10% of profits. The main target industries of the co-fund are artificial intelligence, renewable energy sources, robotics and mechatronics, pharmaceuticals, biotechnology, programming, industrial design, 3D modeling and others. The minimum invested amount 100k$.

The deal flow:

- Pre-screening is carried out by a group of specialists of different fields and some business angel representatives.
- Business proposals are then analyzed and graded by a committee of academics and business angels.
- Successful project owners invited to a meeting where the committee assess entrepreneurs and their team.
- After presentation, the committee carries out due diligence that takes from 4 to 6 months.
- Finally, the results are announced.

The work done by the co-fund



1. Sectoral distribution of invested business projects:
   - Machinery and equipment manufacturing for agriculture:4
   - Software:10
   - Pharmaceuticals and biotechnology:3
   - Tourism:3
2. Gender distribution of invested business projects:
   - Women: 4
   - Men: 6

6.Conclusion

This thesis work has discussed equity investors of innovative ventures(startups) in their development cycle and has tried to evaluate the impact of their investment on an economy and employment rate. It has been paid more attention on business angel investments since they are the main source of equity financing in early and startup stages of the development of a venture. In the past, venture capitalists also were suppliers of capital in early stages, but currently they have changed their attitude toward investment process and started to focus more on later stages to reduce risks. Now, their main objective is to invest large amounts in few firms that are mature enough and to reach an intended capital gain as fast as possible. This behavioral change has lead equity gap in the early development stage that is filled by business angels and crowdfunding.

Crowdfunding is not so well-developed financing option as business angel investment. Since this type of financing offers small amounts of funds from a large set of individuals with no prior investment experience through the internet which is subjected to an easy fail. While business angel investments have competitive advantage since it offers rather large amounts of financing from experienced entrepreneurs or managers that can reinvest in the following rounds of investments. Moreover, angels offer not only capital but also knowledge and expertise.

In addition, business angel networks and groups can pull large economic resources as like venture capitalists allowing them to invest large amounts and increase number of rounds of investments as well as to work more sophisticated and build more value due to knowledge and experience gathering among members.

Furthermore, the thesis work has tried to list different government interventions that are aimed to stimulate business angel market making it more profitable and attractive to new entrants. It is also worth to mention that government interventions have made angel market more visible and easily reachable for researchers than before.

The work also concludes that angels are mainly local investors but with suitable legal and fiscal policies they can invest in long distances and even international.

Moreover, angel investments are not industry specific investments but diverse and pursue not only capital gain but also social contribution.

The work also has discussed about Islamic finance and its instruments as an alternative for conventional financing. It has been discussed four different Islamic finance instruments and their derivatives that could be used by entrepreneurs to finance their projects. The special attention has been paid to partnership agreements Musharakah and Mudarabah since, these both arrangements could be the most relevant financing alternative for young innovative enterprises(startups).

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