

## **A DETAILED STUDY ABOUT THE ANGEL INVESTORS IN TERMS OF ECONOMIC FREEDOM**

**Article Based on the Thesis for MBA**

**Maria Fernanda CRUZ ARROYO**

### **ABSTRACT**

Despite the importance and increasingly common entrepreneurial activity in the world, what is evident in reality is that a high percentage of small and medium enterprises disappear in the short term. Guaranteeing the sustainability over time of the companies, would imply a significant impact on the world's economy and therefore the generation of value, at macro and micro economic scales.

By explaining the effects of the economic freedom and the correlation between the economic growth and facility to obtain financial leverage and defending the Angel Investment Method as one of the best forms of investment for the SMEs and entrepreneurs, the objective of this article is:

First, to ensure that people with small businesses, from disadvantaged groups, or willing to create new companies, are aware of the potential that entrepreneurship may have for them as a labor market activity and to build motivations for pursuing them.

Second, to diminish market, institutional and behavior failures which affect businessmen and entrepreneurs, in under-represented and disadvantaged groups. This includes decreasing barriers in financial markets, barriers to acquiring entrepreneurship skills, barriers to building entrepreneurial networks and building an entrepreneurial culture.

Third, point out how economic freedom affects the entrepreneur both positively and negatively throughout the creation and operation of the company, giving a clearer view to the entrepreneurs of the effect of the social and political environment of the country where their company is founded. Show the importance of the effects and also promote the development of economic freedom in the world.

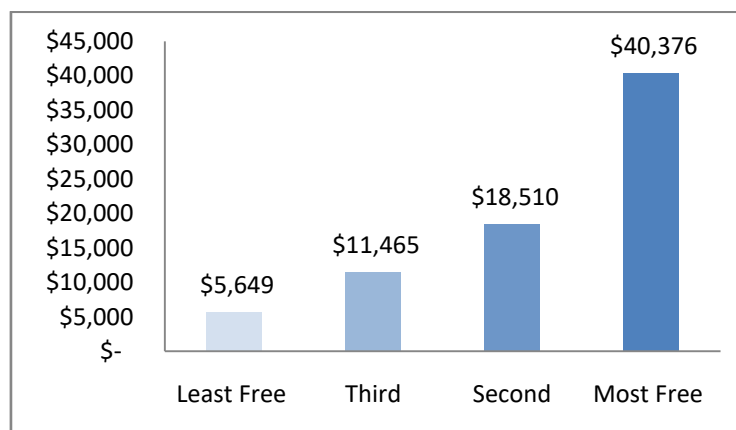
The possibility to diminish these barriers would be expected to come from the exposure of the topic and the awareness of the institutions about these problems.

**Keywords:** *Entrepreneurship, SME's, Economic Freedom, Angel Investment, Financial methods.*

## Economic Freedom

As defined by The Heritage Foundation in the USA, economic freedom is the fundamental right of every human to control his or her own labor and property. In an economically free society, individuals are free to work, produce, consume, and invest in any way they please. In economically free societies, governments allow labor, capital, and goods to move freely, and refrain from coercion or constraint of liberty beyond the extent necessary to protect and maintain liberty itself (Miller, Kim and James M., 2018).

As we can see in Figure 4.1 higher levels of economic freedom correlate with greater economic growth and higher levels of life satisfaction derived by the income per capita. Where economic freedom is high, the number of jobs grows, and the economy is normally successful. Where economic freedom is low the economy stagnates and opportunities are limited.

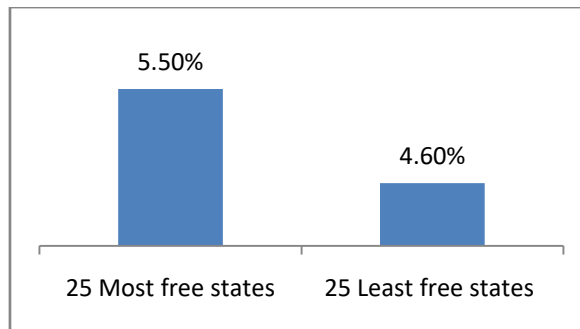


**Figure 4.1:** Economic Freedom and Income per Capita

**Source:** Average Economic Freedom Panel Score, 1995–2016; World Bank, 2017.

**Note:** Income = GDP per capita, (PPP constant US\$), 2016.

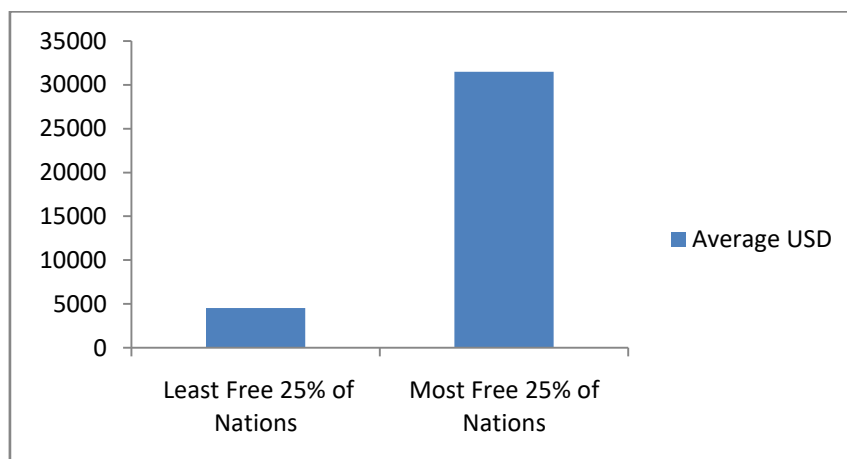
There is a big material of evidence that suggests the economic freedom is associated with many of the things we can relate to a healthy society. As we can see in Figure 4.2, if we look at the economic freedom of North America index, we can observe that states with more economic freedom have higher growth rates of the economy, lower unemployment rates, and lessened debt per GDP than states that are less free.



**Figure 4.2:** U.S. State GDP Growth

**Source:** Economic Freedom of North America 2017 Report The Fraser Institute

All of these things we associate with economic health or also associated with economic freedom. We can observe the same phenomenon if we make the same comparisons in the countries of the world, Figure 4.3; the most economically free countries have GDP per capita there about ten times the size of less economically free countries.



**Figure 4.3:** GDP Per Capita Worldwide

**Source:** Economic Freedom of North America 2017 Report The Fraser Institut

It is not only about the size of the nations or the “large country effect” where we can assume that big country's will tend to be economically free and I'll also tend to have high GDP per capita.

But if we restrict our vision to the poorest 20% of countries: The poor countries that have the most economic freedom, have GDP per capita is that are 50% greater than the poor countries that have less economic freedom.

Even though GDP per capita only measures average income, and that is possible that exist a country with a small number of elite rich people; there are reasons to prove the

importance of economic freedom, for example: If we examine in equality measures, what we find is that the countries that are more economically free also have more equitable income distributions. That means economic freedom associated with higher income levels on average, but it's also associated with a more balanced society(TheFraserInstitute, 2018).

The essential point is that freedom allows people to conduct their own experiments to find out what will be valuable or worthwhile for them and try new ideas. Governments are not concise enough in knowledge to know in advance what new ideas or plans will work in the future. Therefore, economic freedom, by promoting independent and competitive efforts of many people also induces new developments. Everyone should be allowed to do their own experiments and take their own risks, so ideas that prove useful will be adopted. The foundations of economic freedom say that progress should not be directed; only growth should be encouraged.

For purposes of this article, it can be concluded that the economic freedom of the country in which the SME is constituted, generates a very important impact on the possibility of scope for the entrepreneurs. A country with less economic freedom, it restricts to the employer, the possible decisions to take with respect to their sources of financing.

### 1.1.1 Economic freedom around the world

Below is a summary of the 2018 edition of the study that the Heritage Foundation on economic freedom in the world. In Figure 4.1 we find countries considered freer while in Figure 4.2 we can find the countries with the least flexible restrictions that put them in the ranking as economically less free countries.

**Table 4.1:** Top 5 Economies with more Freedom

Ranking	Country	Score
1	Hong Kong	8.97
2	Singapore	8.84
3	New Zeland	8.49
4	Switzerland	8,39
5	Ireland	8.07

**Source:** The Fraser Institute, 2018.

**Table 4.2:** Top 5 Economies with less Freedom

Ranking	Country	Score
158	Siria	5.02
159	Argelia	4.99
160	Argentina	4.84
161	Libia	4.74
162	Venezuela	2.88

**Source:** The Fraser Institute, 2018.

## 1.2 Statistic Analysis: Angel Investments vs Economic Freedom

In this research, a quantitative methodology is used based firstly on three variables for 9 countries. The variables in consideration are:

- The Economic Freedom Score 2016 for each country
- Total amount of Business Angels Investments in 2016 (in Millions of Euros) for each country
- Total amount of business angels existing in that country for 2017.

The countries selected for the analysis where chosen by the criteria of their score in the economic freedom database, searching to have diversity on their level. The availability of reliable data for the rest of the variables needed in the literary material was also a main criteria for the selection of the countries to study.

The conclusions drawn from this article are based on statistical analysis below considering that quantitative methods provide a better understanding of the economic studies.

**Table 4.3:** Economic Freedom VS Angel Investments Capability And Growth

A1				
EF Ranking	Country	EF Score 2016	Total BA Inv. 2016 €M	Number of Bas 2017
4	Switzerland	8.39	15.9	677
5	Ireland	8.07	16.7	770

9	United Kingdom	8	98	8000
18	Netherlands	7.71	12.5	1200
20	Germany	7.69	5	1963
27	Austria	7.58	22	362
75	Croatia	6.96	1	24
107	Greece	6.46	3.2	52
134	Ukraine	5.98	5.1	59
Correlation between A1 and Other Variables:			0.41	0.40

**Sources:** The Fraser Institute, 2018 & EBAN, 2017.

### 1.3 Analysis

The Pearson Product-Moment Correlation coefficient is a measure that allows knowing the degree of linear association between the quantitative variables (X, Y). The Correlation coefficient method, says that when the value is closer to 1 the relation is stronger, the closer the value goes to 0 is weaker until it becomes zero, if the values of the coefficient of relationship is -1 is a perfect negative linear association, if it is 0 there is no relationship and if it is 1 is a perfect positive linear association.

For purposes of this article two analysis where made:

- Correlation coefficient between “Economic Freedom Score in 2016” as a variable X and “T Total amount of Business Angels Investments in 2016 (in Millions of Euros) for each country” as a variable Y.
  - ANALYSIS 1 shows a positive correlation but not highly correlated between the two variables with a value of 0.41.
- Correlation coefficient between “Economic Freedom Score in 2016” as a variable X and “Total amount of business angels existing in that country for 2017”. (In this particular study, the difference of the years are not important due to the period where the measurements are done, since 2017 has no rating in the Fraser Institute data).

- ANALYSIS 2 shows a positive correlation between the two variables with a value of 0.40.

**Table 4.4:** Pearson's correlation coefficient guidelines for strength of Association

Strength of Association	Positive	Negative
Small	0.1 to 0.3	-0.1 to -0.3
Medium	0.3 to 0.5	-0.3 to -0.5
Large	0.5 to 1	-0.5 to -1

**Source:** (Jackson, 2011)

We can conclude then, based on the numerical results of the study that: There is a positive linear association between the Economic Freedom Score for the countries and the total amount of Business Angels Investments.

Considering the difficulty to determine the accuracy of the data respecting the angel investors performance measurements, (since previously explained, they have an "informal" nature in the financing market) we can also conclude that there is a possibility that the strength of association can actually be even greater than the one shown in this article.

Each and every one of the analysis that are made in the article are based on the explanation given previously that the economic environment, mainly the economic freedom in the countries; are the main factor determining the feasibility of financing options for entrepreneurs. This means that the freer the economy of certain country, the more opportunities and feasibility of alternative financing methods will appear; leaving bank loans with high ratios as a second option.

Without a free financial structure, it is impossible to assume that there will be a range of options or possibilities so that the entrepreneur can choose the financing method that best suits them according to their business and stage.

## **Conclusions Related To The Relationship Between Angel Investments And Economic Freedom**

The economic freedom in the countries; are one of the main factors determining the feasibility of financing options for entrepreneurs. This means that the freer the economy of certain country, the more opportunities and feasibility of alternative financing methods will appear; leaving bank loans with high ratios as a second option.

Without a free financial structure, it is impossible to assume that there will be a range of options or possibilities so that the entrepreneur can choose the financing method that best suits them according to their business and stage.

By observing the results of the literate material about Economic Freedom around the world; we can conclude that when countries promote greater economic freedom, the income of the population increases, poverty is reduced, there is greater democracy and education and human development are promoted, improving the cleanliness of the environment that promotes a healthy life.

Only when countries have strong institutions that guarantee the rule of law, democracy, sustainability, human rights and regulatory efficiency, along with the opening of markets, will individuals be more economically free and aspire to a better future.

Freedom allows people to conduct their own experiments to find out what will be valuable or worthwhile for them and try new ideas. Governments are not concise enough in knowledge to know in advance what new ideas or plans will work in the future. Therefore, economic freedom, by promoting independent and competitive efforts of many people also induces new developments. Everyone should be allowed to do their own experiments and take their own risks, so ideas that prove useful will be adopted. The foundations of economic freedom say that progress should not be directed; only growth should be encouraged.