

Does a Funding Gap Exist for Seed Stage and Startup Ventures? A Look at Angel Investors¹

ATP and angel investors provide significant funding for early stage technologies, where there is a capital gap between scientific and technical breakthrough and the validated business case.

Trends in Seed and Startup Investment

Angels traditionally have been largest source for seed and startup capital, and continue to favor these stages.

- In 2004, **43%** of angel investment funding was for seed and startup capital.
- In 2003, **52%** of angel investment funding was for seed and startup capital.

Angel trends in 2004

- Total investment for 2004 equaled \$22.5 billion, up from \$18.1 billion in 2003, continuing a modest annual rise in total investments.
- 48,000 entrepreneurial ventures received angel funding in 2004, up 23% from 2003.
- 225,000 individuals were active angel investors, with an average of 4 to 5 investors joining to fund startup.

Angel trends in 2003

- Modest recovery with total angel investments of \$18.1 billion, up from \$15.7 billion in 2002.
- 42,000 entrepreneurial ventures received angel funding in 2003, up 16% from 2002.
- 220,000 individuals were active angel investors (10 percent increase over 2002), with average of 4 to 5 investors joining to fund a startup.

¹ Much of the data presented herein is derived from data published by Jeffrey E. Sohl, Director, Center for Venture Research, Whittemore School of Business and Economics, University of New Hampshire.

Post-seed funding gap, identified in 2000, has persisted

The increase in post-seed investment, funding beyond seed and early startup stages, is a notable trend that has persisted since 2000. The post-seed funding gap in the \$2-\$5M range has required angels to redistribute seed investment dollars to the post-seed stage in order to fill the needs created by the post-seed gap due to venture capitalists moving up the food chain. This shifting of the angel market has in turn resulted in drawing money away from seed investments, exacerbating the capital gap for seed and startup ventures in the United States. In addition, new ventures face a challenge in raising additional funds from an angel that they have already tapped.

- In 2004, approximately 40% of angel deals represented post-seed or follow-on rounds between \$2 million and \$5 million.
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- In 2003, 35% of angel deals represented these rounds.
- In 2002, 33% of angel deals constituted these rounds.

Rates of angel investment in proposed ventures

Many angels talk about the 100 to 10 to 2 process. If they receive dozens of plans in a month, they might meet or screen 5 to 10, then have to select two to present at their monthly meeting. Of these, 20 to 24 presenters in a year's time, they might go to a term sheet on 6 to 8 and eventually select 4 to 5 as their angel group investments. (A term sheet summarizes the principal terms with respect to a potential private placement of equity by a group of investors, but is not intended to be or constitute a legally binding obligation).

- Of the several hundred business plans that get through the door, there might be 5 to 10 that see an investment of any size—probably less than 5% success rate from angels. A mid-Atlantic regional angel club manager cited these unofficial deal flow results from the last few years as typical of the industry.

Jeffrey E. Sohl, Director of the Center for Venture Research, University of New Hampshire, estimates a more optimistic rate of acceptance of investments that were brought to the attention of investors and received investment for 2003 of about 10.3%. This estimated rate increased from the previous yield rate of 7.1% for 2002. The 2004 rate of 18.5% is unusually high, and does not fall within the normal trend.

To estimate the number of ventures that went unfunded for 2004, since 48,000 ventures were funded during the entire year:

- If these ventures represent only 5% of the proposals submitted, then 912,000 proposed ventures went without funding in 2004.
- If they represent 10% of the proposals submitted, then some 432,000 proposed ventures went without funding.

- If they represent 18.5% of the proposals submitted, then some 259,000 proposed ventures went without funding.

Geographic Location

“According to research on angel investors, 65 percent of them like to invest in deals reasonably close to where they live (within 300 to 500 miles). The remaining 35 percent are comfortable with an investment in a company further away so long as the lead investor lives geographically close to the new company.” (*The Angel Investor’s Handbook*, Benjamin and Margulis).

Stages of Angel Investment²

Angel investors tend to define their investment stages by concept, and not monetarily:

- **Seed Stage:** The idea/concept stage. Company proves a concept and qualifies for start-up capital.
- **Start-Up Stage:** Company completes product development and initial marketing.
- **Early Stage:** Expansion of company that is producing and delivering products or services.
- **Expansion Stage:** Product or service is in production and commercially available. The company demonstrates significant revenue growth, but may or may not be showing a profit.
- **Later Stage:** Product or service is widely available. Company is generating ongoing revenue; probably positive cash flow. It is more likely to be, but not necessarily profitable. It may include spin-outs of operating divisions of existing private companies and established private companies.

Factsheet 1.C12 (April 2005 by Kathleen McTigue)

² Definitions borrowed from Jeffrey Sohl.