PitchBook

Angels: Foundational Investors to VC

Angel investors lay the groundwork for a successful VC industry

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Key takeaways

- Angel investment is an important piece of the VC industry, having provided more than $3 billion to companies during each of the past two years. This is likely a massive undercount of true angel investment, however, as data collection on angel rounds is challenging due to regulations covering how investments are reported as well as the different investment-type buckets into which angel financing vehicles record their deals.

- The data provides evidence of the benefit that angel investors can bring to their portfolio companies. Roughly 74% of companies that raised their first investment through angel financings between 2006 and 2014 were able to raise follow-on funding. By contrast, companies that did not raise angel capital received further funding at a rate of just 59%.

- Although there are many avenues for angels to invest in VC, individual investment and investment through an angel group provide the most direct access and exposure. Angel groups help alleviate many of the time and capital restraints angels face by agglomerating networks, capital, and sourcing capabilities to bring higher-quality opportunities to the group.

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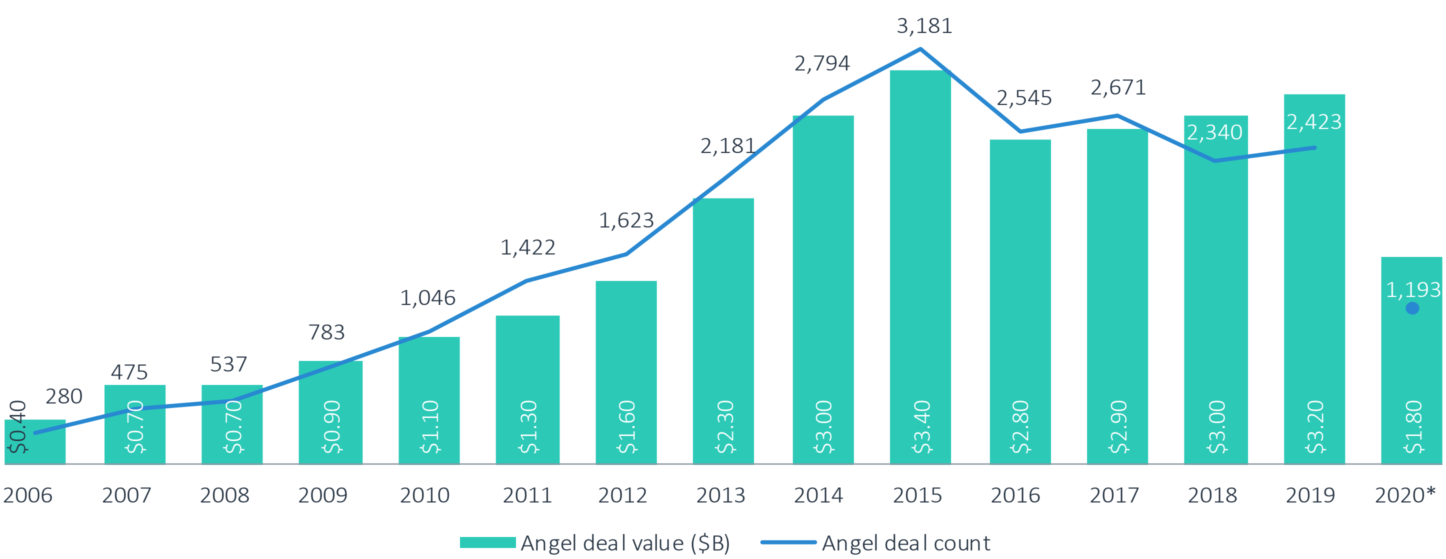
Introduction

Angel investors are a bedrock of the VC industry, even though VC angel activity pales in comparison to overall VC industry numbers. Whether these deals come from high-profile individuals, local angel groups, or opportunistic high-net-worth angels, the capital provided is likely to be early in company development, helping startups establish themselves and begin growth toward their local, regional, or global ambitions. Tracking angel investments presents many challenges: Regulations on reporting allow many deals to go unnoticed, comparing data from disparate sources leads to estimation biases, and many companies raising small rounds don't feel the need to announce their fundraises with the same vociferousness as say, unicorns. As a result, many angel investments fly under the radar.

According to our VC market methodologies, the value of deals funded solely by angels and angel groups that have remained in the US topped $3.2 billion across more than 2,400 investments in 2019. Under a broader definition, the Center for Venture Research estimates that 2019 full-year figures reached $23.9 billion across nearly 64,000 investments.[1] While the importance of angel investors may be evident in the data, they also represent a key piece of the VC ecosystem in ways that are difficult to quantify, including mentorship of new entrepreneurs and startups, as well as deal sourcing and early due diligence for VC firms.

US Angel deal activity

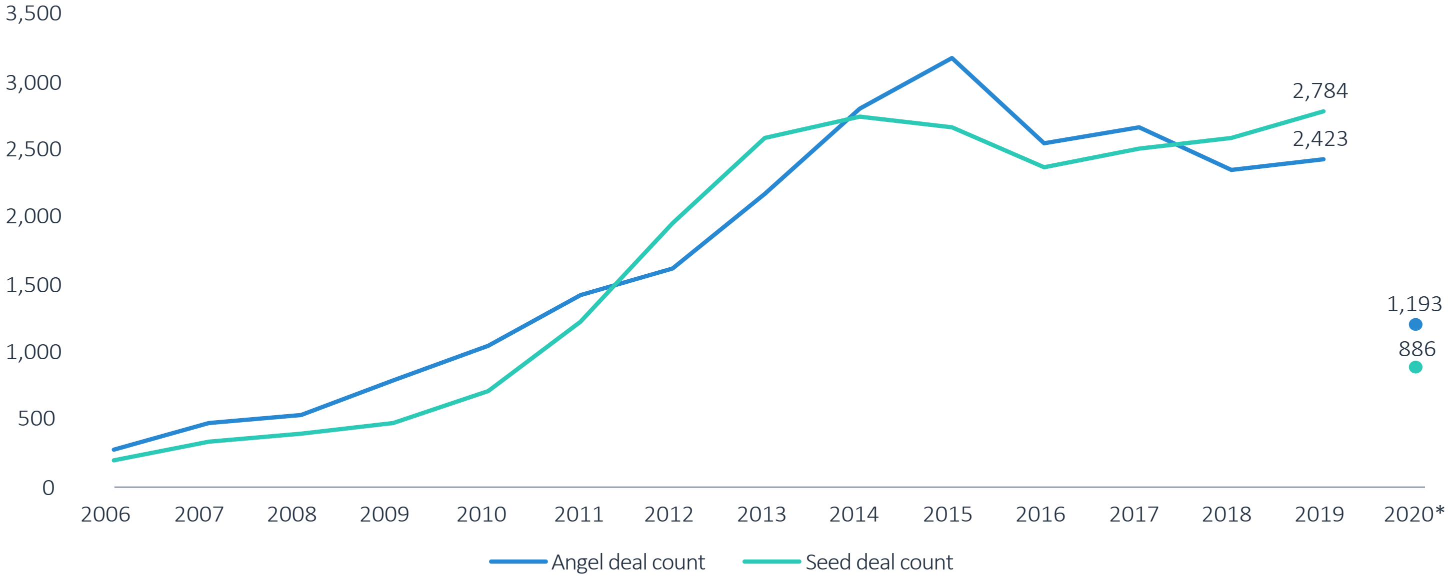


Source: PitchBook | **Geography:** US
*As of June 30, 2020

As the VC industry has grown, angels have likewise adapted their strategies through the development of angel groups, syndicates, and super angels. Even as the nature of angel investment shifts, the core nature of the strategy continues to center on the creation of business. Angels focus on startups unable to attract capital from seed funds because they are still in the idea phase and years away from revenue. This risk appetite by angels is a necessary bridge for VC, and the cultivation of angel networks can help build nascent ecosystems into thriving VC markets.

1: "The Angel Market in 2019: Commitments by Angels Increase with a Significant Rise in Deal Valuations," Center for Venture Research, Jeffrey Sohl, May 5, 2020.

US Angel & seed deal counts



Source: PitchBook | **Geography:** US
*As of June 30, 2020

A glossary of angels

These terms are often used interchangeably because they accomplish similar objectives, but there are slight differences:

Traditional angel

Traditional angels are high-net-worth individuals who invest their personal capital in startups. Within the VC industry, active angels are often former founders, startup employees, or VCs, but the term "angel" encompasses individuals from all backgrounds and wealth levels.

Angel syndicate

An angel syndicate describes the process of angels combining in a single deal vehicle. Often, the decision to invest in a company has already been made before stakes in the syndicate are sold to investors. AngelList has made syndication simple through its platform. Through AngelList, an experienced investor may have a deal ready to go, but instead of footing the entire bill, they syndicate with other angels to fill out the round. A syndicate is essentially a fund created for one deal.

Who are angels?

Angel investment can be a great source of wealth for those who find success; Chris Sacca, Jason Calacanis, Ron Conway, and Marc Andreessen—to name a few—have made huge additions to their billions of wealth through angel investments. But in truth, angel investment is bolstered by investors with much smaller bank accounts. In fact, the average check written by an angel investor is estimated to be around $30,000.[2] This is much lower than the $580,000 median 2020 angel deal size in our dataset and much too small to be worth the time for the high-profile angels many envision as foundations of VC.

Angel investors' motivations can also vary widely. As with all of finance, cash returns are a main driver for many angel investors, but the high risks involved with new company investment add an additional layer of complexity to the investment decision. Unlike traditional investments such as stocks, angel investments require a huge amount of time and effort beyond the writing of a check to be successful enough to generate VC-like returns. Sometimes these outlays are simply too much to satisfy investors' expected financial returns. In many cases, the impetus to support startups derives from an angel's previous experience as a founder or within a certain sector throughout their career. Passion is a frequent driver for angel investment. Social status is, for better or worse, another major draw. The ability to claim a stake in a startup can be an ego-boosting endeavor, with the investor having no intention of working hard alongside the company for growth. This diversity of motivations has led us to observe angel participation along all stages of the VC funding cycle. In 2019, individual angel investors were involved in more than 1,000 US VC deals and participated in over $14 billion in deal value across all stages of investment.

2: "The American Angel," The Angel Capital Association, Laura Huang, et. al., November 27, 2017.

Angel group

Angel groups represent a longer-term collaboration than angel syndicates. The groups may gather on a regular basis to review deals and decide individually whether to invest. Some groups put together demo days or pitch events so founders can showcase their companies to the group, much the same way founders pitch to investors at the end of an accelerator program. The decision to invest by the group is not necessarily a yes-or-no answer, as different parties within the group may decide to invest or not. As with individual angel investors, these entities span a wide spectrum of organization and activity levels. At one end, angel groups can be a loosely tied group of investors who share ideas and network for deals. At the other, some angel groups invest much like VC firms, even leading deals and taking board seats with target companies.

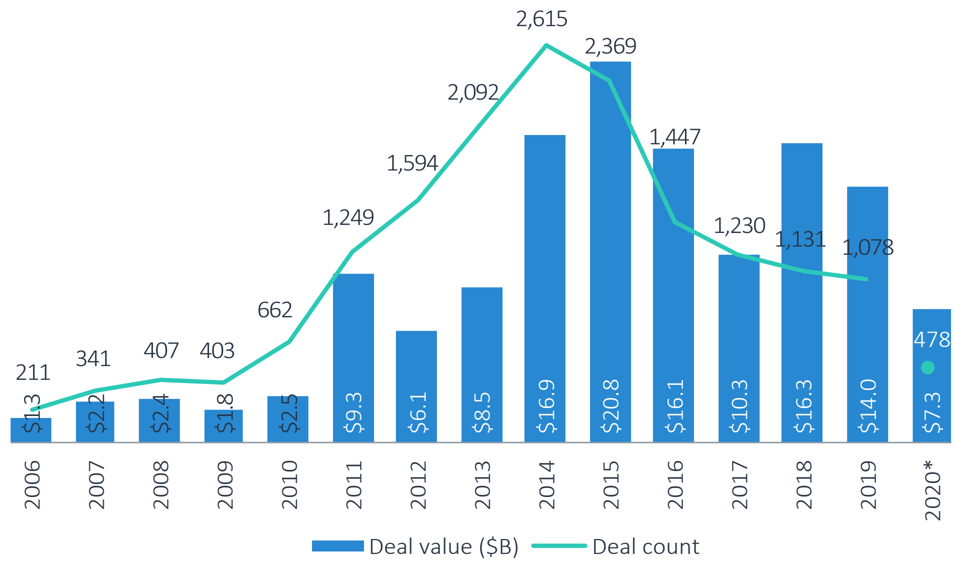
Accredited investor definition

To make angel investments and purchase private registered securities, an investor must be accredited. In the US, this means an individual must make at least $200,000 in annual income for at least two consecutive years or have total wealth of more than $1 million, not including their primary residence. These levels exclude a large percentage of the population, and estimates place a figure of roughly 13 million households in the US as qualifying under this definition, roughly 10% of the current US population—although active involvement is an even smaller number. The Center for Venture Research estimates there were 323,365 active angel investors in the US during 2019, less than one tenth of 1% of the US population.[3]

These requirements for accreditation have remained unchanged since 1982, although updates have been proposed recently that would raise the

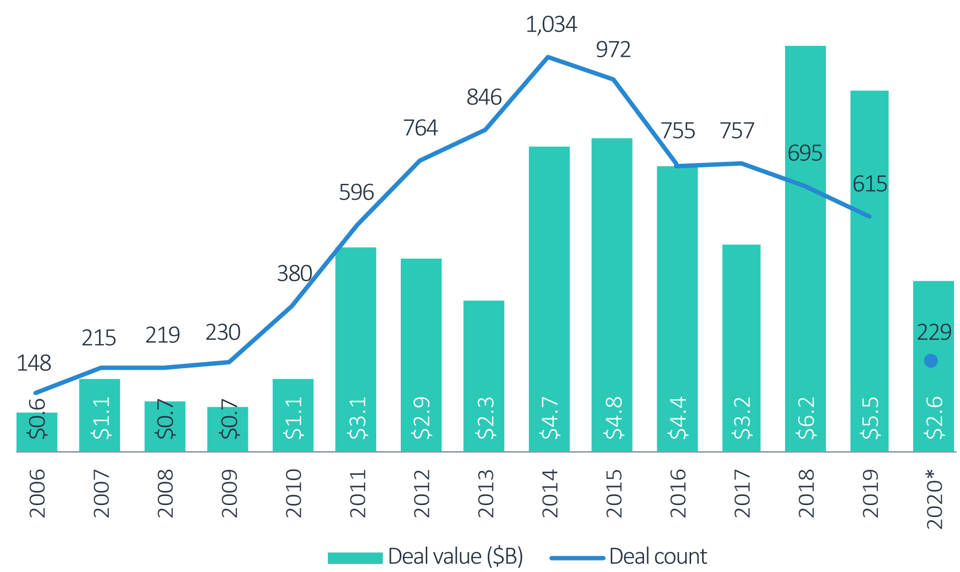
There are several avenues by which angels gain direct exposure to private companies. The most straightforward is to write checks individually on a one-off basis, but investing as an individual angel presents many challenges. Not only does direct investment in companies take time—sourcing deals, meeting with founding teams, negotiating a deal, and monitoring/helping the company are no small tasks—but unfamiliarity with the investment process and startup growth can affect angels' ability to seamlessly interact with the industry. VC is built on networks, both personal and financial; lacking them adds additional barriers to success. This is a major reason why angel groups and syndicates are commonly used for investment.

US VC deal activity with individual angel participation**



Source: PitchBook | **Geography:** US
*As of July 16, 2020 | **Data includes only deals with known investors

US VC deal activity with angel group participation**



Source: PitchBook | **Geography:** US
*As of July 16, 2020 | **Data includes only deals with known investors

3: "The Angel Market in 2019: Commitments by Angels Increase with a Significant Rise in Deal Valuations," Center for Venture Research, Jeffrey Sohl, May 5, 2020.

lower-income level to adjust for inflation. While our data does not go back to 1985, it is not difficult to imagine that investors who fit accreditation criteria in 2020 are drastically different from those who were accredited in 1985. A $200,000 annual salary is much more common today than it was in 1985. These arbitrary-seeming criteria were set up to help protect those with lower levels of wealth from losing it all or from having too much of their assets tied to illiquid investments. It must also be noted there is no formal application process to become accredited.

It should be noted there are exceptions to this rule. Non-accredited investors are able to purchase securities, but they must be "sophisticated," meaning "they must have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment."[4] This is, of course, vague. However, many professionals within the financial industry may qualify, including those from banks, business development companies, small business development companies, or several other categories of business.

On August 26, 2020, the SEC amended the definition of accredited investor to include, among other things, that holders of Series 7, 65, and 82 licenses qualify, as well as "knowledgeable employees" of investment funds.

While sharing ideas and knowledge is a major benefit of angel groups, participating in an economy of scale is perhaps even more advantageous for angels in both syndicates and groups. When comparing the size of typical angel investments to the rising size of investments in the VC landscape, the ability to pool capital widens the breadth of possible investments for angels. Together, 10 angels investing $50,000 can participate in the median angel deal size in our dataset. The pool of individual angels able to alone invest in a $500,000 deal is much smaller. Additional angels or an increase in the average contribution size in the syndicate opens up even further opportunities for large investments, including participation in early-stage or late-stage deals that wouldn't be possible otherwise.

Angel groups and syndicates often create special-purpose vehicles that combine capital for an investment to keep the cap table numbers low for target companies. While companies are permitted to have up to 2,500 individual investors and investment entities before needing to file public documents, combining into a single entity enables faster and easier reporting, monitoring, and eventual payouts if an exit is achieved.

Angel group investment has been relatively steady over the past few years after a decline from 2014. Similar to the decline in individual angel deals, it's likely this stems from several difficulties collecting angel group data, not least of which is many small investments are not announced. Since 2006, angel groups have participated in close to $44 billion of VC deal value, not an insignificant amount considering their focus is still largely on startups and smaller deals.

Although angel group participants may not own as much of a company through a deal as they would investing on their own, research suggests that broad portfolio diversification for angels may lead to higher returns. Through AngelList's research, the conclusion was reached that "Investors increase their expected return by indexing as broadly as possible at the seed stage (i.e., by putting money into every credible deal), because any selective policy for seed-stage investing—absent perfect foresight—will eventually be outperformed by an indexing approach."[5] This, of course, is a value proposition for angel groups, and is consistent with the benefits outlined above.

For some individual angels, the ability to scale without joining a group is possible. Representing a relatively new class of angel, these "super angels" are investors who have gone on to raise a micro fund of their own, as well as ultra-high-net-worth individuals who are able to lead and follow-on in subsequent deals. Along with being able to write larger checks, these angel types still look to provide companies with the same networking and mentoring benefits as groups and syndicates. However, these angel types may fall later in the VC lifecycle and not be cutting the first checks to a company. The past few years have seen a growing number of angels leading deals, even those in the tens of millions in size. In fact, 13 companies have raised at least $10 million through a round led by an individual angel in 2020 alone. Much like unicorns, these angel types are the exception within VC, not the rule.

4: "Electronic Code of Federal Regulations," e-CFR, August 17, 2020.
5: "Startup Growth and Venture Returns," AngelList, Abraham Othman Ph.D., December 2019.

The new concept of rolling VC funds has opened another avenue for angels to raise investment vehicles of their own. These have been instituted through AngelList, allowing angels to act as fund GPs and raise capital from other angels on a rolling basis, generally quarterly. In theory, these lower the barrier to entry and accelerate the investment timeline as funds can begin investment with a lower commitment total than traditional VC funds. Although this model is new, it has had an impact on several of the challenges with raising venture funds, in the process bringing more firepower to angel investors.

Role of angels in the VC industry

While a relatively small slice of overall investment, angels still play an important role within the market. For one, many angel investments are the first money into companies, getting much needed funding to startups that may be far too fledgling to attract capital from VC firms. Beyond cash, angels can work alongside their investments during early development and growth, add credibility to the business and bolster the company's brand, and provide further support and insight into future fundraising events for the company and its founders.

One of the most difficult experiences for founders is financing their business when starting out. In the early stages of a startup, the lack of assets to use as collateral makes it difficult to impossible to obtain a bank loan. At the same time, many VC firms are set up to focus on investments in defined startups in the early stages of revenue generation and growth. To reach that stage, many founders rely on angels to provide initial capital and assume early risks that VC firms won't accept. Without this capital, many companies would not survive long enough to raise VC. In our dataset, the median size of angel investments has stayed relatively steady at $500,000 over the past few years. In 2019, this was nearly one fourth the size of the median seed deal, which has grown significantly over the past few years.

Once an investment is made, angels can assist their portfolio companies in a number of ways, including preparing for VC fundraising, positioning the company for growth, and building out a network for recruiting purposes.

Angels with experience in the fundraising and investment process are advantageous for several reasons. For one, they can smooth out the process for all parties. The intricacies of VC investment can misalign interests of companies and investors if misunderstandings arise over the agreement. Some investors have tried to bridge these gaps by creating documents that lay out specific terms for deals and negotiations, such as simple agreement for future equity (SAFE) and keep it simple securities (KISS) agreements. Fundraising is a time-consuming venture, comprising pitch decks, meetings, negotiations, and more, all diverting focus from the core business.

The name recognition of a high-profile angel can give a company additional credibility when looking to attract larger investors. Associated entities can raise the profile and brand of a company at all levels of VC, but at the earliest stages it can be a major advantage to have a well-known angel on the cap table. VC firms have targeted, and in some cases employed, these well-known angels as scouts for their funds, tapping into the greater angel networks within the earliest stages of VC. Andreessen Horowitz and Sequoia Capital have implemented scout programs for some time, although these types of sourcing programs aren't limited to the best-known firms. Many funds operate in a similar fashion, working with angels, or in some cases micro funds, to expand their active market footprint or to expand the opportunity base for local deals or emerging technologies.

Understanding the VC landscape can be an asset when operating and growing a business. Although many founders have built multiple companies, most companies are founded by individuals or teams with little to no experience running a business. Founders may see raising VC as a validation of their business, but what many initially fail to understand is that VC is a perpetual cycle of growth and fundraising until an exit is achieved or the company is shuttered. The prospect is not just daunting; it can lead to mismanagement: Influxes of cash can lead to frivolous spending, poor hiring decisions, splintered product roadmaps, and other mistakes that can cause a business to miss its goals. Post-investment involvement and participation in the company's growth is a value add provided by many investors in the industry, but it is especially valuable with angels who have the ability to help develop and prepare the youngest startups for the next step.

To continually make successful investments, angels must have their finger on the pulse of a local ecosystem or in-depth knowledge of niche and emerging sectors. As VC firms have moved to invest outside of traditional VC hubs and specialize in emerging industries, angels with intimate knowledge of the entrepreneurial community in areas outside of a VC headquarters can help bridge information asymmetries between the VC firm and that market while helping angel investments receive the outside recognition they deserve.

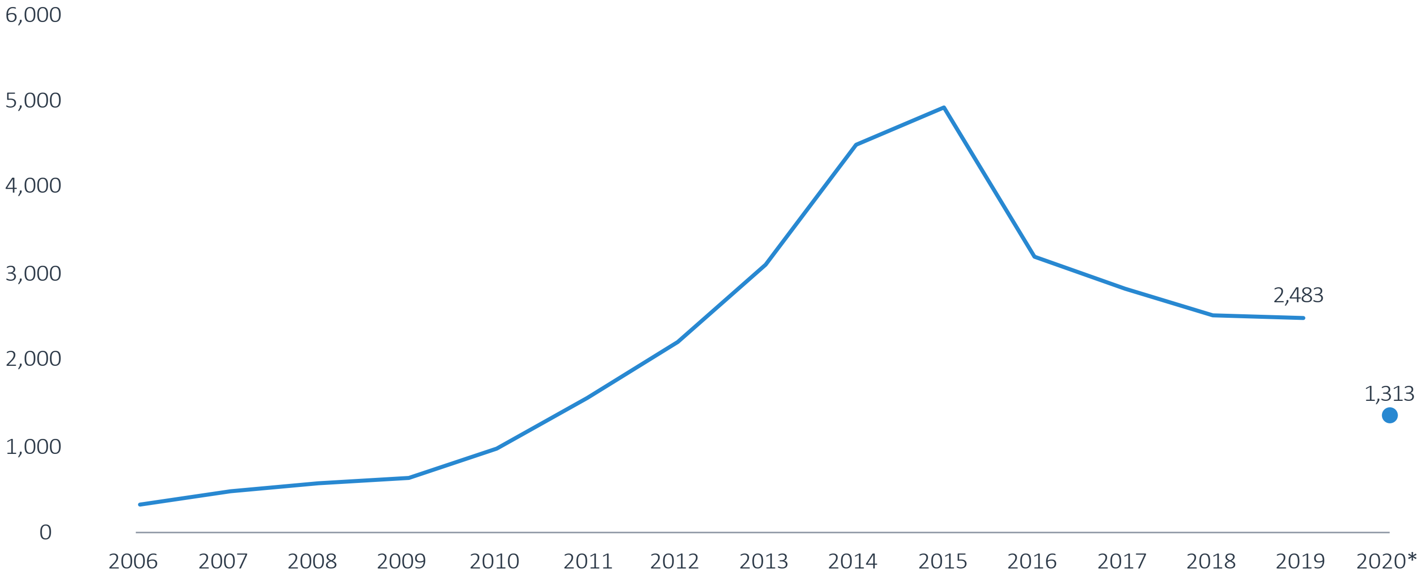
Angels' effect on VC ecosystems

Beyond supporting their own portfolio companies, angels are an integral component of the growth of VC ecosystems. The impact of angel mentorship and networking can be even more influential within ecosystems outside traditional VC hubs. A research paper discussing the flow of capital through the VC industry posits, "The importance of networks in generating investment leads affects the spatial distribution of investment activity because social relations tend to cluster in both geographic and social spaces."[6]

Naturally, these network effects accrue more quickly with angel groups, which has led them to become increasingly common around the US, especially within areas containing growing or strong levels of entrepreneurship and VC investment. Combining networks allows angel groups to agglomerate potential targets to provide a boost to each individual's investment scope. At the same time, the addition of multiple deal networks can expose the individual angels to investments in industries to which they may not previously have had access. From a due diligence aspect or post-investment standpoint, the benefits of participation through an angel group follow much the same lines. Because angels invest in VC for different

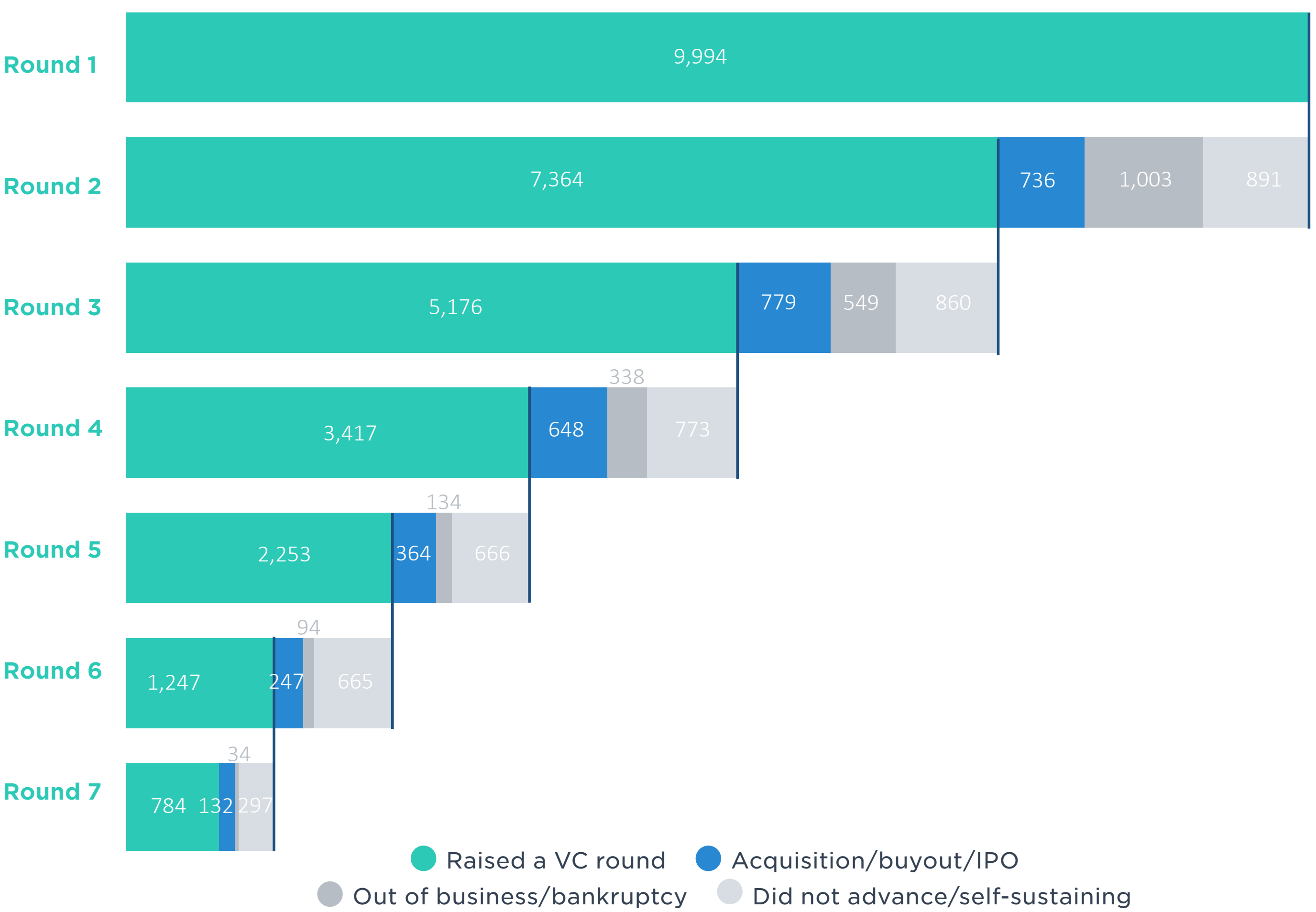
6: "Syndication Networks and the Spatial Distribution of Venture Capital Investments," Olav Sorenson, Toby E. Stuart, December 1999.

Unique angels and angel groups (#) that invested in US VC activity



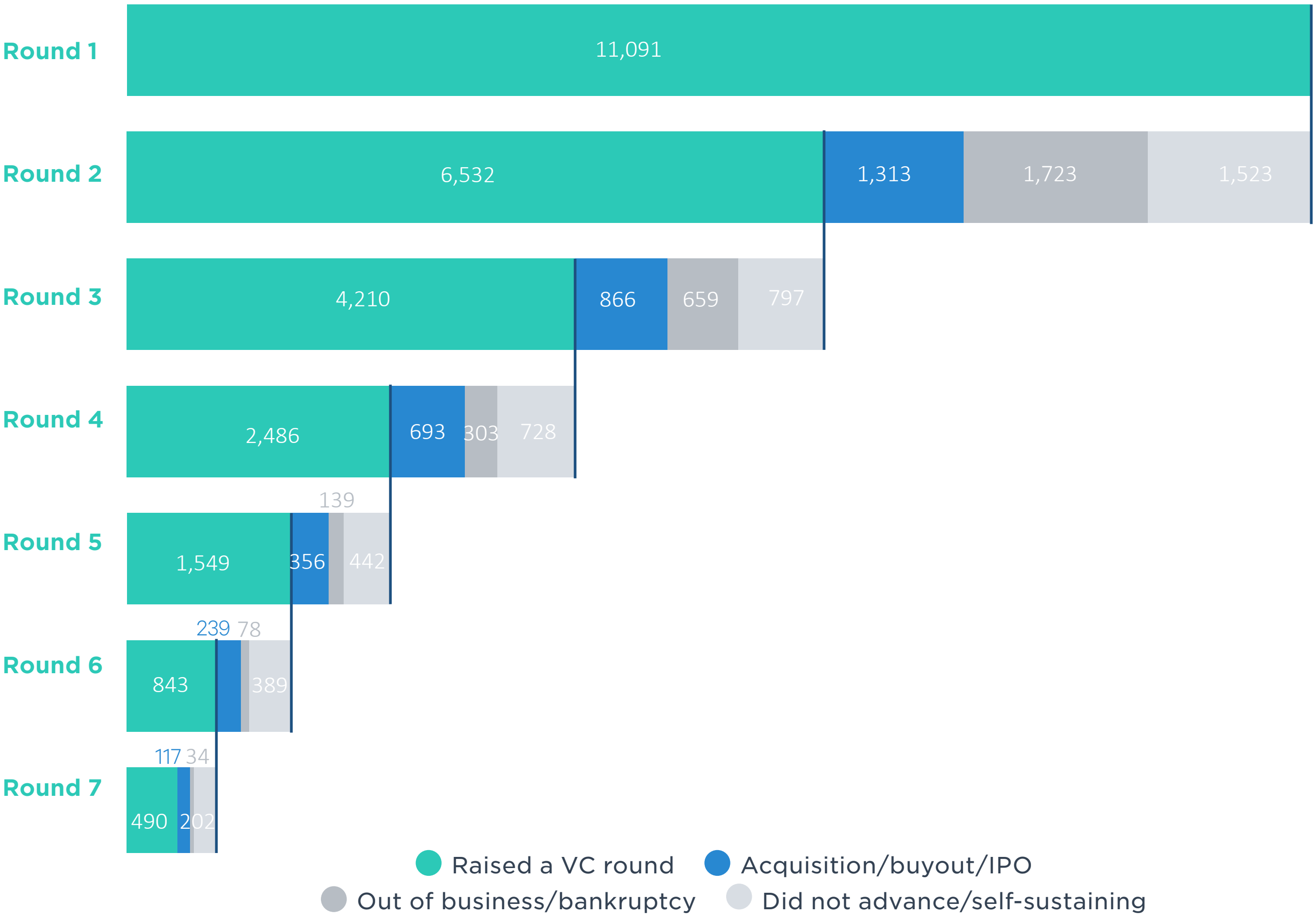
Source: PitchBook | **Geography:** US
*As of July 16, 2020

VC funnel for US companies with angel & angel group investment*



Source: PitchBook | **Geography:** US
*As of July 16, 2020 (1st deal done between 2006-2014)

VC funnel for US companies without angel & angel group investment*



Source: PitchBook | **Geography:** US
*As of July 16, 2020 (1st deal done between 2006-2014)

reasons and from different-sized bank accounts, their understandings of investment strategies and mechanisms for capital deployment are likely to be wide ranging.

Both individual angels and angel groups tend to focus on their local areas. Hyde Park Angels (Chicago) invests in Great Lakes-region companies, with 84% of those investments going into Illinois-based companies.[7] Tech Coast Angels (San Diego) has built a network of five regional locations serving entrepreneurs in Southern California. The Central Texas Angel Network has been one of the most active angel groups in the US over the past decade, focusing most of its investments on Texas companies. A comparison of the combined statistical areas (CSAs) with most active angel networks and the CSAs with the highest VC activity shows them to be very similar, although more research would be needed to demonstrate causality.

Providing capital to local areas is important, but angel investment and the growth that accompanies it can also draw interest from the larger, outside VC-fund investors companies need for further growth. This is not so much the case in Silicon Valley or New York, but other, smaller ecosystems often struggle to bring in late-stage growth financing for even the top local companies.

7: Hyde Park Angels.

In past research, we calculated the distance between lead investors and the target company. Unsurprisingly, the distance between the two can grow exponentially when companies seek late-stage financing. The distance between lead investors and the target company averages only 37 miles at the angel and seed stage; however, a disproportionate amount of large late-stage VC funds are located in Silicon Valley and New York or Boston, making it difficult to raise later-stage growth capital if a company is unable to get in front of investors from these cities. This highlights the important role active angels can play in emerging ecosystems by funding and promoting talented entrepreneurs.

Measuring trends in angel investment

By several measures, angel activity has been at elevated levels in recent years—but the space proves exceedingly difficult to quantify. Regulations and filing requirements help shield many of these investments from public knowledge, and the majority of investments are made into local businesses that never enter the VC lifecycle. Angels and angel groups also invest alongside larger firms, skewing deal sizes and masking angel activity within the broader VC landscape. A Series B with an angel investor participating won't show up as an angel investment in many datasets, for instance. AngelList, a prominent investment platform, saw nearly 1,700 companies funded globally in 2019, although many institutional VC funds also participate through the platform, either raising small funds through syndication or clubbing on rounds in progress.[8]

We have used our dataset to track the number of individual angels and angel groups actively making deals in a given year. While 2015 was undeniably the most active year for unique angels, the aggregate figures of unique angel and angel group participants in VC over the past few years are remarkably larger than they were prior to—and for several years after—the global financial crisis.

The best way to see the impact of angel investment on companies within the US VC industry is by analyzing the success of companies that seek follow-on fundraising. Between 2006 and 2014, roughly 74% of companies whose first investment came from angels went on to raise another round of financing, and more than 50% were able to raise a second follow-on round. By comparison, just 59% of US companies that raised VC without angel investment went on to an additional round of funding, with just 38% advancing further through the funding cycle. Although a higher percentage of these companies have completed an exit, the data shows that companies raising an angel investment first have recorded a lower rate of bankruptcy. These stats include only those angel investments that have been picked up through our research methodology, and surely many more companies have received their initial funding from angel investors.

Angels and VCs have a symbiotic relationship. A deal provided to a VC by an angel is a win for the company and for that angel, as well as a new opportunity for the VC firm. There are many factors that lead to company success or failure, and in presenting this data we are not advocating that angel investment is necessary for company success, nor that it is the best route to VC for all companies. However, the data provides a good argument for the importance of angel investment within the startup ecosystem and provides evidence that there are benefits to raising capital from an angel or angel group.

8: "AngelList: Year in Review 2019," AngelList, January 2020.

Going forward

Angel investment has become a much more formal affair over the past decade, as has VC in general, but what has often been misrepresented as a hobby for wealthy individuals is actually a significant layer in startup formation and a necessary component for the development of VC ecosystems and founder talent.

In accordance with the JOBS Act of 2012, every four years the SEC must consider updates to the criteria for investor accreditation. In fact, the SEC just revised certain eligibility standards to qualify as an accredited investor, including adding certain license holders and "knowledgeable employees" of investment firms to the list. These inquiries have in the past included the possibility of raising the minimum income necessary to qualify as an investor to $450,000, which would make accreditation much more difficult to attain and cut off a wide swath of current investors. While acknowledging that lowering the number of people who qualify would inhibit the movement of capital into early startups, the discussion has largely centered on the fact that in certain cities of the US, $200,000 of income would not be sufficient to guarantee an individual has enough liquid cash to ride out the loss of their investment in long-term illiquid securities.

Raising the salary and wealth levels required to participate in angel investment makes sense only if the focus is on the size of angel investments recorded according to VC industry methodologies. Restricting the flow of capital to private companies would surely be detrimental to companies looking for startup financing, especially local businesses that likely wouldn't attract VC or need future large infusions of cash. While the risks of angel investment are high, and certain regulations should be in place to prevent individuals from over-stepping their financial abilities, access to angel groups or similar vehicles, as well as financial education programs to ensure adequate understanding of private investment, could smooth the way for smaller angel investors and would surely help grow the angel base and flows of capital to startups.

While our data shows angel investment has so far been relatively stable, the COVID-19 pandemic raises more difficulties for angel investors than it does for late-stage firms. The lack of in-person events can stem the growth and development of personal networks, and the inability to conduct face-to-face due diligence can cause deals to be put on hold. Since companies at the angel & seed stage of growth do not show revenue, angels and other early investors rely on the conviction of founders and the commitment to the business idea from other members of the executive team. Although these challenges may be alleviated by either a vaccine or widespread use of online virtual meeting technology, overall activity by angel investors is likely to show signs of strain over the rest of 2020. In addition, a major public market selloff and deep economic recession could hit the net worth of many investors, which in turn would likely mean less capital available for startups.

Angel investment, though, will continue to be an integral part of the VC market moving forward, headwinds or not, and the engagement of angels and angel groups can serve as leading indicators of the future development and growth of VC ecosystems globally.