



Center for Venture Research

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THE ANGEL INVESTOR MARKET IN 2004, Q1 and Q2: THE ANGEL MARKET SUSTAINS THE UPWARD TREND, BUT THE POST SEED FUNDING GAP AND THE INCREASE IN LATENT ANGELS CONTINUES

Market Size

The angel investor market has shown signs of a sustainable upward trend in the first half of 2004, with total investments of \$12.4 billion (total 2003 investments \$18.1 billion), according to the **Center for Venture Research** at the University of New Hampshire. A total of 27,500 entrepreneurial ventures received angel funding in Q1-2 2004, a projected 31 percent increase from 2003. The number of active investors in Q1-2 2004 was 135,000 individuals, a projected increase of 23 percent from 2003, with an average of 4-5 investors joining forces to fund an entrepreneurial start-up. While the increase in total investments is encouraging, a post seed funding gap, identified nearly three years ago, has persisted. Also, the percentage of latent investors continues to increase.

Stage

Angels have traditionally been the largest source of seed and start-up stage capital in the United States and angels continue to favor these stages, with 59 percent of the first half of 2004 angel investments in seed and start-up stage entrepreneurial ventures. This seed and start-up preference represents the largest stage for angel investment activity. Of notable exception is the post seed investing by angels, a trend that has persisted over the last three years. In Q1-2 2004 angel deals in the post seed stage represented 31 percent of the investments. While, angels are not abandoning seed and start-up investing, it appears that market conditions are requiring angels to continue to provide some follow-on funding for their investments in the form of additional rounds of financing.

The post seed funding gap, in the \$2-\$5 million range, has forced angels to redistribute seed investment dollars to this post seed stage in order to fill the needs created by the post seed gap. Angels are shifting their investment strategies toward post seed investments and thus reducing the proportional amount of seed and start-up capital. This restructuring of the angel market has in turn resulted in fewer dollars available for seed investments, thus exacerbating the capital gap for seed and start-up capital in the US.

Sector Analysis

Software garnered the largest angel attention, with 37 percent of total angel investments in Q1-2 2004. The remaining investments were approximately equally weighted across high tech sectors, with each having about 10 percent of the total deals. This market level sector diversification indicates a robust investment pattern and provides a foundation for reasonable growth in the market. One notable exception is the rise in investments in the retail sector, which attracted 10 percent of angel investments in Q1-2 2004. Since the angel market is essentially the spawning grounds for the next wave of high growth investments, this sector diversification provides an indication of investment opportunities that will be available for later stage institutional investors.

Sector	Software	Hardware	Biotech	Life Sciences	Retail	Telecom	Manufacturing
Deals	37%	5%	8%	13%	10%	2%	11%

Market Participation

The angel market has continued the sustainable growth rate of new investors that began in 2002. For this sustainable growth to continue there needs to be a reasonable augmentation in active investors, and thus, level of participation is an important consideration. While the number of individuals that are members of angel groups are increasing, there is a larger percentage of latent angels (individuals who have the necessary net worth, but have never made an investment). In Q1-2 2004, 61 percent of the membership in angel groups were latent angels (as compared to 2003, with 48 percent latent investors). This represents a steady increase over the last four years. This increase in latent investors over time indicates that while many high net worth individuals may be attracted to the early stage equity market, they have not converted this interest into direct participation. This lack of active involvement may be the result of the current trend to rush to form angel groups, rather than meeting the more basic systemic need for educational programs and research to move the latent angel to the active investor.

Yield Rates

The yield (acceptance) rate is defined as the percentage of investment opportunities that are brought to the attention of investors that result in an investment. The peak yield rate of 23.3 percent occurred during the height of the investment bubble in 2000. Since that peak the yield rate has stabilized at around 10 percent. In Q1-2 2004, yields increased to 14.1 percent from the previous year's yield rate of 10.3 percent. This stabilization of yield rates indicates that entrepreneurs with well designed business plans and concepts have about a one in ten chance of securing angel funding. This also indicates that angels, who now spend an average of 3.5 months conducting due diligence (up slightly from 2002) have adopted a measured approach to angel investment decision making.

The **Center for Venture Research (CVR)** has been conducting research on the angel market since 1980. The CVR's mission is to provide an understanding of the angel market and the critical role of angels in the early stage equity financing of high growth entrepreneurial ventures. Through the tenet of academic research in an applied area of study, the CVR is dedicated to providing reliable and timely information on the angel market to entrepreneurs, private investors and public policymakers. The Center for Venture Research also provides reports on state level angel activity. For more information visit www.unh.edu/cvr or contact the CVR at 603-862-3341.