The Angel Investor Market In 2005: The Angel Market Exhibits Modest Growth

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THE ANGEL INVESTOR MARKET IN 2005:
THE ANGEL MARKET EXHIBITS MODEST GROWTH

Market Size
The angel investor market has shown signs of a modest growth in 2005, with total investments of $23.1 billion, an increase of 2.7% over 2004, according to the Center for Venture Research at the University of New Hampshire. A total of 49,500 entrepreneurial ventures received angel funding in 2005, a 3.1% increase from 2004. The number of active investors in 2005 was 227,000 individuals, with an average of 4-5 investors joining forces to fund an entrepreneurial start-up. This continued modest, and sustainable, rise in total investments is encouraging.

Sector Analysis
Healthcare Services/Medical Devices and Equipment garnered the largest angel investments, with 20% of total angel investments in 2005, followed by software (18%) and biotech (12%). The remaining investments were approximately equally weighted across high tech sectors, with each having 6-8% of the total deals. This market level sector diversification indicates a robust investment pattern. 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.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Health</th>
<th>Software</th>
<th>Biotech</th>
<th>Electronics/Hardware</th>
<th>Media</th>
<th>Industrial/Energy</th>
<th>IT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deals</td>
<td>20%</td>
<td>18%</td>
<td>12%</td>
<td>8%</td>
<td>6%</td>
<td>6%</td>
<td>6%</td>
</tr>
</tbody>
</table>

Job Growth
Angel investments resulted in the creation of 198,000 new jobs in the United States in 2005, or 4 jobs per angel investment. However, this tracks jobs created at the time of the angel investment and thus it is likely that this job creation of 198,000 is the minimum number of jobs created by angels in 2005. Since the angel investment is used by the venture to fuel growth, launch new products and explore new markets, it is highly likely that the number of jobs created by the angel investment will increase as the firm grows.
Stage
Angels continue to be the largest source of seed and start-up capital, with 55% of 2005 angel investments in the seed and start-up stage. This preference for seed and start-up investing is followed closely by post-seed/start-up investments of 43%. This increase in post-seed/start-up investing continues a trend that began in 2004 and represents a 10% increase in historical levels. While angels are not abandoning seed and start-up investing, it appears that market conditions, and the preferences of large formal angel alliances, are resulting in angels engaging in more later-stage investments. New, first sequence, investments represent 70% of 2005 angel activity, indicating that some of this post seed investing is in new deals. This shift in investment strategies toward post seed investments reduces 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.

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% occurred during the height of the investment bubble in 2000. Since that peak the yield rate has stabilized at around 10%. In 2005 yield rates continued the upward climb that began in 2004, with the yield rate increasing to 23.0%, on the heels of a 2004 yield rate of 18.5% and a 2003 yield rate of 10.3%. While the increasing yield rate is good news for the entrepreneur, a continued rise in yield rates from the historical average could be indications of an unsustainable investment rate that could be attributed to an influx of inexperienced angels.

Women and Minority Entrepreneurs and Investors
Women angels represent approximately 8.7% of the angel market. Women-owned ventures account for 8.7% of the entrepreneurs that are seeking angel capital and 33% of these women entrepreneurs received angel investment in 2005. Thus, it appears that while the number of women seeking angel capital is low, the percentage that secure angel investments is higher than the overall market yield rate.

Minority angels account for 3.7% of the angel population and minority-owned firms represent 14.2% of the entrepreneurs that presented their business concept to angels. However, the yield rate for these minority-owned firms was 7.6%, which is substantially below the general yield rate. These data indicate that not only do more minority-owned firms need to attract the attention of angel investors, but minority-owned firms, given the low yield rates, need to increase their “investor readiness” through education and networking.
Market Participation

If the angel market is to achieve sustainable growth 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 organized angel groups is increasing, there is a larger percentage of latent angels (individuals who have the necessary net worth, but have not made an investment). In 2005, 62.3% of the membership in angel groups were latent angels (as compared to 55% in 2004 and 48% latent investors in 2003). 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 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.

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 seminars to angels and entrepreneurs, and research reports on aspects of the angel market are also available. For more information visit www.unh.edu/cvr or contact the CVR at 603-862-3341.