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THE ANGEL INVESTOR MARKET IN 2003: THE ANGEL MARKET REBOUNDS, BUT A TROUBLESOME POST SEED FUNDING GAP DEEPENS

Market Size

The angel investor market has shown signs of a modest recovery in 2003, with total investments of \$18.1 billion, up from the previous year of \$15.7 billion, according to the **Center for Venture Research** at the University of New Hampshire. A total of 42,000 entrepreneurial ventures received angel funding in 2003, a 16% increase from 2002. The number of active investors in 2003 was 220,000 individuals, an increase of close to 10% from 2002, 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.

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 52% of the 2003 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 increase in post seed investing by angels, a trend that has persisted over the last three years. In 2003 angel deals in the post seed stage represented 35% of the investments. Clearly, angels are not abandoning seed and start-up investing, but it appears that market conditions are requiring angels 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 26% of total angel investments in 2003. The remaining investments were approximately equally weighted across high tech sectors, with each having about 10% of the total deals. This market level sector diversification indicates a robust investment pattern and provides a foundation for reasonable growth in the market. 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 | Telecom | Manufacturing |
|--------|----------|----------|---------|---------------|---------|---------------|
| Deals | 26% | 12% | 11% | 13% | 5% | 12% |

Market Participation

The angel market has continued the sustainable growth rate of new investors that began in 2002. For this sustainable growth to continue requires 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 2003, 48% of the membership in angel groups were latent angels. 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 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% occurred during the height of the investment bubble in 2000. Since that peak the yield rate has stabilized at around 10%. In 2003, yields increased to 10.3% from the previous year's yield rate of 7.1%. 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 4.5 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.