SBA Office of Advocacy
www.sba.gov/advo

Small Business Research Summary

Advocacy: the voice of small business in government

September 2008 No. 331

The Importance of Angel Investing in Financing the Growth of Entrepreneurial Ventures

An Office of Advocacy Working Paper
Scott Shane, Ph.D., Shaker Heights, OH 44122
2008 [47] pages. Under contract number: SBAHQ-O7-Q-0016.

Introduction

Many observers consider angel investments to be one of the key drivers behind the startup and the growth of new businesses, despite a paucity of information to confirm whether or not this is true. Unlike venture capital investments, angel investments are made by individual investors who do not make up a known population. Therefore, much of what is reported about angel investing comes from anecdotes and surveys of convenience samples, which are prone to biases and inaccuracies. Moreover, research on angel investment is plagued by definitional confusion, in which different investigators confound informal investors, friends and family who invest in startups, accredited and unaccredited angel investors, and individual and group investing. The variation makes it difficult to compare findings across studies.

Purpose

This report seeks to provide an accurate understanding of the role of angel investing in the entrepreneurial finance system. It provides a definition of angel investing and reviews the current state of understanding of the phenomenon, focusing on answering four questions: (1) How large is the angel capital market? (2) How much demand is there for angel capital? (3) What are the primary characteristics of angel investments? (4) What do the companies that receive angel financing look like? Among other databases, the study draws on the Survey of Business Owners (SBO); the Business Information Tracking Series (BITS); the Entrepreneurship in the United States Assessment (EUSA); the survey of the members of the Angel Capital Association (ACA); the Federal Reserve Survey of Small Business Finances (FRSSBF); and the Global Entrepreneurship Monitor (GEM).

Overall Findings

The angel capital market is smaller than is generally believed. Few companies are appropriate for angel financing, a fact that limits demand for this source of financing. Angel investments are smaller and less sophisticated and include more debt than is commonly thought. And the companies that receive angel financing are more similar to typical startups.

Highlights

- According to the EUSA and GEM data, the estimated number of people who made an angel investment between 2001 and 2003 is between 331,100 and 629,000 people.
- According to estimates based on the EUSA data, between 2001 and 2003, angels invested an estimated $23 billion per year.
- Estimates based on several sources suggest that most angel investors are unaccredited investors, but that accredited investors provide the majority of dollars invested.
- Estimates based on data from the EUSA and the 2003 FRSSBF suggest that the number of companies that receive angel investments annually is between 50,700 and 57,300.
- According to the ACA, in 2006, the 5,632 accredited angel investors that make up its member groups made 947 investments in 512 companies, providing startups with a total of $228.8 million.

• According to estimates from the BITS, 3,608 companies founded in 1996 achieved the $10 million or more in sales by 2002 that many experts say angels' target.

• According to the EUSA data, the typical angel investment made between 2001 and 2003 was $10,000.

• According to the ACA, in 2006, the average dollar value invested per angel in an angel group deal was $31,457.

• According to the EUSA data, debt accounts for 40.2 percent of the money angels provided to start-ups between 2001 and 2003.

• Estimates based on the 2003 FRSSBF and the EUSA data suggest that between 0.17 and 0.2 percent of the companies financed by angels go public, and between 0.8 and 1.3 percent are acquired.

• Estimates of the rate of return net of opportunity cost of high-net-worth accredited angels affiliated with groups and willing to talk about their investments is 19.2 percent, according to data from the Angel Investor Performance Project (AIPP).

• According to the EUSA data, 25 percent of angel investments made between 2001 and 2003 went into retail businesses, and 12.5 percent went into personal service businesses.

• According to the 2003 FRSSBF, the typical business of any age—the average age was 13.3 years—that received an informal equity investment in the previous year had sales of $435,000, employment of seven, and profits of $7,500.

• According to data from the 2002 SBO, only 11 percent of firms that were five years old or younger and had received an external equity investment had a female primary owner, only 3.8 percent had an Hispanic primary owner, and only 1.4 percent had a Black primary owner.

• According to data from the 2002 SBO, over two-thirds of the entrepreneurs whose businesses had received an external equity investment and were less than six years old were between the ages of 35 and 54 years.

Scope and Methodology

This study reviewed the literature, including published books and articles, as well as unpublished reports. It also involved a statistical evaluation of data sources drawn from representative samples of known populations the SBO (through special tabulations); the BITS (through special tabulations); the EUSA; the survey of the ACA members; the Federal Reserve Survey of Consumer Finances (FRSCF); the FRSSBF; the GEM; and the Kauffman Firm Study (KFS)—not previously used to examine angel investing in the United States. The study also examined new, nonrepresentative surveys of angel investors, such as the AIPP. Finally, it compared the results of these analyses to previous studies of nonrepresentative samples of business angels.

Ordering Information

The full text of this report and summaries of other studies performed under contract with the U.S. Small Business Administration's Office of Advocacy are available on the Internet at ***www.sba.gov/advo/research***. Copies are available for purchase from:

National Technical Information Service
5285 Port Royal Road
Springfield, VA 22161
(800) 553-6847 or (703) 605-6000
TDD: (703) 487-4639
www.ntis.gov
Order Number: PB2009-100009.
Paper A04 ($33.00)
Microfiche A04 ($27.00)
CD-ROM A00 ($30.00)
Download A00 ($15.00)

For email delivery of Advocacy's newsletter, press, regulatory news, and research, visit ***http://web.sba.gov/list***. For RSS feeds, visit ***www.sba.gov/advo/rss-library.html.***