

Study: Groups are the future for angel investing

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Entrepreneurs looking for risk capital to fund growth will need to get to grips with the rise of the angel group, according to the latest research by leading academics into business angel activity. In a joint project undertaken by the universities of Glasgow and Edinburgh, the growth in the number of managed angel groups signifies a maturing of the angel investment market from a fragmented, anonymous and largely invisible activity in which angels invested on their own or with a few friends to one characterised by formal groups or syndicates of angels investing together. This trend - which has emerged for a variety of reasons, including the contraction of the venture capital industry and its shift to larger and later stage deals - is likely to accelerate as alternative sources of financing from banks and venture capital continue to stagnate or even decline further.

Based on evidence from Scotland, which has experienced a particularly significant growth in angel groups over the past decade, the recently-published study is the first to explicitly and systematically examine this transformation of the angel market. Professor Colin Mason and Tiago Botelho of the University of Glasgow's Adam Smith Business School, who co-authored the report with Professor Richard Harrison, Chair in Entrepreneurship and Innovation at the University of Edinburgh Business School, suggest that angel groups have introduced a level of formality and structure to the investment process by consolidating and channelling finance more effectively.

The full report analyses the nature and characteristics of angel groups,

the role of the gatekeeper manager, the impact on investment deal flow and volume, and the implications for regional development.

In 2002 there were just two angel groups in Scotland, with about 70 members. The majority of angels – some 300 – were solo investors. Since then 24 groups have been created, although some have subsequently amalgamated or closed. LINC Scotland currently has 19 angel groups with a combined membership of just under 1000 members. In contrast there are estimated to be fewer than 100 solo angels. Investment activity by angel groups has increased from 26 deals in 2002 to 80 in 2012, peaking at over 100 in 2010. Investment by group members has risen from £6m to £22.5m. Many of these deals have attracted co-investment from the Scottish Co-Investment Scheme or other investors, so overall deal sizes have been larger (£30.9m in 2012). An increasing proportion of this activity has been follow-on investments. While this greater investment capacity has filled the gap left by the decline in venture capital funds for seed and early growth companies, it has opened up a new equity gap of £2million – £5 million growth capital which Angel groups can't satisfy.

Some academic studies have suggested that organising angel activity in this way could lose several valuable characteristics of the angel investor. However, this piece of work suggests the evidence in favour of a move towards angel group investment is much greater.

For individual angels, the advantages of working together include better deal flow, the ability to create a diversified investment portfolio, superior evaluation and due diligence of investment opportunities, social interaction and learning from more experienced investors. The capacity to invest larger sums and for longer also makes it possible to take a business to an exit themselves, without the need for follow-on [venture capital](#) funds. Advantages for the entrepreneur include a more professional funding process, commonly managed by the group

administrator or 'gatekeeper', and potential access to a pool of wealthy, experienced backers with sufficiently deep pockets to provide follow-on financing along with a range of expertise and contacts.

Professor Richard Harrison says: "Our analysis of the evolution of the angel market in Scotland suggests that it has found an effective model of angel investing that overcomes the potentially small scale of its angel market resulting from a historic low level of entrepreneurial activity. This model makes efficient use of its relatively small pool of active angel investors as nodes around which to mobilise capital from high income investors looking for tax efficient investments. In the absence of angel groups this capital would likely be invested with traditional fund managers, with no assurance that it would fund entrepreneurial businesses in Scotland."

However, this transformation of the angel market is creating new challenges for investors and entrepreneurs, according to Professor Colin Mason: "Whereas angel groups are effectively filling the conventional sub £500k equity gap, there is a new gap emerging for businesses that need further rounds of growth funding in excess of £1m. The Business Growth Fund, which is set up to provide long-term capital, is therefore a welcome development. Angel groups might also consider the development of side-car funds, as in the USA, as co-investment vehicles and working with crowd funding platforms. "

More information: Read "The Transformation of the Business Angel Market: Evidence from Scotland" here"

www.gla.ac.uk/media/media_286597_en.pdf

Provided by University of Glasgow

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