Exploratory Note 11

Angel Investment

**INTRODUCTION**

Though venture capitalists seemingly get all of the attention, angel investors—wealthy individuals who generally invest at an earlier stage than their institutional counterparts—fund more than sixteen times as many firms as do venture capitalists. To an extent, it is surprising that angel investors play as large of a role as they do in the startup world: especially given the failure rates inherent to entrepreneurial ventures and the tendency for angels to get banged up (due to dilution) in subsequent funding rounds. But, invest they do—and in fairly large amounts.

**ANGEL TYPES**

Angel investors are not all alike, but typically fall into one or across a couple of the following categories: guardian angels, operational angels, entrepreneurial angels, hands off angels, and control freak angels.

***Guardian Angel***

Guardian angels possess relevant industry experience and expertise. What is attractive about guardian angels? What do they have to add?

Are there drawbacks to investors with too much exposure to any particular industry? What about if the investor has been out of the game for a while?

***Operational Angel***

Operational angels have significant experience as upper-level executives in major corporations. What is attractive about operational angels? What do they have to add?

Does corporate experience relate to the skillsets needed to run a small business? Can it be counterproductive?

***Entrepreneurial Angel***

Entrepreneurial angels have first-hand entrepreneurial experience. What is attractive about entrepreneurial angels? What do they have to add?

Are their potential drawbacks to entrepreneurial angels? Consider the shortcomings of war stories and anecdotes.

***Hands Off Angel***

Hands off angels are typically wealthy professionals—doctors, attorneys, etc.—with an interest in private firm investment. What is attractive about this type of investor?

Do hands off angels have anything beyond money to add? Does this matter?

***Control Freak Angel***

Control freak angels have all the answers. What is attractive—or appears to be attractive—to entrepreneurs about this type of angel?

What are the downsides? Is the money worth it?

**WHY DO ANGELS INVEST?**

Angel investors play a major role in the startup community and have helped to create some of the world’s greatest companies including Amazon.com, Salesforce.com, and Google, among many others. That said, angel investment strategies have not proven, on average, to be particularly profitable. Why?

If the historical record suggests that angel investors are badly beaten in subsequent institutional financing rounds via dilution, why do they invest in the first place?

Though angel investments are clearly high risk, angels often behave in a fairly risk-averse way after their initial investment is made—a point manifested by the lack of follow up investments. Why is this bad for returns? What are the implications for entrepreneurs?

Is systematic underperformance of angel investors relative to the market unexpected? Do other investor categories, on average, produce different results?

So, why do angels invest? Are they foolish? Are they focused on paying it forward?

**CONCLUSIONS**

Angel investment seems to be as ineffective as most other active investment strategies; however, the contribution of angels to the startup world is beyond question—from the magnitude of the dollars invested to the empirical associations between angel investment and both higher rates of firm survival and subsequent investment rounds.