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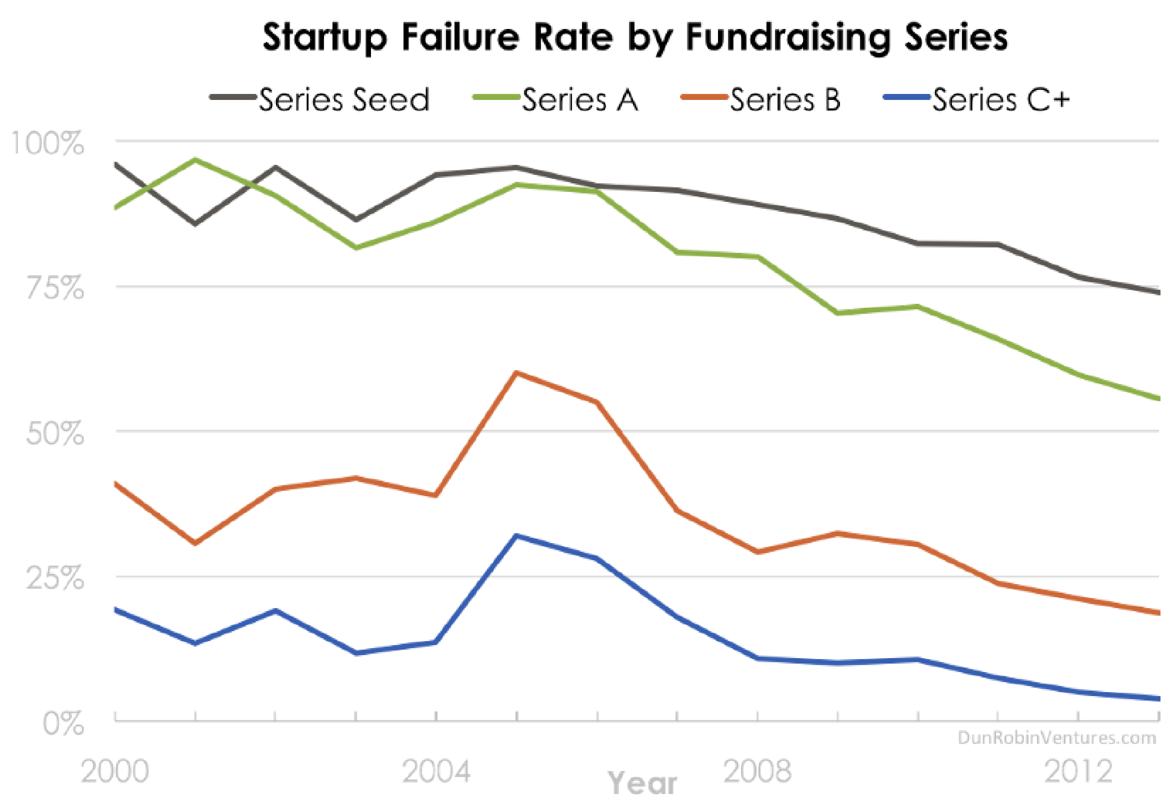
Evaluating the Risk — Reward Relationship Across Funding Rounds

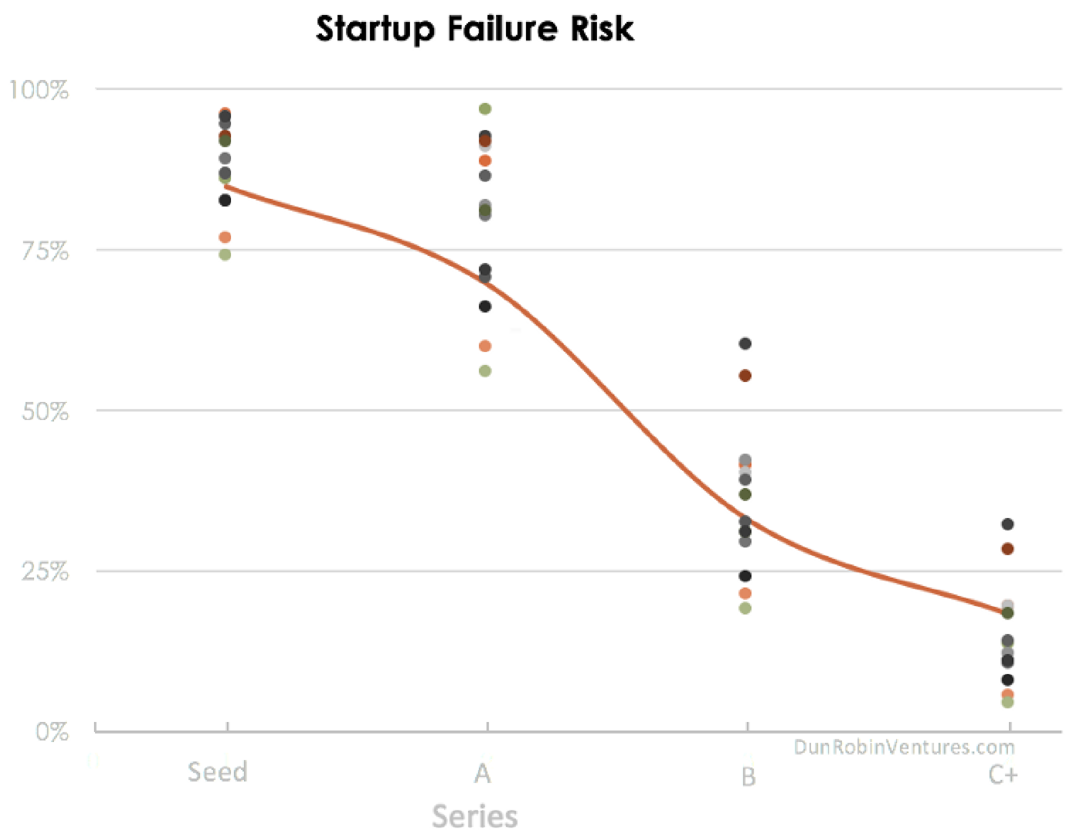
What is the best startup funding round for investors? Let's take a look from the risk-reward perspective:

Risk:



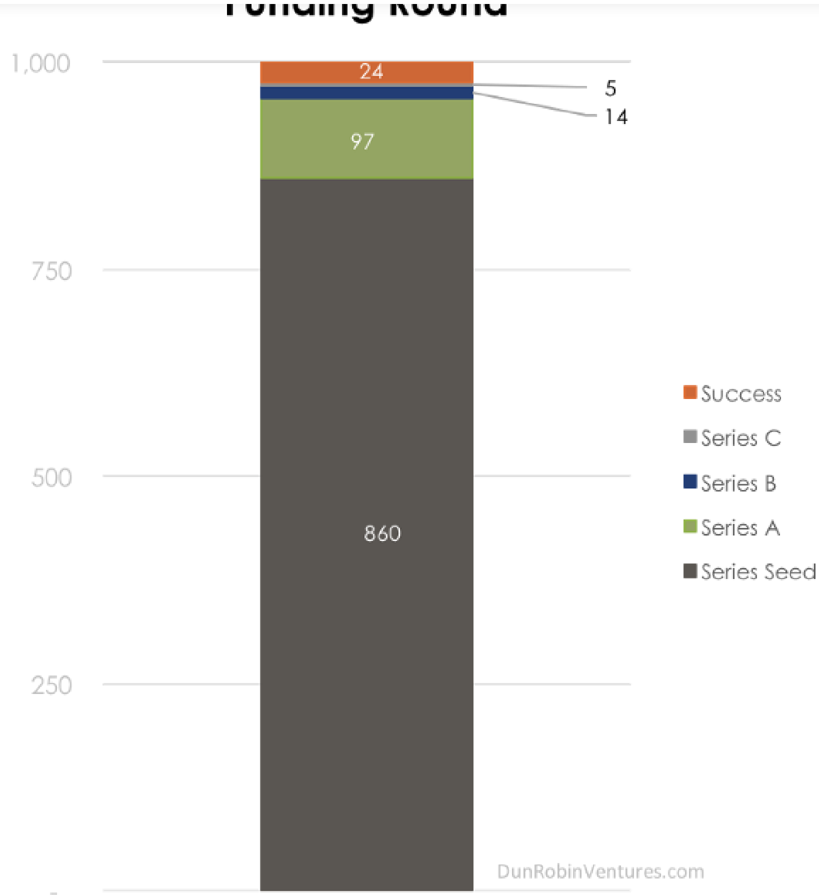
Failure rate defined as a startup failing to reach the next round of funding prior to ceasing operations.

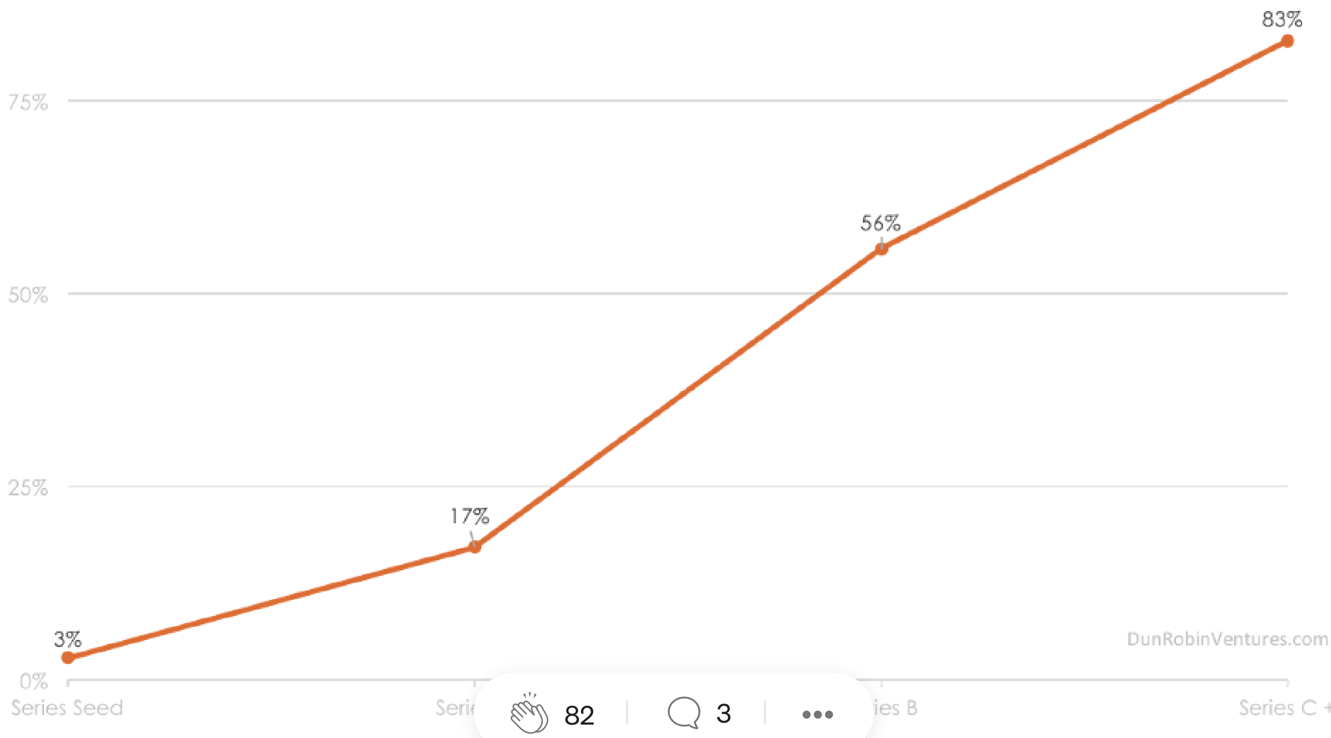
Firstly, it should be stated that to reach a Series B a startup must first raise a Series A, and so on. From this perspective, a startup's risk trajectory looks something like this:



A startup's failure risk decreases as it grows. Another intricacy to note is that startup investments cannot typically be exited until a final sale or IPO because of liquidity issues within the market. Accordingly, "total risk of failure" on a startup investment is truly the compounded risk contained within every future round as well as the current round's risk. For example:

If 1,000 companies complete their Series Seed funding rounds, the Series Seed average failure rate of 86% means that only 140 companies will close a Series A funding before failure. With the Series A average failure rate of 70%, only 42 of the remaining 140 will advance to a Series B and so on until just 24 of the original 1,000 startups have achieved success. When graphed, it looks like this:


1,000
750
500
250
-
24
5
14
97
860
Success
Series C
Series B
Series A
Series Seed
DunRobinVentures.com



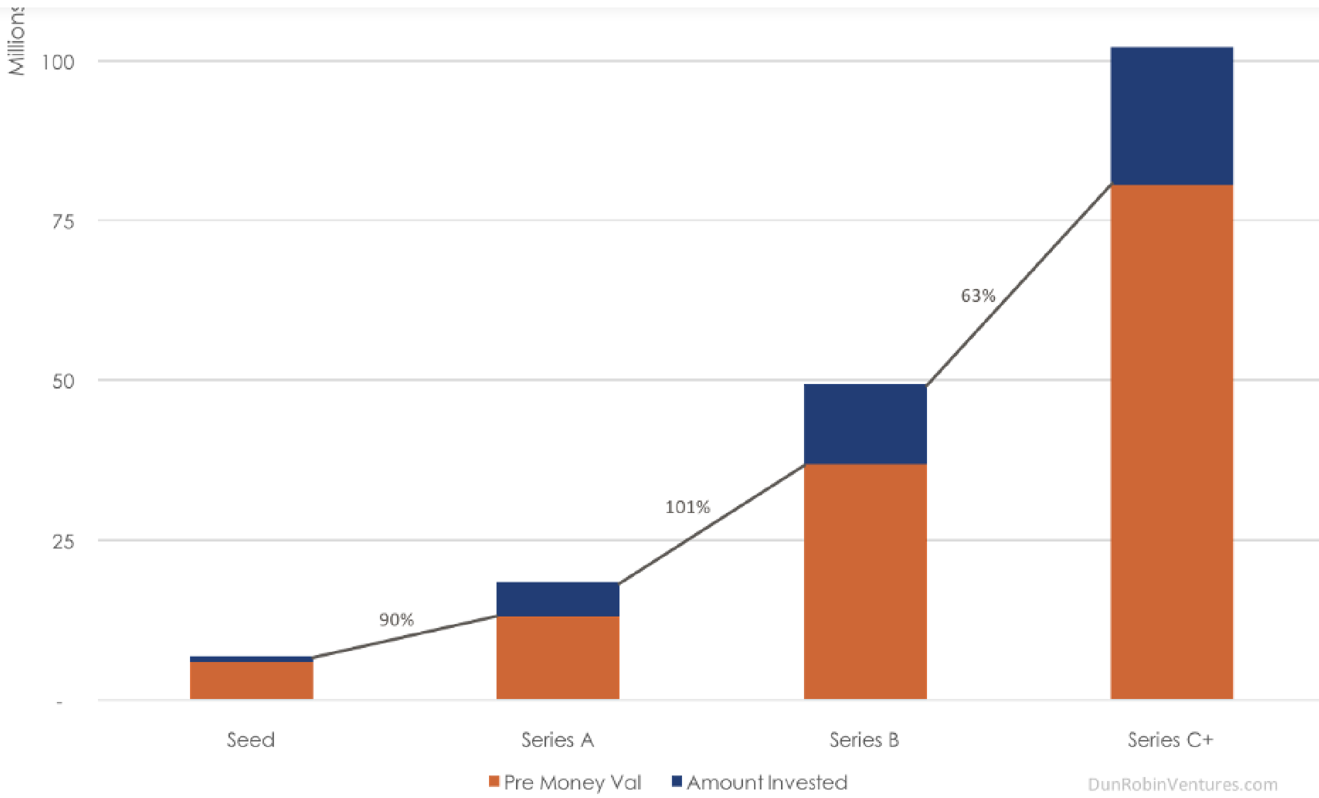
Converting this view to look at the overall chance of success, the numbers are more blunt; only 2.4% of Series Seed, 17% of Series A, 56% of Series B, and 83% of Series C companies succeed to exit.

From this perspective it seems clear. We should be investing in late stage companies. But that is not the full story.

Returns:

While there is undoubtedly more risk in earlier rounds, there is also the opportunity for significant returns to compensate for the risk.

Here is how valuations change from round to round:



To calculate ROI we need to look at post-money to pre-money valuation changes. From the median valuations we find that returns are:

- Series Seed to Series A: 90%
- Series A to Series B: 101%
- Series B to Series C: 63%
- Series C to Series D: 20%

Which equates to the lifetime cash-on-cash return, if held to exit, of:

- Series Seed: 644%
- Series A: 292%
- Series B: 96%

factors inherent to early stage investments?

Weighing Risk and Return:

By multiplying the lifetime return statistics against the lifetime failure data, we get the total expected returns on investments in each round, which look like this:

Clearly the sweet spot for venture investing comes in the Series A and Series B investments, where a diversified investor should see around a 50% capital appreciation. However, angel investors tend to stay in the Series Seed space where risk adjusted returns are the lowest and the investment timeline is the longest.

Compared to Series Seed, it seems rational for angel investors to move into the Series A and Series B space where angels would see almost double the risk adjusted returns with a significantly shorter investment period.

which only founders and a few insiders were offered the opportunity. Just a few months later Uptake was Chicago's newest billion dollar company.

Similarly, most Series A and Series B investment deals are all but unavailable to angel investors. Thanks to a mix of VC competition, large check requirements, and expectations for additional value adds by investors, it is extremely difficult for angel investors to dabble in later funding rounds in the same manner as Series Seed.

At DunRobin, we believe that we provide a unique model that attempts to address this issue for angel investors. DunRobin has already introduced its angel investors to a few later stage deals with familiar terms and will increasingly do so as the opportunities arise.

Data was provided by Crunchbase, Angel.co, and Pitchbook.

DunRobin Ventures is a full service venture capital firm backed by an exclusive angel investor community, where investors are offered the opportunity to invest in the midwest's best startups. We're giving investors access to deals that have never been available to them. If you haven't already, check us out!

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