Financing high-growth firms: The role of angel investors

Why is angel investing important?

Angel investment is the most significant source of outside equity for seed and early stage start-ups.

- Banks are even more reluctant than in the past to fund young firms due to their perceived riskiness and lack of collateral.
- Venture capital firms are, for the most part, focused on later stage start-ups and therefore have left a significant funding gap at the seed and early stage.
- Angel investors are increasingly forming groups and syndicates to pool funds to fill this funding gap.

Equity investors at the seed, early and later stage of firm growth

Informal investors		Formal investors
Founders, friends and family	**Angel investors** (typical investment size: 25-500K USD)	**Venture capital funds** (typical investment size: 3-5M USD)
Seed stage investments	***Early stage investments***	***Later stage investments***

Financing gap

Angel investors, who are often experienced entrepreneurs or business people, invest in innovation more broadly than venture capital firms.

- Angels invest in a wider range of sectors and geographies (most angels invest locally, not just in high-tech hubs where VCs tend to concentrate).
- Angels invest not only for a potential financial return, but in many cases, to give back by helping other entrepreneurs. Also, being former entrepreneurs themselves, it is an activity they enjoy.
- Angels tend to be less sensitive to market cycles than banks or VCs.

Angel investing is becoming more visible, formalised and professional.

- The formation of groups and networks has helped entrepreneurs and angel investors connect with each other, addressing some of the information asymmetries in the seed and early stage financing market.
- At the same time, angel investing differs across countries and regions in terms of both activity level and form. In some countries, angels organise in groups and in others through networks and each of these also can take several forms.

Is there a role for policy?

Policies and government support can't create an angel market but can be a catalyst for developing the market.

- While there is not always evidence of a market failure in seed and early stage financing, it is clear that the funding gap has widened. A number of countries have chosen to take action in this area, citing information asymmetries, additionality, and potential spillover effects as well as fit with a broader economic strategy.
- There are an increasing number of examples around the world of programmes and policies to support angel investment, ranging from tax incentives to co-investment funds to support for national angel associations, groups and networks.
- At the same time, there has been little formal evaluation of these policies and programmes to date, so further work is needed in this area. Policies that have worked in one country may not necessarily work the same way, or be as successful, in another country.
- Another challenge for policy makers and practitioners alike, is that there is limited data, as well as a lack of clarity on definitions, which make the angel market difficult to measure.

The lack of an entrepreneurial culture and ecosystem remains a barrier in many countries.

- Without entrepreneurs there will be no start-ups. Changing culture is difficult and requires the proper framework conditions as well as a long-term effort focused on awareness-raising and education.
- Entrepreneurship can only flourish in a healthy entrepreneurial ecosystem in which a range of stakeholders (entrepreneurs, companies, universities, governments, VCs, accelerators, services providers, etc.) play a role. If policies and programmes are put in place too early before the necessary pieces of the ecosystem are in place, they may fail.

What is the OECD doing in this area?

OECD High Growth Financing Project

- In June 2010, the OECD launched a project to study seed and early stage financing for high growth companies in OECD and non-OECD countries, with a primary focus on angel investment. The project included interviews with over 100 practitioners, experts and policy makers in 32 countries.
- The project was generously supported by the Australian government with input provided by the member countries of the OECD represented on the Committee for Industry, Innovation and Entrepreneurship (CIIE). National angel associations and federations around the world generously provided information and data.

Publication

The project findings were published at the end of 2011 in an OECD book entitled *Financing High-Growth Firms: The Role of Angel Investors*. The report provides an overview of angel financing and a description of how it has evolved in OECD and non-OECD countries, and highlights policy interventions within some countries. Further information is available at www.oecd.org/sti/angelinvestors.

Possible future work

- This project appears to be the first time angel investing has been covered on a global basis. There is clearly a need for more work across OECD and non-OECD countries. Given the both the policy and data issues in the angel market, the OECD will be considering further work in this area.

Contact
Ms. Karen Wilson
Structural Policy Division
Directorate for Science, Technology and Industry
karen.wilson@oecd.org

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