Taking the pulse of the angel market.
Foreword

The UK Business Angels Association and Deloitte LLP have collaborated to gather insight in the common belief that angel investment is a vital source of risk capital which facilitates growth in the UK economy and enables entrepreneurs to achieve their potential.

We have identified that there is a lack of market intelligence on trends, opportunities and challenges in current angel investing; a result of activity which is carried out by individuals who use their own money; acting alone or in groups. This insight and knowledge is vital to encourage new investors into the market place and back high growth UK businesses; promote the maturity of this asset class and provide important context to inform new policy development. This will ensure that angel investment continues to be a valued growth enabler which supports entrepreneurs within the UK.

It has been nearly five years since we last gained the detailed views of angel investors, in the “Siding with the Angels Study” carried out by Nesta and the BBAA in 2008-9, so how have things changed? Our aim was to take the pulse of the angel investment market in 2013, not to quantify the market or extrapolate statistics. Instead we have set out to hear from angels about the deals they have been doing between 1 April 2012 and 31 March 2013 and gain their views on the market place. 62 angels have been directly surveyed in all regions; from the East and West to North and South. Views were taken from individual angels, angels in networks, syndicates, new angels in their first year of investing and the new breed of ‘super angels’. Over 250 angel deals were analysed to explore what the market looks like in 2013.

Through this survey we have sought to identify: What does the market look like in 2013? What are the trends in angel investing? What has been the impact of government measures and market drivers? What are the challenges and what more could be done to support angel investment at the level of government; the UK Business Angels Association; other funding measures; the Angel Community and the Corporates?

Setting this baseline against the current market is important so that it can be benchmarked in future years. We hope you find this snapshot of the angel market in 2013 useful and interesting and we welcome your views and feedback.

Jenny Tooth
Chief Executive
UK Business Angels Association

Paul Fletcher
Practice Senior Partner, Private Markets, London
Deloitte LLP
“As Chair of UKBAA and an active angel investor, I know how important information about the market is to encourage more individuals to get involved in angel investing and promote further policy backing. I am delighted that Deloitte LLP has supported our trade association with this valuable piece of new research.”

Sir Nigel Rudd, Chair, UK Business Angels Association

“Deloitte believes in the power of business ecosystems to help support entrepreneurial businesses and that they play a vital role in stimulating growth in the economy. To this end, we believe the angel investment market creates opportunities for entrepreneurs at the most critical stage in their business life cycle. I am therefore pleased to have supported the UKBAA and this research which will inform our understanding of angel investing and help inspire future investment.”

David Sproul, Chief Executive, Deloitte LLP
Executive summary

During the course of our research, we examined 262 angel deals which were completed between 1 April 2012 and 31 March, 2013. The combined deals involved £137m of risk capital; and investments were made through individual investors, angels in networks, syndicates and groups; including online platforms and co-investing alongside venture capitalists (VCs) and other alternative funding sources.

The following findings are based on analysis of these deals, combined with our online survey and interviews with 62 individual angels across England, Wales and Northern Ireland during the period 1 May 2013 to 30 June 2013.

Status of the Angel market in 2013

• Angels invested more capital in 2012/13 than in previous years, with the vast majority going into early stage ventures. More than half of all capital was invested in the South East and more than half was invested in internet and digital businesses.

• The deal environment is becoming ‘noisier’ with both more deals and more angels in the market. Angels perceive that the proportion of quality deals is falling, making origination harder for some angels.

What are the government drivers?

• Government introduced initiatives such as the increased tax relief in the Enterprise Investment Scheme (EIS) and the new Seed Enterprise Investment Scheme (SEIS). Together with the £100m Angel CoFund (which came into force during this period) these schemes are attracting new capital into the early stage market. As a result, some investors believe expectations on valuations have increased and perhaps may be contributing to a valuation ‘bubble’.

What are the market drivers?

• By creating syndicates and leveraging co-investment funds, angels are moving up the value spectrum and beginning to fill the perceived funding gap being vacated by early stage venture capitalists (VCs).

• A new breed of ‘super angels’ is not only substantially investing increased amounts of money but also providing extensive business support for portfolio companies.

• Equity crowdfunding is part of the funding ecosystem and is fast becoming an alternative source of capital for entrepreneurs, as well as a possible lower-risk introduction to angel investing for new investors.
What are the challenges for angel investing in 2013?

• Angels’ view of growth capital and the potential for exits is generally optimistic. Trade sale to a foreign buyer is seen by angels as their most likely route to exit.

• Many angels feel there will be more portfolio casualties at seed level as lower quality businesses fail to close follow-on rounds. Increasingly, a lack of liquidity is a problem for many angels as their capital is becoming tied up in their current portfolio businesses. This is already causing some established angels to reduce the amount they invest in new deals, syndicate, or seek co-fund arrangements.

• Promoting angel investing as an asset class with substantial tax benefits is regarded as an important factor to attract new angels into the market.

• A lack of knowledge about investing fundamentals among new angels was highlighted as a potential barrier to growing a sustainable pool of UK angel capital.

We have set out at the end of this document an overview of what could be done to improve and grow the angel market at government level, through the UKBAA trade association, the angel community itself and other key players in the ecosystem such as corporates; reflecting the views of the angel investors, which we hope will open up the debate.

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What does the angel market look like in 2013?

In the UK, angels remain the main source of early stage investment. A large amount of angel money continues to be invested in digital and internet businesses. Businesses in London and the South East attract the largest proportion of capital available to this community and angels continue to be attracted to ‘seed’ and ‘early stage’ deals.

We looked at 262 deals done by individual angels, networks and syndicates totalling £137m of investment. Angel money comprised £76m and £64m came from VCs, co-investment funds and other sources, investing alongside angels. The average angel investment per deal was £324k, and the median investment was £160k.

Angel investment was concentrated in digital and internet businesses, which made up 50% of angel capital invested from our sample.
In our sample, businesses in London and the South East attracted 54% of angel investment in 2012/13, followed by the South West (13%), Midlands (11%) and Northern Ireland (6%). Average angel investment per deal per region was: South East £411k, South West £682k, Midlands £253k and Northern Ireland £250k.

The South West represented 6% of the deals in our sample. However it punched above its weight in terms of money invested (13% of the total) due to a relatively large proportion of £1m+ deals in 2012/13.

83% of angel capital in our sample went into early stage businesses, with 29% going into businesses at seed and start-up level.

54% of angel capital in our sample went into 'early stage' businesses, with 29% going into businesses at 'seed' and 'start-up' level.
What does the angel market look like in 2013?

Figure 5. Angels’ investment levels in 2012/13 compared to previous years

The deal environment is getting noisier, but investors’ perception of quality is that it is not keeping track. This can make origination harder for some angels. 76% of our respondents say there are more deals out there compared to previous years, while 75% believe that the number of quality deals is either the same or worse.

Angels say:
“A lot of entrepreneurs who get into accelerators are not ready, yet they still get pushed into the investment machine after finishing the programme.”

58% of angels say they are investing more of their own money than in previous years.

Angels say:
“There are more investors and networks joining the market, there’s an investor appetite out there for the right deals.”

But …
“We need to get more people from The City to become angels.”

Figure 6. Deal quantity and quality compared to previous years

% of respondents

<table>
<thead>
<tr>
<th>How 2012/13 compares to previous years</th>
<th>Quantity</th>
<th>Quality</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less</td>
<td>20%</td>
<td>22%</td>
</tr>
<tr>
<td>Same</td>
<td>58%</td>
<td>60%</td>
</tr>
<tr>
<td>More</td>
<td>20%</td>
<td>18%</td>
</tr>
</tbody>
</table>
What is making the market tick?
Government drivers

Tax breaks are welcomed by angels and are encouraging new entrants, in addition to more capital being driven back into the market from existing angels. However, many angels are concerned it could drive a valuation bubble.

Figure 7. How significant was EIS in your investment decisions in 2012/13?

74% respondents said that the Enterprise Investment Scheme or the Seed Enterprise Investment Scheme (EIS/SEIS) were significant or highly significant to their investment decision making, and 86% say that they usually or always use EIS/SEIS. 58% would have invested less or not at all if EIS/SEIS were not available.

SEIS was used in 12% of the angel deals in our sample. Many angels we interviewed said they would not have invested in their seed deals without SEIS. However the view of the scheme across our sample is mixed. 77% of respondents felt that valuations were higher or much higher than in previous years as a result of new money through SEIS.

Angels say:
“EIS de-risks my deals and gives me more firepower so I can invest more.”

“Without EIS I would’ve still invested, just not as much.”

But...
“There are more start-ups now because there is more seed capital, but quality is variable so investors must have stronger filters.”

“Are SEIS tax breaks too good, encouraging new money with the wrong motives?”
Angels say:
“Overall this new money is good for the market – it increases liquidity and drives new start-ups.”

But …
“SEIS is driving a new inflow of inexperienced investors offering unrealistic valuations. They will learn their lessons and become good investors in the future.”

The Angel CoFund is mobilising new angel money to fill the perceived gap being vacated by VCs. 14% of the angels in our sample had accessed Angel CoFund capital and reported a positive experience. However, 86% of our sample had never used the Angel CoFund. Some were not aware of it and others felt it was not useful to their investing.

The Angel CoFund has invested £10m alongside £30m from angels and other investors, over 29 deals. Average deal size where the Angel CoFund participated is £1.35m (source: Angel CoFund, June 2013).

Source: Angel CoFund, June 2013
What are the market drivers?

Syndication is becoming more common and is enabling angels to leverage significant amounts of capital to fill the perceived gap left by VCs as they retreat up the value spectrum; and to do more follow-on investing. They provide assistance and infrastructure for new angels. However, lack of liquidity in the market is also driving more angels to syndicate deals, stretching investment capital and sharing risk.

Figure 10. In 2012/13, did you syndicate more or less than in previous years?

73% of angels in our survey usually or always invest in syndicate and it is growing: 35% say they are investing in syndicate more than in 2011/12. Lack of liquidity in the market is also a driving factor as some angels are now investing less per deal in order to keep spreading their risk. The average syndicate size from our sample is 6 angels.

Angels say:
“Syndication allows us to pool skills and contacts.”

“I used to invest £100k per deal, now only £25k, so I have to syndicate more.”

“Angels have a role to play to fill the Series A crunch. The issue however is that angels need to diversify, and for big rounds there just aren’t enough angels out there who can put in the large amounts and still be diversified. There is therefore a strong reason to do ‘super syndication’.”
Super angels are a new breed of extremely active angels, mainly full-time angel investors with significant capital investing, and building up large portfolios. They are a growing force which is helping to fill the perceived VC gap.

The super angels in our sample invested nearly 3 times as much as other angels, and 81% of super angels say they are investing more than in previous years, versus 55% of other angels.

Equity crowdfunding platforms are attracting angels to invest smaller amounts of capital per deal using their SEIS tax breaks. Angels have also spotted the opportunity to invest in the equity crowdfunding businesses themselves.

To grow their businesses, equity crowdfunding platforms have become part of the funding ecosystem seeking to build relationships with angel networks to top up angel rounds, or to take seed deals which are not ‘angel ready’ yet.

Angels say: “SEIS + equity crowdfunding is a great way to get City money into the angel market.”

Crowdfunding platforms say: “Crowdfunding acts as a lower-risk on-ramp to angel investing for the ‘mass affluent’.”

“Experienced angels can use equity crowdfunding to diversify using lower amounts of capital.”

Figure 11. Average number of deals done 2012/13

The super angels are creating informal syndicates (e.g. Angel Lab) and teaming up with seed level VCs to source and share dealflow. They are not only investing, but also applying their experience and provide active support, door-opening, follow-on capital, and even work space. Examples include The Friday Club, Warner’s Yard and White Bear Yard.

Figure 12. Investment raised on UK equity crowdfunding platforms

Source: Crowdcube, Seedrs, FundTheGap
What are the market challenges?

While some angels in our survey are optimistic about growth capital, others feel that lack of quality deals affects capacity to attract expansion funding. Exits remain a concern, with many feeling they take longer than planned. Liquidity is becoming an issue preventing recycling of investment gains into more start-ups, with many angels scaling back their investing as they approach or exceed their desired risk level.

Figure 13. Do you believe there are sufficient or insufficient growth capital and opportunities to exit?

<table>
<thead>
<tr>
<th>Growth Capital</th>
<th>Exit opportunities</th>
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<tbody>
<tr>
<td>Sufficient</td>
<td>61%</td>
</tr>
<tr>
<td>Insufficient</td>
<td>39%</td>
</tr>
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Angels say:
“There’s enough growth capital for the number of quality deals out there. But this does mean there will be more casualties at seed level.”

But …
“VCs are retreating from Series A because they can’t get the returns they need.”

“Government-supported VCs are supposed to fill that gap, but even they are looking for turnover of £1m minimum.”

Growth capital
Many angels felt the failure to attract growth capital resulted from the current ‘noisy’ market, making it more difficult for quality deals to get noticed.

60% of angels felt there was sufficient growth capital, whilst nearly 40% felt the opposite and feel the funding gap is widening due to VC firms retreating up the value spectrum away from earlier stage businesses in order to reduce their risk and preserve returns.

Liquidity and exits
Our respondents view liquidity as a temporary issue; 70% are more optimistic and feel there would be sufficient exit opportunities in the current economic environment, mostly trade sale to foreign buyers. When it comes to exits, the prevailing view is that businesses need to scale revenue and hit profitability quickly to attract buyers. In contrast, some angels are focusing on a more ‘American’ model and feel that product development and market penetration are more important for exits than growing revenue and achieving profitability. Either way, confidence in exits is building.
However, a commonly held view from our respondents is that many angels are reaching their limits and follow-on investments are draining them further, though they would like to continue investing. If they could free up some capital, many angels say they would recycle the money back into the early stage market.

Angels say:
“‘If you create a successful company, there will always be an exit.’”

“Exits cannot be orchestrated – the exits come to you! So the business needs to keep itself in good shape for when opportunity comes knocking.”

But:
“‘I’m investing 75% less per deal now, so I can continue spreading my risk.’”

“I’m having to invest more in follow-ons than previously, in order to protect early investments regardless that I’m beyond my desired investment exposure. I’d rather invest in new deals, not follow-ons.”

Angels believe valuations are much higher than previous years driven by renewed confidence in exits, new entrants and stimulus by EIS/SEIS. Many respondents also felt that this stimulus is attracting lower quality deals into the seed market, making it ‘noisier’. Additional causes of higher valuations highlighted in our survey included a greater number of deals coming out of accelerator programmes receiving funding, and equity crowdfunding platforms attracting large volumes of unsophisticated investors into the system.

Lack of education and ongoing support was also seen as a barrier to attracting new angels into the market, although syndication was seen as going some way to fill this gap, allowing new angels to learn ‘on the job’ alongside more experienced investors.

The need for more awareness of angel investing as an asset class, and for government to do more to promote the tax benefits of EIS/SEIS and in addition simplifying the process was identified by 21% of our respondents to attract more angels into the market.

Angels say:
“SEIS is good at attracting new angels into the system, but they then struggle to figure out how to be an angel. New angels need training.”

“The government should simplify EIS and SEIS and market it more widely.”

But, there was a vocal minority who felt the market should be left to run its course:
“The government should not be encouraging more angels. It is bad public policy and market distorting.”
What more could be done to improve the angel market?

A role for government?

- Improve awareness of EIS/SEIS and angel investing to target people with financial capacity and relevant experience, but avoid promoting tax breaks to drive ‘dumb money’ into the market.

- Review current limit of 3 years to take account of the potential for ‘short exits’ especially for technology businesses and offer protection for tax breaks should positive exits occur during this period.

- Review the maximum level for SEIS, currently at £150k, to ensure that seed stage growth potential businesses can attract smart angel investors with capacity to take the business through further rounds.

- Support and promote the new measures proposed by LSE and AIM to improve access to public markets for angel-backed high growth potential businesses.

A role for other key funding measures

- Business Growth Fund should offer a clearer path to growth finance for angel-backed growth businesses and offer liquidity for angel investors.

- Angel CoFund to promote greater awareness and facilitate usage among angel syndicates, reviewing processes to ensure that it is accessible and responsive to the normal deal closure cycle.

- Business Bank to provide framework to improve access for angel-backed businesses to relevant sources of debt and lending to support growth and expansion.

A role for the UK Business Angels Association

- Promote further awareness and understanding of the asset class, including among wealth managers and advisers, to encourage HNW individuals with finance and entrepreneurial experience to bring smart money into angel investing.

- Support the development of skills training for new angels to build on the opportunity of SEIS, drawing on the experience of existing angels, notably through the new UK Business Angels Institute.

- Promote syndication as the best model to share knowledge, skills and build investment levels to fill VC gap and encourage identification of experienced lead angels.

- Support a connected ecosystem to link angel investors into all relevant sources of finance and support to ensure access to effective deal flow growth capital and liquidity.

A role for the angel community?

- Act as ambassadors to promote others to take up angel investing.

- Support opportunities to transfer skills and experience to new investors, encouraging new angels to become active participants in the market.

- Identify new ways to share deals and mutually leverage finance and experience through online and in physical communities.

A role for corporates

- Identify the opportunity for greater interface with angel-backed businesses as a key source for acquisition or corporate venturing whilst supporting liquidity for angel investors.
Contacts

Paul Fletcher  
Practice Senior Partner, Private Markets, London  
Deloitte LLP  
pafletcher@deloitte.co.uk

Lea Pateman  
Head of Private Markets’ Marketing  
Deloitte LLP  
lpateman@deloitte.co.uk

The UK Business Angels Association is the national trade association representing angel and early stage investment in the UK. (England, Wales and Northern Ireland). For further information visit www.ukbusinessangelsassociation.org.uk or contact: info@ukbusinessangelsassociation.org.uk

UK Business Angels Association, Pinners Hall  
105-108 Old Broad Street, London, EC2N 1EX  
t. +44 (0) 207 628 7222

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