UK Business Angels Association

THE ANGEL ECOSYSTEM

developments, challenges and opportunities

The early stage finance ecosystem - and the role of angels within it - has changed radically since the financial crisis. Technological innovation, government tax policies and wider macro-economic factors have all played their part. It's time to take a fresh look at the ecosystem: to understand how it is operating at present and what works, where the problems and bottlenecks lie, and how we can improve it. How precarious is it, and how can it be strengthened?

UKBAA has consulted with many market participants and observers and organised two round table sessions with key representatives of the market to enable in depth discussions. This document sets out the results of these discussions.

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The Positive Developments

The emergence of crowd equity platforms and the digitalisation of investment has allowed more people to invest - when they want, and the amounts that they want

Britain has become a nation of angels. By making it easier for people to invest, crowd equity platforms have democratised investment. They have broadened the base of the pyramid by enabling many people to invest small amounts in early stage companies. At the same time, significant large investments are also being made on the platforms. More angel investors have been created, including many time-poor professionals in the City and beyond. Crowd equity funding is maturing: it is not just for securing seed finance. Established businesses are raising finance through crowdfunding. Seasoned entrepreneurs are using the platforms.

Government tax incentives have been enormously successful

The introduction of SEIS and the extensions to EIS has created a tax environment that is encouraging many more individuals to invest - and not just through crowdfunding platforms. EIS and SEIS play a key part in helping early stage businesses bring in angel investors. The tax reliefs enable investors (including VC firms) to get in early.

Angel investing has become more professional, and the growth in the number of angel syndicates is driving this forward

Angels are adopting more sophisticated approaches to investing, acting more like VC funds and conducting greater levels of due diligence. In some cases, angel syndicates now compete directly with VC firms. Angel funding rounds are increasing in size. Angel co-investment funds are adding to firepower and capacity. The average Angel CoFund deal is £1.4m - an unimaginable round size just ten years ago. Growth companies can look to angels for scale-up finance. The growing strength of angel syndicates and the professionalism of people involved is dispelling the view that angels are individuals who are difficult to do business with

The climate and culture is positive towards entrepreneurship

The Government has recognised and supported the climate for entrepreneurship and has encouraged startups. It is cheaper to start a business: it is feasible to build a MVP with £150k, so more companies are being created. While the age and experience of entrepreneurs has fallen dramatically, there is more support for entrepreneurs, such as the number of accelerators.

Our thriving entrepreneurial culture really does have the potential to create more billion pound businesses

Increasingly, founders and investors do not automatically seek an early exit but focus on building substantial global enterprises. Serial entrepreneurs are spawning multiple new business ideas in collaboration with VCs and angels. The new generation of incubators and accelerators, when properly executed, provide high-quality mentorship and access to quality deal-flow for investors. Corporate investors and sector-specific angel syndicates are giving growth companies clear frameworks by which to access their chosen markets.

Early stage finance is more visible

The investment in marketing by crowdfunding platforms has built up their brands and created a greater awareness of how to access finance. Social media enables greater brand awareness for VC firms, angel syndicates and individual Lead/Serial angels. Angels are no longer secretive. They are making themselves visible and accessible - and in return they are seeing quality deal-flow and attracting co-investors (when previously all angels kept themselves under the radar).

Angel and early stage investment sources are growing in scale and diversity

New sources of finance, including next generation family offices, are entering the market and wish to invest in early stage companies. The professionalisation of investors is leading to better returns and outcomes, which in turn acts as a driver to attracting more investment. Changes to pensions both in terms of regulation and participation create a substantial opportunity for more investment within the angel ecosystem. Individual people will want or need more diversity and investment opportunities - and that will include angel investing.

The Challenges

There is insufficient scale-up finance available

The focus has been solely on startup finance and SEIS/EIS funding. It has become even harder for growth companies to secure proper series A rounds. The funnel has fewer people at the higher end.

Exits will continue to be difficult to achieve

The number of startups has increased and far outstrips the potential for exits. The proportion of startups that will exit is shrinking. Traditional routes of trade sale and IPO remain, but it now takes between 8 to 12 years to get a positive exit. How can this meet the expectations of investors on crowdfunding platforms? There is a clear need for a better secondary market to improve the whole ecosystem.

Managing expectations of new investors and entrepreneurs

The ease and convenience of online investing, the tax advantages of SEIS and EIS, and sustained low interest rates, have all contributed to a surge of new investors. Many of them are led by trends and general market behaviour rather than by their own knowledge of angel investment. At the same time, the growth in the number of startups (often led by first-time entrepreneurs) and crowdfunding platforms has created a wave of dealflow. There is frothiness in the market. Poorly advised or lacking understanding of the market, many entrepreneurs and new angels have unrealistic aspirations of valuation. "Dumb money" and over-hyped valuations lead to later stage finance becoming more difficult to obtain.

Potential Correction in the Market if Platforms Fail

The past few years has seen a proliferation of entrants to the marketplace - such as incubators, accelerators and crowdfunding platforms. There has been huge change in the number and nature of market players. It is unclear how this much altered ecosystem will cope when there is a market correction or when individual players or platforms fail.

Uncertainty over the future of EIS/SEIS

Angel investment in the UK has been built around the success of EIS and SEIS. Since EIS was launched in 1993-94, almost 22,900 individual companies have received investment through the scheme and over £12.2bn of funds have been raised. Yet proposed EU changes to state aid rules could harm these schemes and thus have an impact on early stage and growth finance in the UK. Any uncertainty surrounding the future of EIS and SEIS is extremely damaging.

The ecosystem is patchy across the UK regions

The London-Cambridge-Oxford triangle is indeed a golden one - yet its strengths do not yet benefit the rest of the country. There is negligible co-investment between the north and south. In many regions, angels and early stage VCs are less visible and key players are not well connected. Local entrepreneurs cannot access significant growth capital from outside of their region. While initiatives such as Tech North are attempting to address these issues, much remains to be done.

Opportunities for Action- Shaping the ecosystem for 2020

Our roundtable discussions identified four key areas where concerted action would strengthen and improve the angel and early stage finance ecosystem over the next five years. It is vital that the different parts of the ecosystem come together around a shared agenda. With a collective focus on these areas, many of the challenges that face the ecosystem can be successfully addressed. The four opportunities for action that we have identified are:

1. To achieve greater collaboration among all key players in the ecosystem

Whether between angels and VCs, individual investors and syndicates, or syndicates and corporates, there are substantial opportunities for achieving greater collaboration and co-operation among key players in the ecosystem.

- There is scope to improve communication between all the different funding sources (e.g. re their requirements/parameters)
- Knowledge about deals and information on outcomes can be shared more widely
- There are more opportunities for co-investment

- More investors and entrepreneurs should tell their stories and case studies could be 'showcased' online, providing greater understanding and insight for entrepreneurs and investors

2. To create better connectivity across systems and structures

There are clear opportunities to improve the connections between different parts of the ecosystem. Some of these opportunities are systems-based, such as the development of deal-sharing platforms and secondary markets. Others require stronger structural links between institutions and market players.

- There are many aspects of public policy that affect the ecosystem: startup and general business support, and innovation (BIS and the LEPs); tax incentives (HMT/HMRC); financial regulation (FCA); regional devolution (Cabinet Office/DCLG). In addition, there are sector-specific strategies. There are clear opportunities to connect and unify these areas.
- There are bottlenecks between funding sources (such as angel/VC co-investment) that can be tackled
- New and dynamic co-investment relationships across regional boundaries are required to ensure entrepreneurs can access the finance they need
- Issues of exit and liquidity must be addressed, particularly by
    - growing the number and scale of secondary markets
    - encouraging greater interaction with corporates

3. To make the market more transparent

A more transparent market will lead to greater capacity and better connectivity. With wider and faster access to more data, more players in the ecosystem can share and communicate their successes and challenges.

- Investors and especially crowdfunders need to share intelligence on successes and failures; all players in the ecosystem should have clearer understanding of what works and what doesn't
- The ecosystem needs access to more robust statistics and data on outcomes to be provided from all players, including HMRC who should open up access to EIS Tax Return data
- There should be greater sharing of knowledge on methodology and attitudes towards pricing and valuations
- Clearer information and signposting is required for entrepreneurs, in order to enable them to identify the right source of investment to meet their growth needs

4. To build increased capacity and capability for entrepreneurs and investors

Given the growth in the number of entrepreneurs, there are opportunities to equip them with the skills, tools and information to help them become investment-ready. The emergence of many novice investors means significant opportunities to build up their understanding, so that they remain committed and engaged to angel investing.

The rise of angel syndicates and co-investment funds creates an opportunity to build a larger cadre of lead angel investors, in order to further professionalise the marketplace. The growth in the number of deals means that there is an opportunity for more entrepreneurs and investors to share their successes and, just as importantly, their failures.

- Increase the quality and availability of investment readiness for entrepreneurs
- Increase the knowledge and professionalism of individual investors, such as through angel investor e-learning and accreditation
- Increase the number of lead angels
- Showcase the success stories of both entrepreneurs and investors, so that the whole ecosystem can be learning continuously

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