

## The Angel Bubble (or why I would rather be a VC)

Much has been written over the last few years about the poor performance of the venture capital asset class since 2000. And on average, the performance has been terrible. Median returns according to Cambridge Associates for the 2000 vintage year were -3% â€œimprovingâ€ to -1% for the 2001 vintage year. Top quartile returns kicked in at 4% and 6% respectively. [Kaufmann](#) thinks the VC model is broken as it relates to LPs. [Fred Wilson](#) thinks the problem is concentration of money in a few big firms. [Silicon Valley Bank](#)'s research demonstrates that small VC funds deliver bigger returns than big VC funds.

At New Atlantic Ventures, we think now is the time to be doubling down in venture capital, and we laid out [our reasons why](#) in May of this year. We think Kaufmann, Fred Wilson and SVB have it right â€œ smaller is better when it comes to venture.

Taking this â€œsmall is betterâ€ perhaps to an extreme, many institutional LPs have experimented with investing in micro-VC funds, super angel funds, and seed stage funds, chasing the earliest of the early stage. Many VCs, as well, have started their own seed programs as a carve-out to their traditional VC funds. The premise here is that angels can now fund companies to scale, and that if you are not an investor in the seed round, you will be locked out when the company goes to raise institutional capital.

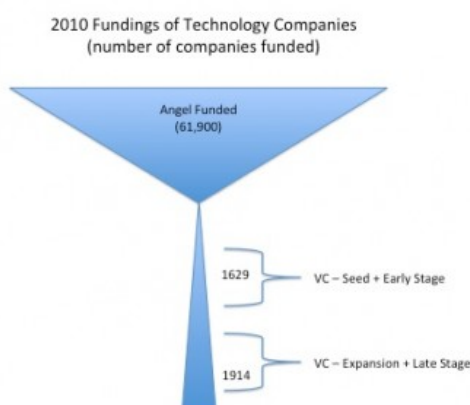
Entrepreneurs, angel investors and venture capital funds have always lived in a symbiotic ecosystem, where each depended on the other for success. Relative power in the ecosystem changes over time â€œ The bubble in the 1990s benefited entrepreneurs and VCs disproportionately, as winners were often determined by the size of their funding round. The tech implosion of 2000 gave the power back to the VCs, who too often used a heavy hand in trying to â€œsaveâ€ companies through severe down rounds. But starting round 2006, the power moved back to the angels. The cloud drove this move, as companies could now be started with an order of magnitude less capital. Entrepreneurs didn't need VC-scale money to start their companies, and angels could see a company get to market without too much cash.

But is it possible to be â€œtoo smallâ€ when it comes to the venture capital asset class? I ask this question because of the rapid growth in angel capital, the resurrection of the incubator/accelerator model, and the rise of the micro-VC.

I'm not sure that this new trend is a great strategy, and I won't make a lot of friends by saying it. But the angels and the seed funds have a math problem.

The University of New Hampshire conducted a [nice bit of research](#) on the angel market, noting that in 2010, angels invested \$20b in 61,900 companies (that is \$323,000 per company.) TechCocktail published a great list of the [top incubators](#), most of which are still toddler-age. And Dave McClure at 500 Startups has the loudest megaphone trumpeting micro-VC as an alternative to traditional VC, which he calls [stupid, arrogant](#) and a few other words best left to the imagination.

So I did a little digging, and asked myself, sitting here in 2012, would I rather be an Angel or a traditional VC. I gathered some data from the [NVCA](#) and the University of New Hampshire to answer the question, and the data surprised me.



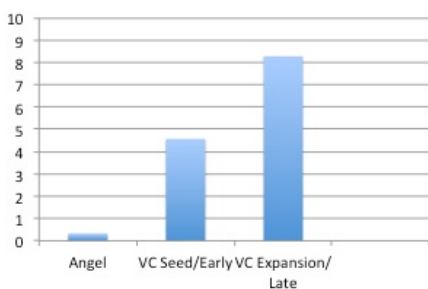
I am a big believer in supply and demand, and as a VC I like the “supply” of angel funded deals that are coming my way. For every early stage company that receives venture funding, there are 40 angel-funded companies. VCs do have the pick of the angel-funded litter. Said another way, only 2.5% of angel-funded companies will ever raise venture capital. What happens to the rest? Most crash and burn. Some are acquired for their talented teams. Some become good lifestyle businesses. And a few have nice exits without ever having to raise an institutional venture round.

There is also a lot of angel money (\$20b) funding these 61,900 companies. In fact almost 3X the money that goes in to Early-Stage Venture (\$7.4b). And almost 1.5X the money that goes in to late stage venture (\$15.8b).



But the amount of money per company tells the real story. The average angel round (\$323k) is dwarfed 14X by the average early-stage VC round (\$4.6M) and late stage rounds, at \$8.3m are almost twice the size of early stage rounds.

### \$m Dollars invested per deal



My conclusion? We are in an angel bubble that will keep inflating when Crowdfunding meets Main Street in 2013. But the bubble will burst. Not tomorrow. But soon. Mark my word. Perhaps in 2014?

But the angel bubble benefits traditional VCs. And when the bubble bursts, even more companies will come looking for institutional grade venture capital. I like where I am, investing as an early stage VC. I am also the biggest fan of the angels and incubators. They

make my job easier. So thank you â€“ and keep it up!

Written by John Backus August 28, 2012