Is it worth it? The rates of return from informal venture capital investments

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ABSTRACT:

Despite growing interest in venture capital, there is a paucity of information on the rate of return to these investments and the limited research that is available refers almost entirely to portfolio returns for venture capital funds. The investment returns to business angels have been virtually ignored. This paper provides the first attempt to analyse the returns to informal venture capital investment using data on 128 exited investments from a survey of 127 business angel investors in the UK. The paper finds that the distribution of returns is highly skewed, with 34% of exits at a total loss, 13% at a partial loss or break-even, but with 23% showing an IRR of 50% or above. Trade sales are the main way in which business angels harvest their investments. The median time to exit for successful investments was 4 years. Large investments, large deal sizes involving multiple co-investors, and management buyouts (MBOs) were most likely to be high-performing investments

KEY FINDINGS:

- The hypothesis that Business Angels will have a poorer investment performance than venture capital fund managers was not supported.
- The hypothesis that Business Angels will have a systematically superior investment performance to that of venture fund managers was not supported.
- The hypothesis that Business Angels and venture capital funds will have different returns profiles because of differences in their approaches to managing risk was strongly supported. However, it was negatively skewed, suggesting that Business Angels have fewer investments in which they lose money, but a significantly higher proportion of their investments either break-even or negatively generate only modest returns.

IMPLICATIONS FOR MANAGERS:

- Little data is available on the investment returns and track record of Business Angels.
- Most Business Angels only hold onto their investments for around 4 years and they generally seek to exit via trade sales not IPO.
- Their approach to investment decisions is largely defensive, seeking to avoid making bad decisions rather than aiming to "hit a home run" by trying to pick winners.
- Governments seeking to stimulate additional venture capital for early stage ventures should focus on enhancing the capital gains tax regimes to encourage Business Angel investors