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ANGEL RETURNS: A CASE OF PSYCHIC INCOME? (SUMMARY)

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SUMMARY

ANGEL RETURNS: A CASE OF PSYCHIC INCOME?

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Principal Topic

This paper provides data that indicates that Angel investors, generally wealthy individuals investing alone or in an informal group, have accepted lower returns on their investments than have Venture Capital firms (VCs) investing in similar seed/early stage investments. The hypothesis of this paper is that Angels seek, and receive, non-economic returns to make up the shortfall in financial returns.

Method

This paper uses findings from Wiltbank and Broeker (2007) and data provided by the National Venture Capital Association website (“NVCA”) as the basis for the comparison of Angel and VC realized returns. A study by Scott Shane (2005) for the Federal Reserve provides information about why angels invest and is used as a source of the discussion non-economic returns.

Results and Implications

Both Wiltbank and Boeker (2007) and the NVCA website provide return data in terms of exit multiples. An exit multiple of less than 1x means that the deal returned less than the amount of capital invested. Wiltbank and Boeker find that over 50% of the exits reported by Angels had exit multiples of less than 1x while VCs reported approximately 26% of their early stage investments had losses of initial capital. Wiltbank and Boeker also provide an estimate of an IRR for the Angel transactions of 27%. The NVCA data shows that realized returns for VCs investing in early/seed stage investments during the same period is 38%. Despite realizing lower financial returns than their VC counterparts, Angels continue to be an important source of financing for start-up companies. The explanation for this apparent irrational behavior of angels, is that they must receive non-economic returns on their investment – psychic income. Venture capital firms are professional money managers with fiduciary responsibility for investing the funds committed to them by others. Therefore, the primary motivation for VCs is financial returns. The motivations of Angels, as reported in the Shane study (2005), include more than the achievement of financial returns. Other reasons for investing include the desire to create and grow companies, to make use of their expertise, and for personal enjoyment.

This paper proposes a model for estimating psychic income received by angels and proposes further areas of research into the behavior of angel investors.

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