

Why Business Angels Do Not Invest

Findings on obstacles preventing investment in startups

entrepreneur plan
valuation balance
scalability angel
tax sector preparation
competition risks
investment skills
ethics return startup business
market traction
negotiate impact
lean



The European Trade Association for Business Angels,
Seed Funds and Early Stage Market Players

Introduction

EBAN – the European Trade Association for Business Angels, Seed Funds and Early Stage Market Players – is pleased to present its latest research report focused on understanding the reasons why angel investors choose not to invest in early stage SMEs.

Our organization undertakes continuous research to produce practical information on the early stage investment market in Europe, which is available to the general public via the Knowledge Center section of the EBAN website: <http://www.eban.org/knowledge-center>

This year, we are adding a new report to EBAN's body of research titled "Why Business Angels Do Not Invest: Findings on obstacles preventing investment in startups". The report is based on direct responses received from EBAN members and participants of our investor training workshops organized during the years 2016-2017. 683 participants from 41 different countries, the vast majority of them being active angel investors, participated in a brief 8-question survey administered at the end of each workshop. In this report, you will find an aggregation of the survey results with a brief commentary explaining the main findings.

Taking into account the underlying limitations of this report, which are largely caused by the size of the sample analyzed, our main objective is to provide a better understanding of the main reasons hindering angel investment in early stage SMEs, commonly known as startups. It is our hope that the report will enable more entrepreneurs to address the areas of concern indicated by business angels prior to approaching them for funding.

EBAN expresses its gratitude to all individuals who kindly provided their input for this publication.

For any questions, please contact the EBAN Secretariat.

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Survey Results

The present report on “**Why Business Angels Do Not Invest**” is based on survey responses collected by EBAN from the participants of our investor training masterclasses and workshops organized throughout Europe during the years 2016-2017.

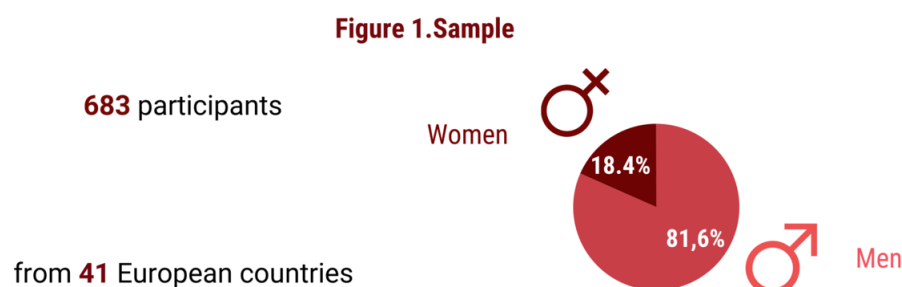
The first three questions of the survey asked respondents to indicate their gender and experience when it comes to making angel investments during the past five years.

1. DEMOGRAPHICS

As indicated in **Figure 1** below, the great majority of the **683 survey participants** are male, although it is very important to note that female investors are becoming more active in the early stage investing space. This can be attributed to the considerable efforts from the EU Commission, member states, and private market players. EBAN proudly participates in such efforts by launching initiatives like the Rising Tide Europe Program (<http://www.risingtide.eu/>), the only training and investing program created and led by women investors and working to increase women’s participation in angel investing as an asset class; and by being a partner of the EU-funded Lean In EU WBAs project, which aims to educate women business angels and launch women angel networks across Europe (<http://www.leanin-wba.eu/>).

EBAN’s 2010 statistics estimated women to be slightly below 5% of the angel population. Since then, the interest shown by women in angel investing has grown considerably

The 126 women that responded to our survey are just the tip of the iceberg of a large and rapidly growing population of investors in Europe. The overall size of the female angel investor population in Europe that we have estimated in our latest Statistics Compendium report (<http://www.eban.org/eban-2016-statistics-compendium>), estimates women to be approximately 10% of the angel population in western Europe, and 30% of the population in Central and Eastern Europe . To give our readers a feel for the growth recorded in the recent years, our 2010 edition of the Statistics Compendium and White Paper on “Women in Early Stage Investing” estimated the population to be slightly below 5% of the overall angel one.



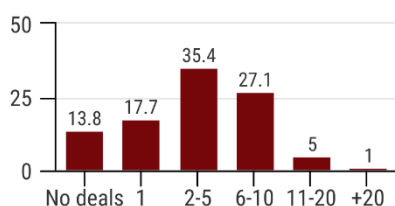
2. RESPONDENTS' EXPERIENCE AS ANGEL INVESTORS – NUMBER OF INVESTMENTS AND INVESTMENT PHASES

Figures 2.1 and 2.2 show information on **how many investments** respondents made in the last 5 years and **at what stage** of development the ventures were in when the investment took place. The responses are grouped in brackets of 0, 1, between 2 and 5, between 6 and 10, between 11-20 and more than 20, in terms of the number of deals, and in Later stage; Startup stage; Seed stage and Pre-seed stage in terms of the level of development.

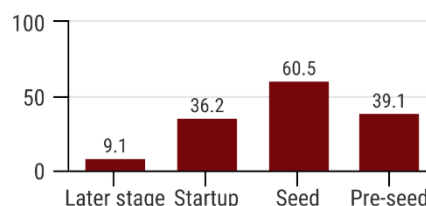
At first glance, **Figure 2.2** seems to show that angel investors are more prone to invest in seed and pre-seed phase companies. However, the percentages shown are calculated based on the number of deals done and without taking into account the amount of money invested in the company as it relates to the latter's stage of development. For example, if an investor invests 200.000 Euros in a company in the Startup stage, as well as 50.000 Euros in 4 other companies that are in the pre-seed or seed stages, it would appear that 80% of deals are seed or pre-seed. The lack of information regarding the amounts invested as they relate to the investment phase represents one of the limitations of this report.

Figure 2.1 and Figure 2.2. Business angels' experience

Number of investments in the past 5 years (% of participants)



Investment phase (% of participants)



*Note: Several participants took more than one option

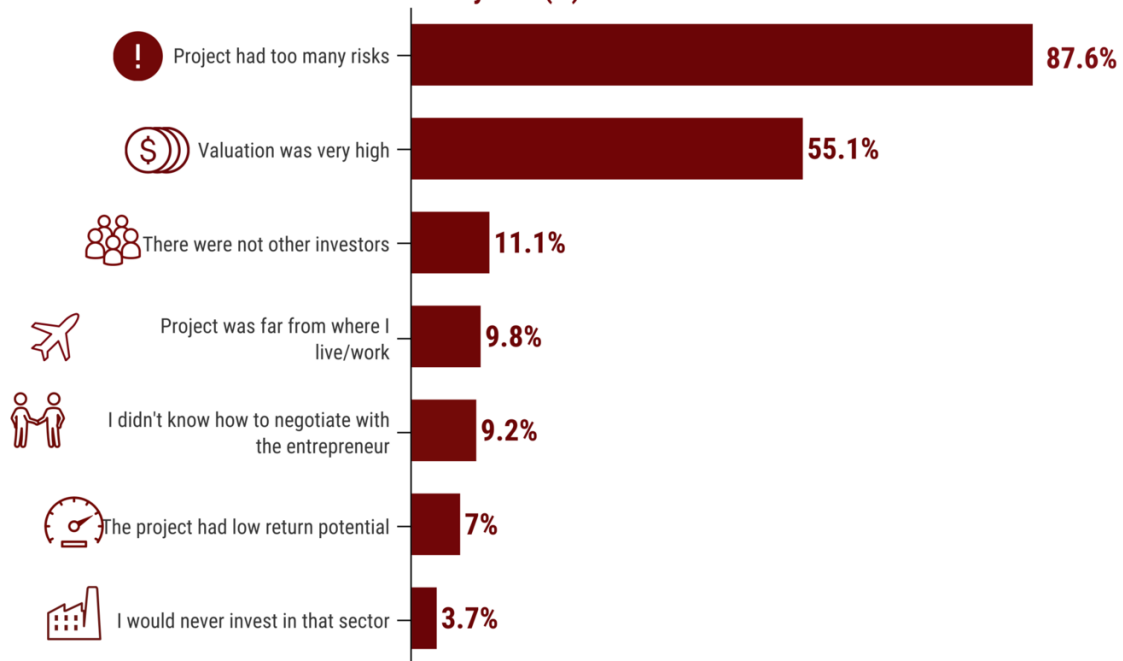
3. REASONS INVESTORS CHOSE NOT TO INVEST

The main aim of the survey was to uncover the reasons why angel investors did not invest in the startups that approached them during the past 5 years. High risk of failure and exaggerated valuations were the two main reasons for not moving forward with an investment for the vast majority of respondents. Regarding the high-risk profile, it is clear from this result that entrepreneurs are either unaware of all the risks embedded in their business plans, or at least they have not addressed all of these risks properly.

High risk of failure and exaggerated valuations were the two main reasons for not moving forward with an investment for the vast majority of respondents

Surprisingly, only 7% of the respondents indicated that they had considered low return on investment as a reason not to invest. This result shows that the large majority of the projects presented to angel investors have, on paper, an acceptable or excellent return potential. Therefore, the large majority of entrepreneurs do not need to increase artificially the potential of the project in order to get funded. Instead, entrepreneurs should focus on addressing the risks associated with their project.

Figure 3. Reasons why you didn't invest (on average) in investment opportunities in the last 5 years (%)

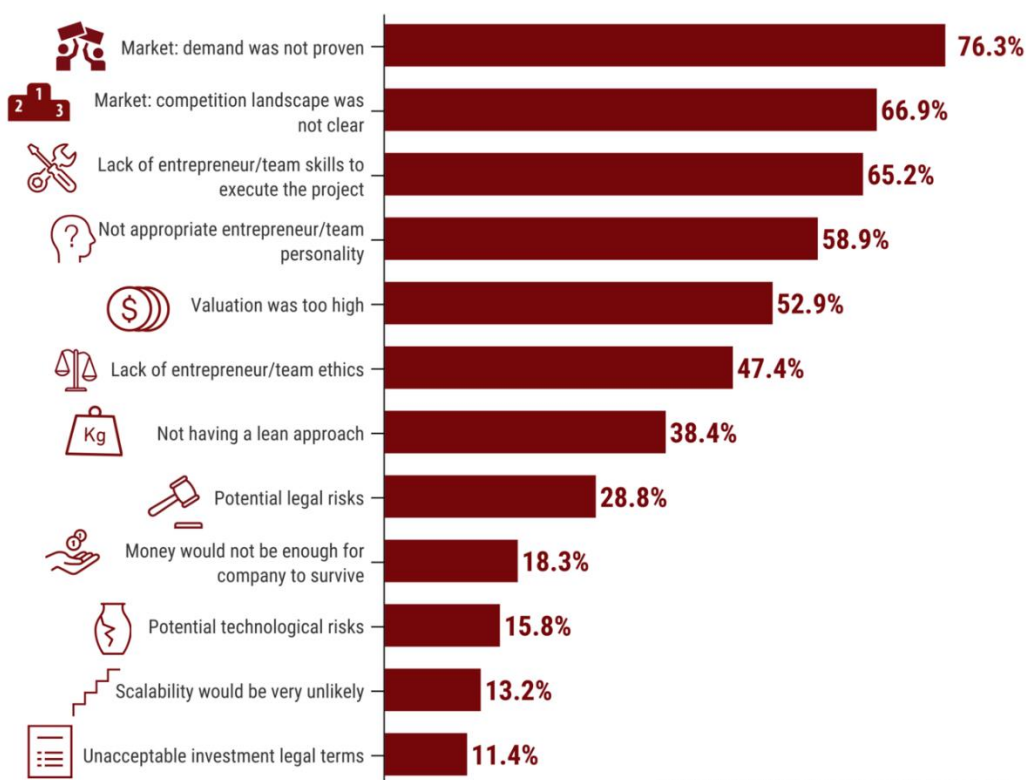
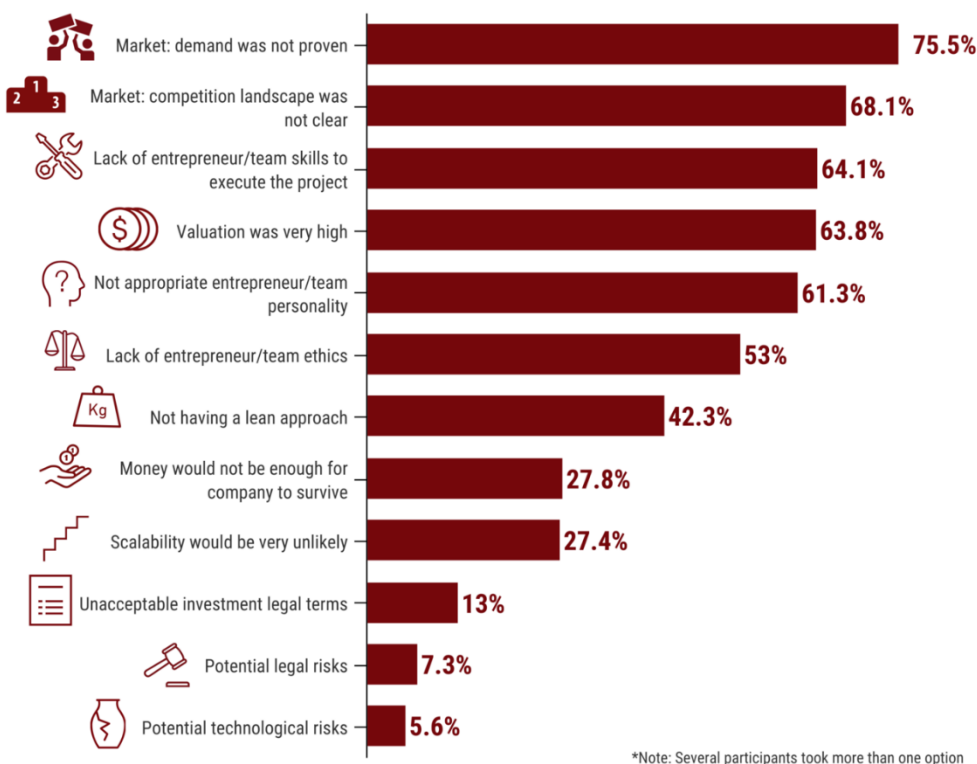


*Note: Several participants took more than one option

4. MAIN PROBLEMS/RISKS THAT PREVENTED RESPONDENTS FROM INVESTING

As a follow up question, respondents were asked **what their main problems and reasons were for not investing in both tech and non-tech startups**. As expected, responses focused on market demand and competition, team structure and ability to execute, and, finally, the valuation of the company. It is interesting to note that, whereas entrepreneurs tend to focus on the product/technology, investors are more interested in knowing if there is a market for the product/service and if the team is capable of executing their business idea. Therefore, if entrepreneurs focus more on the market in their business plans and presentations, they might increase their chances of getting funded. It seems that valuation is considered as “excessive” more often in non-tech deals, as compared to tech deals. This phenomenon could be related to the scalability of tech projects, which justifies their higher valuations. This is also confirmed by respondents’ views on scalability, which is a bigger concern in non-tech deals.

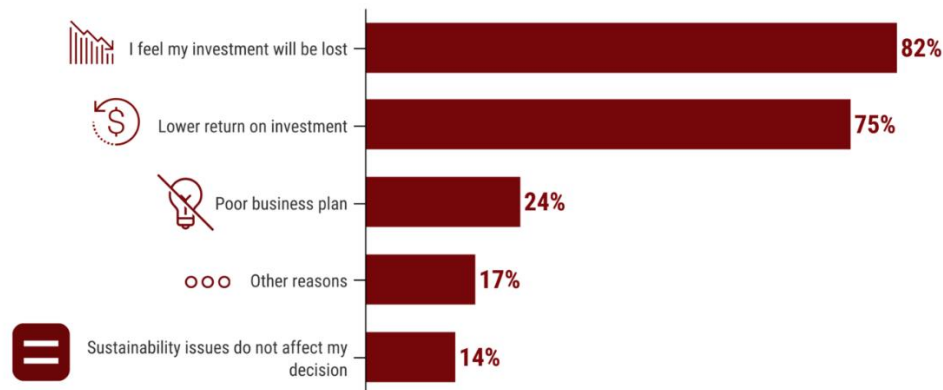
Market-related factors, such as unproven demand and an unclear competition landscape, are the main issues that prevented participants from investing in both tech and non-tech deals

Figure 4. Main problems that prevented you from investing in tech deals (%)**Figure 5. Main problems that prevented you from investing in non-tech deals (%)**

5. MAIN REASONS RESPONDENTS DO NOT INVEST IN IMPACT PROJECTS (PEOPLE, PLANET, PROFIT)

The survey also asked respondents to specify their reasons for not investing in “impact” projects working towards the triple bottom line of “people, planet and profit”. Unfortunately, and despite the numerous efforts made to clarify the difference between impact investing and charity, a worrying percentage of responses suggest that investors feel they will only lose money or have low returns on these investments. Despite the existence of numerous reports that confirm through research and statistics that impact investing is just as (if not more) profitable as traditional investing (see, for example, the latest report published by the Global Impact Investing Network (GIIN) titled “GIIN Perspectives: Evidence on the Financial Performance of Impact Investments”), **there is a need to showcase more success stories in the impact investing area**, otherwise investors tend to see these investments as charity projects.

Figure 6. Reasons not to invest in impact projects - people, planet, profit (%)



*Note: Several participants took more than one option

6. FACTORS THAT REDUCE THE RISK ASSOCIATED WITH INVESTMENTS

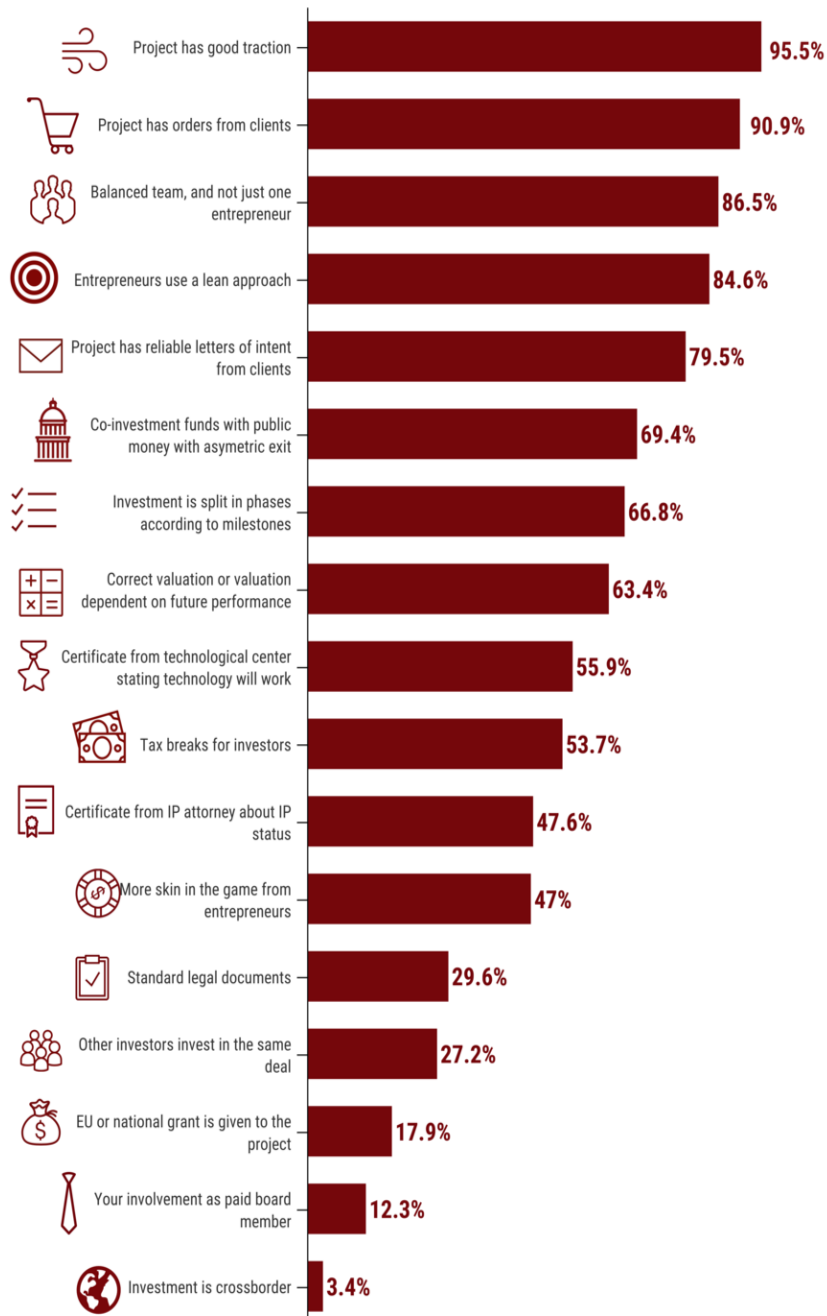
In terms of situations that could reduce the overall perceived risk for investors, there is no real surprise that survey results indicate market and team risks to be the main factors considered by the respondents.

A project having good traction is widely acknowledged as a risk reducing factor

However, it is interesting to note that co-investment funds are ranked higher than tax breaks as preferred measures to reduce investment risk, despite the fact that the latter give investors an immediate return. These results can be linked to the fact that tax breaks only protect on the downside

of the investment, whereas co-investment funds, characterized by asymmetric exits, protect the downside while also boosting the upside of the investment. Another possible explanation for this preference could be due to the fact that professional angels in many countries do not benefit from tax breaks on capital gains, given that many tax break schemes only apply to labor income.

Figure 7. Choose which of the below situations would reduce the risk of your investment (%)



*Note: Several participants took more than one option

7. CHANGES IN LIKELIHOOD OF INVESTMENT WHEN PROJECT RISKS ARE REDUCED, OR INVESTMENT READINESS IS INCREASED

While **Figure 8** below only reconfirms the obvious assumption that less risk makes investors more likely to invest, **Figure 9** shows that **approximately three quarters of respondents have had to deal with entrepreneurs that were not yet “investment ready”**. The remaining 24% of investors that came across “investment ready” startups could indicate that the many efforts undertaken by incubators, accelerators, as well as EUREKA E!nnovest and European Commission programs, including but not limited to InvestHorizon, ePlus Ecosystem and Future Internet Business, are producing important results. Nevertheless, there is still a need to increase targeted efforts and programs towards raising the investment readiness level of startups. This can be achieved not only through specific programs, but also through building the capacities of universities, incubators, accelerators, and other relevant organisations. Finally, in **Figure 10**, we would expect a higher number of business angels showing a preference for dealing with skilled entrepreneurs, but it seems that some investors would be hesitant to work with highly skilled entrepreneurs or may think that projects that are more investment ready would have higher valuations. In any case, **the large majority of business angels prefer to invest in projects where entrepreneurs understand the role of an angel** and are ready to accept some traditional angel clauses such as the "tag along" clause.

Figure 8. If project risks are reduced, your willingness to invest increases (%)

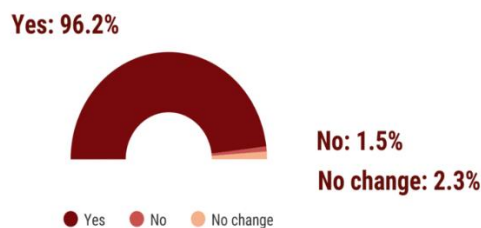


Figure 9. Rate the preparation of entrepreneurs when interacting with investors (%)

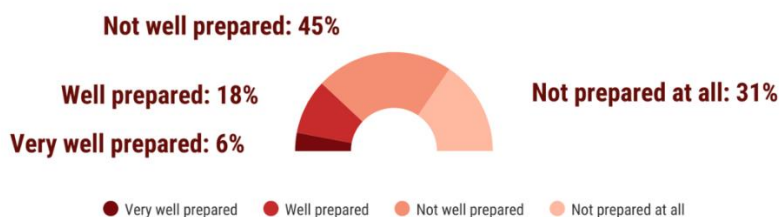
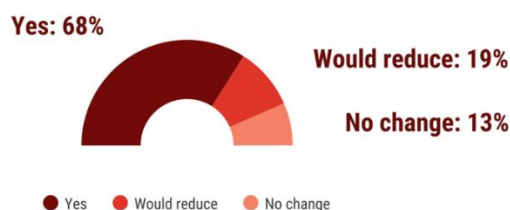


Figure 10. If entrepreneurs were better prepared to interact with investors, your chances to invest in the projects would increase (%)



Conclusion

The report on “Why Business Angels Do Not Invest: Findings on obstacles preventing investment in startups” endeavored to understand the main reasons behind angel investors’ decisions not to make investments in any given startup. The 8-question survey, administered to 683 participants (of which 81,6% were male) of EBAN’s investor training workshops during the years 2016-2017 showed the following results:

- The majority of respondents have made between 2 and 10 investments in the last 5 years (with 35.4% having made 2-5 investments and 27.1 – 6-10 investments);
- In terms of the number of deals, a large majority of respondents favor seed and pre-seed stage companies, however, these results need to be augmented by the amount of money invested as it relates to the investment phase;
- High risk of failure and exaggerated valuations were the two main reasons for not moving forward with an investment for the vast majority of respondents;
- Market-related factors, such as unproven demand and an unclear competition landscape, are the main issues that prevented participants from investing in both tech and non-tech deals;
- A large percentage of respondents feel that impact investments will only result in losses or low return on investment, despite numerous reports and statistics that prove the contrary;
- A project having good traction is widely acknowledged as a risk reducing factor, along with other factors that reduce market and team risks;
- Investment readiness is a crucial factor for investors deciding whether or not to invest in a startup.

Identifying and addressing the areas of risk that investors pay attention to will surely create more investments in startups in the short term and, very likely, more global success stories in the mid to long term. However, there is a strong need to develop tools, based on input provided by investors, that can help startup entrepreneurs better identify, quantify and mitigate the risks related to their businesses.



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