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The Evolution of Angels into VC's

Rob Go

We've been witnessing an institutionalizing of angel investing in recent years. For the most part, it's good. There continues to be a gap in the market for stage appropriate seed investors, especially in the East Coast. But it's interesting to watch some of these funds pursue a predictable path of evolution.

It's goes something like this. An angel investor writes a lot of checks and has some level of success. It's amazing how right out of the gate, and individual angel can get into many good deals with a bit of hustle and a willingness to deploy capital in small chunks. They find themselves coinvestig with many great funds and getting a bunch of write-ups and some small wins. "Man, this is easy!", they think. Those big funds are dinosaurs. I'm in way more interesting deals than many of them. And I bet I could do even better with more money.

Some LPs agree, and the angel becomes a small VC (aka a super angel). Maybe managing $7M-$25M. They continue to pursue their strategy of writing many small checks. But they quickly realize that this doesn't work well. That $50K they have in the next hot company may yield a 20x, but it doesn't move the needle on the fund. The logical strategy evolution is: "Ok, I must invest more per deal, and I must focus only on companies that have the potential to move the needle in my fund."

Then, they realize something. Hey, it's tougher to get into great deals now! It used to be easy for investors to let me in for $50-$100K. But now that I'm writing a bigger check, there isn't enough room because I'm actually eating into another investor's target ownership. I need to work harder to encounter companies earlier, and I need to spend more time on each company to develop a reputation of being an excellent, value-added investor.

To make matters worse, the Super Angel is not in a great position to lead many deals. They quickly realize there is a big difference in tagging along on another investor's deals and leading one. There is usually only room for one or two leads, and you usually need to write a meaningfully sized check to do it.

The super angel also realizes that they need a follow on strategy. "Guess what, investing heavily into your winners makes a lot of sense" they say. "I knew company X was going to be a winner, I should have put way more capital behind it!" . The funny thing is that this conclusion is made with incomplete data. The angel only responds to the regret of the good companies that they wish they had invested more in. They look back and say "it was obvious that this was the winner!". But it's more difficult to know this prospectively than one would think, and the super angel does not have the scar tissue of throwing good money after bad that many VCs have seen happen themselves.

At this point, the portfolio is starting to get pretty hefty. So the super angel starts thinking of scaling their team. More people means more mouths to feed.

So, here are all the motivators that have arised to raise a bigger fund:

1. Wanting to put more into each deal to make them meaningful

2. Wanting to be able to lead deals and get ball control

3. Wanting to reserve more to invest big in the winners

4. Having more mouths to feed and needing more fees.

So, what happens next? Viola! The next fund is a traditional VC fund with $50M/partner or more. Meanwhile, the VC is annoyed by the new crop of seed investors that somehow keep on getting into good deals with their small checks.

Parting Thoughts:

1. This isn't immediately obvious, but as an individual angel, there is actually an advantage in terms of deal flow. You can invest at a scale where most investors will let you in, especially if you see an investment early and have a reputation for helping.

2. Institutionalizing is harder than it looks. There are some terrific firms that have had the opportunity to raise much larger funds but have resisted in order to stick to their strategy. But this is hard to do and many end up raising larger and larger funds or pursuing new strategies like growth or international expansion.

3. Super Angels are VC's. They are governed by the same incentives or anyone else managing money. And have a tendency to look and behave more like VCs over time, unless they start out with a completely different strategy from the beginning and are very disciplined about sticking with that strategy (ie: Ron Conway, Paul Graham).