Building a diversified startup portfolio

Variety is the spice of life as they say, and this is particularly true in building your angel investment portfolio. Diversification is a much discussed topic in the investing world, but it takes on added importance in the risky world of angel investing.

Diversification is the process of allocating capital in a way that reduces the exposure to any one particular asset or risk. This can easily be done in public markets by buying many different stocks, or more simply, through buying a diversified ETF or mutual fund.

Even though diversification takes on added urgency in private equity investing, it has historically been harder to achieve. No professional VC fund will put all of their fund's money into one or two startups. They will diversify into (generally) twenty or more different companies. Experienced angel investors take a similar approach. Investing in 20 or more companies is recommended for diversification when supporting startups. This can be difficult, as many startups will have hefty minimum investment requirements (often more than $10,000). So unless you have $200,000 dollars to put towards startups, achieving a diversified portfolio by investing directly may be unrealistic--especially if you are just getting started in building your angel portfolio.

Innovation in the world of angel investing is bringing down the high-barriers to entry and making diversification easier and cheaper. Online angel investment platforms are democratizing access to startup investing. Not only are they making promising startups available to a wider swath of angel investors, they are also allowing smaller investment minimums, making it easier for angel investors to diversify. Here's how!

Syndicates:

Syndicates make angel investing accessible for more people. Steadily gaining popularity in the investment world, syndicates lower the minimum investment required from $25,000 to as low as $3,000, allowing you to spread your money over a broad range of startups and thus create a more diverse investment portfolio. Being part of a syndicate also makes it easier for you to participate in future rounds since syndicates often negotiate what is called pro-rata investment rights, which give an investor in a company the right to take part in subsequent rounds of funding.

Propel(x) is a big proponent of this approach, and all of the investments on our platform are made through syndicates because it makes angel investing more accessible to investors, giving them the same power as larger investors by pooling resources. We're not the only ones. AngelList and others also provide syndicates.

Index Funds Emerging in Angel Investing:

The introduction of index funds heralded a huge growth in individual investors taking part in the public markets in a diversified and inexpensive way. We anticipate the same will happen as index funds become more readily available in the private investing world. One notable example is CircleUp's Marketplace Index Fund. Just as the public investing world is full of investment options, expect the same evolution to take place in the private world as the market for startup investing matures.

Sector approach:

Diversification should also go beyond simple numbers. Having 20 investments in the same sector does nothing if that area goes through a large bout of volatility. Just like investing in public markets, you should not have all of your startup investments in a single sector area (like life sciences), or in a single technology (like robotics). Diversifying startup holdings should be treated with the same respect that would be used when diversifying stock holdings. In fact, you're doing the exact same thing, just for the ultimate small cap companies.

At Propel(x), we think about investing through the lens of sectors and the underlying technologies that power them. This lens helps us structure our thinking in terms of where a startup fits in the marketplace. We have found that this is the most effective way to help angel investors build a diversified portfolio.

Investing across sectors ensures diversification. It's not uncommon, however, for investors to invest in what they know or what they are particularly interested in. Even if you are only interested in committing to one or two sectors, you can still ensure a good mix by diversifying among the underlying technologies.

In the end, angel investing success will still reflect some element of timing and luck. But diversifying your portfolio by investing smaller amounts and across multiple sectors puts you on much stronger footing.