

what to expect from

angel networks by William Payne

Ten years ago, access to individuals who invest in early-stage companies - commonly called "angel" investors - was hard to come by for entrepreneurs seeking such financing. These days the angel investing landscape has changed. As angels increasingly pool their funds or connect in networks, they are becoming more accessible.

That is good news for today's company builders. The bad news, however, is that the process of securing such funding remains as tedious and as inefficient as it always has been.

I should know. I was an entrepreneur myself, having been involved in the launch of a half dozen businesses, including Solid State Dielectrics, Inc. which I started with a partner in 1971 and sold 11 years later to E. I. DuPont Nemours. Since then, I've become an angel investor, putting money into 25 fledgling ventures. I know the ins and outs of dealing with angels from both sides of the table.

A Different Landscape

For today's entrepreneurs, the different landscape provides opportunities that might not have existed in the past. While angel investors - exited entrepreneurs and experienced business people who have the time and money to put into early-stage companies - have always been a part of the entrepreneurial scene, they are now breaking down into sub-categories. Some, called "lonerangers," prefer to invest alone or with a small informal group.

Others, namely "angel funds," pool their resources and invest collectively, in a sort of "one for all, all for one" approach determined by a vote of the majority. Finally, there are the "angel networks," whose members study companies as a group but make individual investment decisions. Usually, only a fraction of the total network invests in any one company.

Some Things Never Change

Angel networks work well for entrepreneurs, and not only because of their

accessibility. Before I delve into the reasons, let me start with a primer about when company founders should seek angel financing. The key is that the company shouldn't be too young. Funding for the start up still at the kitchen table - called "pre-seed" money - is the province of an entrepreneur's family and friends, and, undoubtedly, his or her personal resources.

Angel financing comes into the picture when the entrepreneur has a management team in place, or has team members waiting in the wings; a product ready for the marketplace, or a least a prototype that can be demonstrated to customers; and finally, customers or potential customers who have expressed interest in buying the product.

Angel investors are looking to invest in companies with the potential to grow to at least \$30 million, and preferably much more. Why? Angel investing is a risky business. These investors must be assured of a return of, say, 25 to 30 percent a year. At the same time, they have calculated that nine out of every 10 investments they make will fail. The one company that

makes it, therefore, needs to be a wild success.

If only one investment out of 10 is expected to be a winner - and the investor doesn't know which it will be - then it follows that each investment must have the potential to provide a huge return on the investment to achieve the expected angel portfolio upside. In angel circles, this means that "scalable equals fundable," a maxim about angel financing that entrepreneurs need to keep uppermost in their minds when approaching angels.

Finding Angel Networks

OK, you qualify, so now what? First, zero in on the angel networks, which often display their information on Web sites. Most tend to invest in companies located within an hour's drive of their headquarters, so founders can work the local community and approach them personally.

Contacts can also be made through knowledgeable professionals, such as local accountants, attorneys, and bankers who serve young companies, other entrepreneurs, or venture clubs.

Walking the Talk

When approaching angel networks, understand that there is a process by which the investors decide which investments to make. Entrepreneurs need to familiarize themselves with the process, which for most angel networks breaks down along the following lines:

Application - Angel investors know exactly what documents they want to review at the initial stage (and it is not likely a 60-page business plan, at least not initially.) Now that networks have formed, a list of this information is readily available on Web sites or from the gatekeeper of the local group. Be scrupulous about assembling just what the group wants on the application form, a process that generally takes applicants a week or two to complete.

Pre-Screening - When the angel group gets a completed application, one or two of its staff or members takes a quick look at the all of the plans received and returns applications that are incomplete, don't meet the organization's minimum requirements, or do not comply with the investing preferences of the organization. Expect one or two weeks for the pre-screening process to run its course.

Screening - Once an application has been accepted for more review, a small group of staff and angels meet with the entrepreneur to review and further define the opportunity. If the entrepreneur passes muster at this stage, the network selects a "champion" for the opportunity, creates a committee and begins due diligence. In general, only 10 to 25 percent of all entrepreneurs who apply reach this stage, which is usually completed within another one to three weeks.

Due Diligence - At the critical due diligence phase, a team from the network is assembled, consisting of members interested in investing and specialists with knowledge of the industry under consideration. The objective is to validate the business plan, including the management team, market opportunity and amount of funding required, and to negotiate a term sheet, thus placing a value on the investment. A further cut is made: 25 to 50 percent of the companies that reach this stage are actually funded, and the process can continue for two weeks to several months.

Investment Meeting - Once the network has negotiated a term sheet, the entrepreneur is invited to make his or her pitch at an investment meeting of all members of the angel organization. Commonly, the leader of the due diligence team introduces the entrepreneur; a question-and-answer session follows the founder's presentation; and members are invited to sign up for subsequent meeting with the entrepreneur. Such investment meetings are usually held every month or two.



ANGEL CAPITAL ASSOCIATION
THE PROFESSIONAL ALLIANCE OF ANGEL GROUPS

The **Angel Capital Association** was formed in January 2004. It is the preeminent North American association of angel investor groups. ACA's mission is to advance angel investing by supporting the development of successful angel groups, sharing best practices and industry data, building public awareness, and establishing professional standards. Currently, 53 angel groups throughout the United States and Canada are full members of the organization, with another six groups as provisional members.