What is an angel investor?

An angel is a high net-worth individual who invests his or her own money in start-up companies in exchange for an equity share of the businesses. The Angel Capital Association which represents angel groups recommends that entrepreneurs work with investors who are accredited investors (who meet requirements of the Securities and Exchange Commission) and who can add value to the company via high quality mentoring and advice. Other important things to know about angels include:

- Many angels are former entrepreneurs themselves
- They make investments in order to gain a return on their money, to participate in the entrepreneurial process, and often to give back to their communities by catalyzing economic growth.
- Angels make a return on their investment when the entrepreneur successfully grows the business and exits it, generally through a sale or merger
- It is estimated that angels invested 19 billion in more than 55,000 start-up businesses in 2008 (Source: Center for Venture Research)
- Angels tend to invest in companies that are located near them regionally (or to co-invest in a wider geography if a local investor they know and trust is involved)

What are angel groups?

In an angel group, individual angels join with other angels to invest collectively in entrepreneurial firms. Angel organizations come in many forms, but all have certain characteristics:

- They meet regularly to review business proposals
- Selected entrepreneurs make presentations to the membership of the group
- Member angels decide whether to invest in the presenting business
- Angels work together to conduct due diligence to validate the plans, statements and history of the entrepreneurial team

Other points of interest about angel groups are:

- The size of angel group investments in entrepreneurial firms varies widely. A survey of member organizations of our companion organization, the Angel Capital Association, found that the median investment per round per angel group in 2008 was about $277,000. Many angel groups co-invest with other angel groups, individual angels and early-stage venture capitalists to make investments of $500,000 to $2 million per round.

- Groups invest in innovative firms in a range of industries. The most common areas are software, medical devices, telecommunications, and manufacturing.
- While some groups focus on a specific industry area, the majority are open to a variety of areas and select those markets with which some of their members have expertise

How do one find an angel group?

- Because some angels and angel groups are more likely to invest in firms that are recommended by people they know and trust, it is important to network in your community to gain a referral. Examples of people to contact include: entrepreneurs who are backed by angels or venture capitalists, attorneys who specialize in equity investment bankers, accountants and business counselors

What is the difference between angels and venture capitalists?

While both invest in entrepreneurial firms and take equity (ownership) in those businesses, there are some important differences:

- Funding source- Angels invest their own funds directly in a business, while venture capitalists invest funds from other sources (e.g. pension funds, insurance companies, foundations.
- Stage of entrepreneur – In general, angels invest in seed, start-up and early-stage businesses, while venture capitalists invest in later-stage businesses (although there are exceptions).
- Size of investment – Venture capitalists generally invest $2 million and up in a financing round, while individual angels make much smaller investments ($5,000 to $100,000). Angel groups can make investments in the mid-range, between most individual angels and VCs.

How does an entrepreneur know his business is right for an angel group investment?

Angel investment is the right source of funding for only a small proportion of entrepreneurial businesses. When considering yourself for investment by an individual angel or angel group, ask yourself these key questions:

- Am I willing to give up some amount of ownership and control of my company?
- Can I demonstrate that my company is likely to realize significant revenues and earnings in the next 3-7 years?
- Can I demonstrate that my company will produce a significant return for investors?

- Am I willing take the advice from investors and accept board of director decisions I may not always agree with?
- Do I have an exit plan for the company that may mean I'm not involved in 3 – 7 years?

When should an entrepreneur approach an angel group?

In general, the best time to seek angel funding is when:

- Your product is developed or near completion.
- You have existing customers or potential customers who will confirm they will buy from you.
- You've invested your own dollars and exhausted other alternatives, including friends and family.
- You can demonstrate that the business is likely to grow rapidly and reach at least $15-30 million in revenues in the next 3-7 years.
- Your business plan is in top shape.

What criteria do angel groups use to select entrepreneurs?

No two groups are exactly alike, but generally groups expect to at least see the following:

- A strong management team with experience and proven skills.
- Unique product or service distinguished by an identified competitive advantage and large market
- Your personal financial investment in the company and investments from your friends and/or family
- A clear picture of the market for your product or service and realistic plan for market penetration
- An exit strategy for the investor that is reachable within 5 to 7 years
- The potential for a strong return on investment

What process can I expect if an entrepreneur applies to an angel group for funding?

Angel groups follow several stages of review in order to make funding decisions. Below is a listing of these steps. It is important to recognize that groups may conduct these steps in a different order than is presented here.

- **Application** Check with the angel groups Web site to determine what documents are required initially. Many groups want the executive summary of your business plan, while others have an application form.
- **Pre-Screening** When the angel group receives a completed application, staff or a committee of members reviews it quickly to determine if it meets the group's general requirements. The pre-

screening will eliminate applications that are incomplete, don't meet the organization's minimum requirements, or does not comply with the investing preferences of the organization. Expect one or two weeks for the pre-screening process.

- **Screening** Once an application has been accepted for review, a group of staff and angels review and further define the opportunity. If the entrepreneur passes muster at this stage, the organization may select a "champion" for the opportunity and create a due diligence committee. The angel group may ask for your full business plan in this stage and some groups hold meetings with the entrepreneur during this stage. In general, about 10 to 25 percent of all entrepreneurs who apply reach this stage. Screening is usually completed within another one to three weeks.
- **Investment Meeting** The entrepreneur is invited to make his or her pitch at a meeting of all members of the angel organization. A question-and-answer session follows the founder's presentation. Members discuss key issues about the company and determine initial interest in making individual or group investments after the entrepreneur leaves the meeting. Such investment meetings are usually held every month or two.
- **Due Diligence** A team of members interested in investing and specialists with knowledge of the industry under consideration conduct a thorough check on you and your business. 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.
- **Term Sheet** If the group chooses to invest in your company, they will negotiate with you a term sheet, a document that guides lawyers in preparing investment agreements and which determines the relationship between the company and investors. Sometimes angel groups will begin term sheet negotiation during Due Diligence. For more information on standard term sheets, other investment documents, and issues to consider, click here or visit the Books page on this website.

Will angel groups sign non-disclosure agreements? If they don't, how do entrepreneurs protect confidentiality?

During the initial portions of the evaluation process, the vast majority of angel organizations will not sign non-disclosure agreements. Angel groups just see too many deals, often in a similar space. When submitting executive summaries and even business plans, the entrepreneur needs to explain the business so that the potential investors can understand the company's opportunity for success, but don't learn about any confidential issues. If you have intellectual property that has not been patented, it is best not to disclose it to the angel group when you are first submitting your company for investment. Remember that angel groups are most interested in the business behind the technology or idea they don't invest in the inventions but in the business models and management teams that will grow the companies. If your company makes it through to final due diligence, the angel group may need to research intellectual property issues and then would sign non-disclosure agreements at that time.

(Source: Angel Capital Association at http://www.angelcapitalassociation.org/entrepreneurs/faqs/)