Chapter 7

ANGEL INVESTORS

INTRODUCTION

Angel Investors provide capital to a segment of the risk-reward spectrum that institutional investors overlook, or will not consider. In this chapter we will discuss who angel investors are, where they can be found, when an entrepreneur should consider using an angel investor, the stage of development angels prefer, and some of their criteria for making an investment decision.

Angel investors often provide more than money and we will discuss how finding and engaging the right angel can have a multiplier effect on invested capital. This chapter will explain angel investor expectations about the reward they expect, their time to exit, how angel investors fit into the broad spectrum of capital sources, how angel capital can be leveraged to raise capital from other sources, and how and entrepreneur can find and capture an angel.

WHAT IS AN ANGEL INVESTOR?

Angel investors are private individuals who invest their own money in someone else's business. They are called "angels" because they invest in companies that don't qualify for other types of investment. Angel investors are usually one of the first funding sources an entrepreneur receives after

exhausting self help sources such as credit cards, investments from friends and family, and home equity loans.[1]

Some angels are professionals and some have inherited wealth. Many angels are business people who have built their own companies and taken them public or sold them. As a result, they bring both money and business experience to entrepreneurs. Angels who have such experience and want to invest their time, talent, and advice as well as their funds are called "warm money." Angels with experience in an entrepreneur's industry are especially valuable because they can (i) mentor the entrepreneur and help avoid costly mistakes, (ii) introduce him or her to potential clients, (iii) help identify and recruit new employees, and (iv) make contacts needed for further rounds of funding. Such advice is particularly important for pre-profit or pre-revenue development stage companies, which have high risk.[2]

ANGELS GO WHERE OTHERS FEAR TO TREAD

Except for the entrepreneur, friends and family, every capital source except angel investors is institutional in nature. What does that mean? Banks are institutions that must answer to depositors, shareholders and regulators. Venture capitalists, commercial lenders and asset based lenders must answer to the pension funds, insurance companies and corporations providing capital. Answering to someone else can make an investor timid. Angel investors, by contrast, invest their own money and answer to no one. While they minimize risk every way they can, they still have a greater risk tolerance than other capital sources and this leads to a risk-reward profile that has a different from other investors.

Consider some of the alternatives to angels. Banks want to know that a company is making steady and predictable profits and they want collateral. Few start-ups have high value, unencumbered assets, and predictable profits. Many start-ups have no profits, and some have no revenue. Clearly banks won't consider such companies. Asset based lenders and commercial credit companies have a higher tolerance for spotty earnings, but still want assets to secure a loan. Again, something a start-up is not likely to have. Relatively few venture capitalists invest in early stage companies. They want a company with demonstrated high growth and large potential markets. Many early and development stage companies just can't make the case that they will be high growth. Avoidance of such companies by institutional investors leaves an opening for angel investors whose objective is to get in on the ground floor of potentially high value companies.