

## Approaching Business Angels

By BNET Editorial

published on BNET.com 10/10/2007

A “business angel,” also known as an “angel investor,” is an affluent individual who provides capital for a business, typically an equity investment. Angels rarely make loans or outright grants. Business angels most often support individual entrepreneurs and brand-new ventures, although they can assist any venture in need. The term “angel” once characterized a savior who, at the eleventh hour, rescued a venture about to be abandoned. Today business angels are far more common and, as often as not, are involved in a venture early on. In the last decade, an increasing number of business angels have organized “angel networks” that are able to share research, better assess opportunities and requests, and pool their capital.

While some angels are content to remain silent partners or occasional mentors, they are more likely to be active partners in their ventures. Angels fulfill an increasingly important financing niche. Banks only loan money at interest; stock exchanges deal in vast sums; and venture capitalists, too, invest relatively large sums. That leaves angels to support untold numbers of businesses each year in need of fresh capital.

### What You Need to Know

---

#### Where should someone look for a business angel?

Accountants or financial advisers are as good an initial source as any. First, they should have a good idea of how much capital a business needs and where it is most needed. Moreover, a savvy accountant tends to know instinctively where funds can be located. Thanks to the Internet, rosters of angel organizations and partnerships can be found almost within minutes. There are also services whose sole mission is to match angels with enterprises that need them. Literature is available in many libraries, too. Matchmaking services do charge fees, though, often a flat rate for a listing and then a percentage of revenues or net earnings if a match generates financial success. And do not overlook your own customers, either. A mature company in Florida received \$35 million from two of its customers who liked its expansion plan so much they offered to help finance it! Wherever you decide to look, you should find plenty of prospects. There were a reported 234,000 active angels at the end of 2006, and more than 250 business angel organizations.

#### How much can someone expect an angel to contribute?

While there is no minimum or set sum, the average angel investment in U.S. last year was \$500,000. By comparison, venture capital firms look for opportunities that start at the \$1 million mark. Some angels limit investing in any one venture. For example, an angel might have \$500,000 to invest but in increments of no more than \$25,000. That said, you need not worry about money not being plentiful.

Angel investor network investments totaled \$26.5 billion in 2006 (10.8 percent more than in 2005) among some 51,000 U.S. companies. High-tech ideas and ventures remain the darlings of business angels, along with medical devices and equipment.

## How long will it take to find an angel?

It is impossible to know, but assume weeks, and perhaps even months. It is not unusual for a new venture to spend several days each with a dozen prospects, get close, but fail to reach any deal. It all depends on answers to other questions. How polished and well thought out is the business idea? How capable and well prepared is the company acting on it? Do specific market or general business conditions bode well? Due diligence is axiomatic and takes time. Legal consequences can slow the process, too, especially in the U.S. The relative experience of a prospective angel is another factor. Surely, it is better to have an angel who has already flapped his or her wings than an ambitious novice with a lot of capital burning a hole in his or her pockets.

## How does the process work?

Experts liken it to a giant game of hide-and-seek except that in this case, *both* sides initially are blindfolded. There is no magic, just a matter of finding one or more prospects, getting acquainted, and seeing if there is a good fit. With angel networks gaining popularity, standard forms are becoming commonplace, much like those the grant-application world uses. Form language can be as simple as, “We cannot work together because...” or “We are continuing to meet and...” Whatever information is sought, provide it! While not doing so might be a mere oversight, a prospective angel might consider blank space as admission of guilt. Another kind of form makes sense, too: a confidentiality agreement to protect the ideas needing financial support. Expect to compete, too. One business angel who created an investment firm received 400 inquiries in its first year.

## Why and where might business angels fear to tread?

One example is a business in which they have little or no confidence in the ownership, especially if experience and talent appear to be lacking. The limited growth prospects of the idea or a limited market is another—although the history of products like the Xerox copier caution against dismissing ideas *too* quickly. Other hurdles could be the proposed value of the equity stake in question, the quality of management, a sketchy business plan (or no plan at all), and whether the future of the idea appears to depend totally on one individual’s skills and enthusiasm.

## What to Do

---

### Understand What Angels Look For

A business angel instinctively looks at the possibilities and tries to appraise the future value of an investment. So having a business plan ready for inspection goes without saying—one that includes pro forma earnings and related assumptions. Angels also study revenue streams, key costs, anticipated future prices, customer base, capital requirements, the viability of the industry the business operates in, and staffing—are family members on the payroll, for instance, and, if so, to what extent? Angels also review potential liabilities, statutes that may affect the business, copyrights and trademarks, contracts, and customer relationships. Intangibles count, too, such as an owner's personality. If the business is a going concern that recently was sold, its prospective angels will probably want to know why. Angels also may want an indemnity policy or legal protection.

### Understand an Angel's Motivations and Desires

There are questions for angels to answer, too. What are they seeking: just a return, the satisfaction of contributing to success, to diversify their investment portfolio? Some angels simply enjoy investing for the fun of it—within limits, of course. Others like new experiences in sectors that have always intrigued them. Still others seek some cash but also a “psychic” reward to enhance their reputations. Do not assume anything. Angels can have unrealistic expectations, too. Look for those. Angels are not necessarily older men anymore either. Typically, they are still men in their mid 50s who have sold their companies or interests and have dollars to invest. Even so, younger angels in their 30s are no longer uncommon.

### Structure a Deal

Once an angel has been found and has agreed to help, the next essential step is the financial arrangement. For example, for investing \$40,000, an angel might initially receive a 12.5 percent ownership, and in two years might receive an additional 7.5 percent ownership in lieu of cash if “X” targets are met, pending a review of the year-end operating statement. Whatever the figures, structure the deal so *both* creator and investor can profit. Once terms are agreed to, next is preparing a letter of intent, followed by any desired further review, and a closing date. In all likelihood, you will need the expertise of legal counsel, and that of an accountant or financial adviser.

## **Establish the Level of Involvement Early On**

Ideally, a business angel will provide not only capital but also expertise and experience. The best and brightest angels also can help open doors to additional expertise, important contacts, and perhaps customers. But it all hinges upon establishing the relationship right away. Some angels do not want to be involved at all. Others want to be active partners in every sense of the word and help build an organization around their money. What is crucial is not precisely *what* angels will do, but establishing the level of involvement and their relationship with the principal owner or management. Doing so can prevent untold headaches and crises later on.

## **Get Feedback Promptly**

A structured and carefully considered reporting and advisory procedure is critical, too. While tales of visionary entrepreneurs clashing with crusty financiers are legendary, too little involvement and feedback can be equally problematic. Determine when and how often to meet right away: monthly? quarterly? It does not matter, as long as it is structured. Moreover, meetings tend to generate ideas that help everybody. A reasonably thick skin is helpful, too. If you ask for objective feedback, be ready to accept brickbats with bouquets and act on the advice.

## **Get Enough Money! And Be Patient**

Do not be afraid to ask! As often as not, enterprises fail because they either are under-capitalized, or they throw in the towel and call it quits just when they are on the verge of success. If you need \$150,000, do not be afraid to ask for it. Bring patience to the deal, too, and ensure your angel does, as well. Self-evident? Yes, but it still needs to be remembered! As long as the business is making progress, improving, and meeting targets, angels are apt to be satisfied.

## **What to Avoid**

---

### **You Underestimate the Risk**

New ventures are highly speculative, with or without angels. A rule of thumb in the U.S. is that nine of every ten new ventures fail and in their first year. Angels, too, need to grasp this reality!

## **You Keep Mum about Bad News**

No one likes surprises, and business angels are no exception. That is one reason why regular mileposts are important. But do not wait if the unexpected occurs, for the angel may help solve whatever problems have come up. As the late management guru Peter Drucker observed time and again, it is not the mistake itself that can bring a company to its knees, but how quickly a management can react to it that counts.

## **You Expect a Silent Partner**

Silence still may be golden, but it is increasingly rare. Successful people with money and time to commit are not apt to sit still. More often than not, one's business angel is also one's business partner. As extreme as it sounds, a partnership that gives 40 percent of an entity to an entrepreneur, 40 percent to his angel, and puts 20 percent in a separate trust is not particularly uncommon.

## **You Think It Is “Nothing Personal, Strictly Business”**

Do not ever believe that! Finding a business angel is still a person-to-person adventure, no matter how many formulas, scenarios, projections, and assumptions a computer may spew. Compatibility is vital! Both angel and owner need time to get acquainted, to evaluate the idea at hand, and to feel comfortable about working together. In that sense, it is much like hiring a key executive or even getting married.

## **Where to Learn More**

---

### **Books:**

Benjamin, Gerald A., and Joel Margulis, *The Angel Investor's Handbook: How to Profit from Early-Stage Investing*. Bloomberg, 2001.

Hill, Brian E., and Dee Power, *Attracting Capital From Angels: How Their Money—and Their Experience—Can Help You Build a Successful Company*. Hoboken, NJ: Wiley, 2002.

May, John, and Elizabeth F. Halloran, *State of the Art: An Executive Briefing on Cutting-Edge Practices in American Angel Investing*. Darden Business Publishing, University of Virginia, 2003.

May, John, and Cal Simons, Every Business Needs an Angel: Getting the Money You Need to Make Your Company Grow. Crown Business, 2001.

## **Web Sites:**

Whittemore School of Business & Economics, University of New Hampshire:  
<http://wsbe2.unh.edu/center-venture-research>

Angel Capital Association: [www.angelcapitalassociation.org](http://www.angelcapitalassociation.org)

Great Lakes Angels: [www.glangels.org/index.htm](http://www.glangels.org/index.htm)

Midwest Investment Network: [www.midwestinvestmentnetwork.com/home](http://www.midwestinvestmentnetwork.com/home)

Copyright © 2007 CNET Networks, Inc. All Rights Reserved.