
Angel Investing Group Best Practices – Managing Members, Guiding Presentations and Finding the Right Deals

April 2003

Angel investing has long been an important source of financial support and mentoring for new and growing businesses, bridging a gap between individual and institutional venture capital rounds of financing or being the only source of external financing. Over the past several years, the number and types of organized business angel groups has grown, and the business models for the groups continue to evolve. These organizations are generally better financed than ad hoc groups of individual investors, but they also face their own organizational and structural challenges. This paper outlines some of the lessons shared among business angel investment groups around North America during an “Angel Organization Summit” held in October 2002. Best practices shared by the 25 groups participating in the summit include: managing membership participation, coordinating company presentations, finding the right fit for potential investments and working with other investors, particularly venture capitalists and other angel groups.

MANAGING PARTICIPATION OF MEMBERS

Since angel groups are disaggregated organizations of individual investors, one key goal for angel group leaders – whether they are members themselves or hired managers – is to maintain appropriate levels of member involvement and application of members’ expertise. Strong member involvement ensures that the group provides more value-added contributions to portfolio companies and makes the group more valuable to those looking for financing and assistance. When members provide contributions when the assistance is not needed, there is a lost opportunity to harness expertise. A lack of member participation when opportunities or problems arise also can hurt investment performance. Identifying member’s motivations and areas of contribution is fundamental, but, conversely, angel group leaders also need to be aware of members’ concerns and help manage member needs and perceptions about risk.

Staying in Touch

Many angel group leaders find that getting on the phone with the membership helps to get them more interested in the activities of the group. The leaders also find that presenting and dealing with activity and involvement expectations up front is very helpful in maintaining an active membership. Most groups agree that getting members involved in day-to-day activities – at least at some level – helps to maintain ongoing participation. These activities include conducting due diligence, championing deals, negotiating term sheets for deals, introducing companies for presentation, leading meetings, and forming group meeting agendas.

Fostering Group Participation

Most groups have a team to prescreen deals, and in almost all cases they appoint or have a champion for the deal. The better the deal, the better the membership involvement. The converse tends to hold true as well: the better the membership involvement, the better the deal becomes through greater coaching and assistance. The champion is the point of contact for the deal, which also increases their interaction, communication and understanding of the group's own dynamics.

Deal champions and coaching committees are responsible for ensuring the company is ready to present to the membership and also making any necessary introductions. Internally, having a good database of membership skills, interests, and experiences is important, as is allowing members to communicate through a common internal Web site. Many angel groups now offer advice to entrepreneurs even if they are not portfolio companies as a way to have positive accomplishments through mentoring. This practice also refines and strengthens group dynamics.

One group has had success in getting more members to serve as lead investors by developing an "apprentice program." They ask experienced lead investors to help members who are new to the role in completing the work. Not only has this helped the quality of their selection and due diligence processes, but it has increased members' willingness to be more significantly involved in the operation of the angel group. It also provides value to the members as they learn anew skills and have new experiences themselves.

Integrating New Members

In some cases prospective members are invited to a presentation meeting so they can see how the group works and are provided with written expectations as part of their "application" to join the angel group. The board of directors or membership committee then votes on whether to accept the individual. New members so far have seemed to appreciate the significance of getting peer education and encouragement for involvement, having shared expectations and as a result, tend to be more active members than those who were allowed to join informally.

GUIDING COMPANY PRESENTATIONS

In helping entrepreneurs prepare for a presentation, a coach or champion should explain how their angel investment group differs from local venture capital firms. Most angel groups have greater diversity and looser organizational structure than their venture capital brethren. Allowing an entrepreneur to make a "canned" venture capital presentation to an angel group likely means missing out on areas where the angel group can help the entrepreneur, find value in the deal and help build a stronger investment opportunity. The key to financial success lies in finding the best fit with an entrepreneur, which starts with the presentation.

Setting an Investment Standard

Although many investors often speak of companies in terms of "good deals" and "bad deals," there are no such things in absolute terms. If this were true all investors would be selling a commodity, i.e., money - and have no competitive advantage against other players. Rather, think about finding a "good fit" for your organization and focus on making the deals better. Analyze the group's strengths and weaknesses to develop an investment strategy that draws on the

organization's comparative advantage to other investors. Then, use the group's insights and resources either to pick undervalued investments or to give them additional assistance to beat the market.

Reviewing and Refining the Presentation

After determining an investment opportunity's fit with the group, tailor the presentation accordingly. Assign a member or a coaching committee to help the entrepreneur refine their presentation for this audience, which also increases member involvement. Tailor the level of detail based on your group's personality. A software-focused group might want several slides and more discussion on the technology, while a group of financial executives might desire more information on sales and capital requirements. Highlight areas where the group can help the company as well as areas where outside expertise or analysis may be necessary. Manage time carefully as well. The story should only take 10-15 minutes, followed by a ten-minute question and answer period, to maintain momentum and rhythm. Do not be shy to ask for help or highlight areas where you might want assistance.

Gaining and Giving Feedback

Once a company presents to the membership, ask the entrepreneur to leave the room. This gives the membership the opportunity to speak freely and give a quick ten-minute "thumbs up or down." Ask members to provide additional feedback to a spokesman – usually the champion – in writing, so comments are clear and can be synthesized accurately. This member then is responsible for determining and providing the group's feedback, so the company receives one corporate view, possibly highlighting outlying feedback, to help them refine their own strategy and coordinate next steps.

FINDING THE RIGHT DEALS AT THE FRONT END

Angel groups have many good practices at the back-end of the process to ensure the best deals for their groups, but what about ensuring that the group is aware of all of the potential deals in the community and qualifying their fit with the organization? Beating the bushes is often the hardest work!

Fostering External Communications

Finding a fit between entrepreneurs and angel groups begins with helping entrepreneurs self-select whether to contact or engage the angel group in the first place. A Web site that clearly and effectively communicates the group's investment criteria, processes, personality, interests and goals helps entrepreneurs decide whether to submit a business plan or not. It provides a window or visibility into the angel group. The site should be formatted so that it is easy for the entrepreneur to provide their business data, and should not require more information than is needed for an introductory contact. Members should continually promote and update their own information on the group's Web site and the site should include links to partner organizations such as venture firms, accountants and lawyers. Speaking engagements at local entrepreneurs' meeting and networking events help spread understanding of the group's profile, as do conversations and connections with lawyers, accountants and other service professionals who work with new ventures. Often having the ability for entrepreneurs to sign up for a regularly

distributed newsletter or email update can help maintain your group's activities in the forefront of their minds and maintain consistent communication with the external community.

Coordinating Internal Communications

Angel groups also should provide a safe, constructive environment to discuss plans. A large group of individuals – particularly those with industry experience – can raise an entrepreneur's suspicions about how confidentially their plan will be kept. Mixed feedback – often spontaneously provided and well-intentioned – can sow confusion and create an image of inconsistency and impulsiveness. Rather, the manager or screening committee should provide structure for discussions without creating unnecessary bureaucracy that dampens the inherent creativity and energy of the group. Members could be used as sounding boards and advisors to company founders and employees. Such steps demonstrate that the group represents more than just a source of capital they provide advice, feedback, domain expertise and connections. Some groups also offer entrepreneurs business courses to improve their skills.

Asking a Key Question: Valuation

“Everything boils down to price,” is a common financial saying, and in venture investing, “price” is the company's valuation. Some groups ask entrepreneurs if they are negotiable on their valuation, and the answer tells them much about management's sophistication and flexibility. If the valuation presented by the company is substantially too high for the group's profile, the odds are low that the entrepreneur and potential investors will likely work out other details of a relationship. If it is too low, the entrepreneur may appear desperate or overly value the new infusion of cash at the expense of their long-term success.

FOSTERING BEST PRACTICES

The comments above merely represent some of the first areas of consensus among angel group leaders developed at a meeting in October 2002. There was general agreement that several other areas are important to angel groups' success but additional data, discussion and analysis is needed to determine best practices in these areas or to develop collaboration among angel groups throughout North America. These include the following:

- Tools such a standard term sheets, due diligence checklists, and presentations.
- Group organizational structures and core legal documents.
- Structure and operations of side-car and central funds.
- Methods of collaboration to draw on others' domain expertise and co-investment.
- Angel group categories such as by investment segment, region, or type of management.
- Benchmarks for angel group performance.
- Evolution of angel investing industry. What does the future look like?
- Definition of an angel investor as it may change depending on sector, region and background.

CONCLUSION

Over the past several years, institutionalized angel investing has become more prominent as a source for funding for the next generation of early-stage companies. Its success will depend on how well these groups develop, implement and refine the practices for their situations as well as communicate them to internal and external constituencies. This report is the first step in this direction. We hope this paper provides a window into the world of angel group investing for both entrepreneurs looking for financing and for venture capitalists that typically get involved in follow on rounds of financing and for those thinking about starting or formalizing their own angel investment group.

Comments or Questions

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