Best Practice Guidance for Angel Groups – Post Investment Monitoring

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Your angel group has sunk the money into a start-up or growing business, now what? Who's on the board? What do you do when things go wrong? How do you get to the exit?

Monitoring the performance of your investment is essential to being a successful angel investor, and having solid monitoring processes is as important as due diligence. During the pre-investment dance and documentation, you should determine the level of involvement your group will have with the company post investment. This includes how frequently you will receive financial updates and of what type, as well as whether you will have a board seat or other official role in the company. Even without a board seat you need to maintain a relationship, though it may be more informal, and provide advice and connections for the portfolio company. However you've structured your investments, staying involved with the entrepreneurs and monitoring the progress of the companies can impact the level of success of your investments.

To provide more insights into the Post Investment Monitoring stage of your investments, Stephanie Hanbury-Brown of Golden Seeds, Catherine Mott of BlueTree Allied Angels, Carol Sands of The Angels' Forum, Paul Sciabica of New York Angels, John May of New Vantage Group, and James Geshwiler of CommonAngels were interviewed on the following topics:

- *Deciding who will be involved with the entrepreneur*
- *Mentoring, Coaching and Advice*
- *Level of communication*
- *Company and portfolio measurement and assessment*
- *Board of Directors*
- *Board Logistics and Issues*
- *Dealing with problems*
- *Follow on Fundraising*
- *Exits*

Deciding Who will be Involved with the Entrepreneur

If you have negotiated for a seat or seats on the board of directors you will have regular contact with the entrepreneur at the board meetings. Paul Sciabica shared that most commonly the lead investor from the angel group takes the board seat and will be the main contact with the entrepreneur. Yet if the lead has no expertise in the industry and another investor does, it may be of greater benefit to have the secondary investor with expertise take the board seat. You may also select the investor who does the best job of leading meetings, people, and a board. Carol Sands added that the board seat is held by the organization, not an individual, so keep the person on the board who has the best skills to serve the needs and stage of the company.

If a board seat has not been awarded to the angel group, it is still critically important to maintain open communication with the entrepreneur. Either the lead investor or the investor with the most related expertise should be designated as the main point of contact for the entrepreneur. And if more than one board seat has been awarded, it is also wise to select a lead representative for the angel group. By establishing a main contact for the entrepreneur, he or she knows specifically where to bring needs, concerns and requests, and similarly the angel group knows who is following that company and who should be communicating any angel group messages to the entrepreneur. The lead person should be copied or notified of any communication from the other board members to the entrepreneur so one specific person from the angel group has the full picture of communication between the group and the company.

In deciding whether the lead investor is the best person to serve as the main contact with the entrepreneur, some questions to consider are:

- Has the original lead investor developed a good rapport with the entrepreneur?
- Were negotiations strained or could the entrepreneur have any unspoken resentments towards the original lead?
- Does the original lead have a solid understanding of the market and company or were they the lead because of a personal relationship or other non-subject reason?
- If the original lead has a personal relationship with the entrepreneur might that interfere with the business relationship between the group and the entrepreneur, especially if the entrepreneur needs to receive challenging communications?

If there is a decision to make regarding who will be the ongoing lead contact, the group can put forth a person or persons and a vote is taken. Additionally, a small number of the group may want to agree to work with the entrepreneur and put forth a lead person from their sub-group. The group should come to a formal decision and notify both the group and the entrepreneur that this is the main contact for all direct and copied communication.

The lead contact should be diligent in assessing his or her ability to maintain the expected relationship with the entrepreneur, and the angel group needs to check in periodically with the contact and also the entrepreneur to make sure both sides are “in sync”. This requires that the angel group have a person designated to make the periodic assessment. This can be one person who checks on all entrepreneur-lead contact relationships, the group manager, or a secondary contact for the company.

Secondary leads are a good idea in case of vacation, illness, or death of the lead contact. The secondary lead can be a very low-demand position only requiring cursory involvement and maintaining knowledge of the relationship through copies of communication between the lead contact and entrepreneur.

If the relationship between the entrepreneur and the main contact becomes strained or disconnected, then the group should speak with both parties to assess the reasons behind the estrangement. If the entrepreneur has become detached or become belligerent, the group may want to bring in a consultant to bridge the problems. If the lead contact is part or all of the problem, the group should not hesitate to replace the lead contact with the secondary contact or a new lead contact.

Don't rely on board meetings for your connection with the entrepreneur. The lead contact should have an open email and phone call relationship with the entrepreneur in order to continuously share information and provide advice.

Mentoring, Coaching and Advice

Investing money is typically only a portion of the commitment an angel group makes to an entrepreneur and the company. Your group's network of resources can be of tremendous benefit to the entrepreneur, and the lead contact should employ these resources for the entrepreneur's benefit. Additionally, the lead contact can act as a mentor, or select a member from the angel group to be a mentor to the entrepreneur. The need for such mentorship will depend on a number of factors:

- How seasoned is the entrepreneur?
- How experienced is the entrepreneur in the industry the company operates in?
- Does the entrepreneur already have a mentor?
- Is the entrepreneur asking for a mentor?
- Does the main contact, board of directors, or angel group see areas where the entrepreneur needs mentoring?
- Does the angel group have an appropriate mentor who will volunteer time mentoring?
- If no gratis mentoring is available, what is the cost of mentoring and how does that fit in the budget?

While mentoring requires additional time or financial resources, investing in the management of a company is part of the "value-add" an angel group brings with its initial investment. The angel group may want to agree that each member of the group provides a certain minimum amount of time each month or each year to mentoring at least one entrepreneur. Mentoring can also be need specific, e.g. an expert in HR can help the entrepreneur with staffing mentorship, an expert in time management can help with prioritization, etc. Stephanie Hanbury-Brown noted that for a troubled company her group's contact met in-person with the CEO for two hours every week and spoke on the phone with him between meetings until the crisis was resolved.

Services such as legal advice, accounting work, etc., can also be arranged through the angel group and are of great help to entrepreneurs. If the entrepreneur already has existing legal or accounting relationships, the angel group may still want to offer the entrepreneur new contacts so rates and services can be compared. As the company grows, the original lawyer and accountant may be insufficient to address the expanding needs of the company. Stephanie Hanbury-Brown emphasizes the importance of helping the entrepreneur with contacts. An angel group will have a rich rolodex, which can help the entrepreneurs more easily succeed via good connections.

James Geshwiler points out that innovation of organizations is very important in start-ups. Why is it necessary to have a new organization in this market? The angel group should help the entrepreneur continue to evolve the company structure and practices as it grows, and become something unique in the marketplace rather than morph into a clone of an incumbent organization.

Level of Communication

Hopefully, during the due diligence and structuring phase of the deal you have established a good relationship with the entrepreneur and management team. If not, get it back on track and build a strong relationship with the entrepreneur. As John May commented in our interview, performance by the entrepreneur is key to a successful exit. To ensure that your knowledge is shared and the company stays on track, your angel group needs to be tight with the entrepreneur. Not so tight that she or he is spending more time with you than on the business, but tight enough that when the entrepreneur and/or business gets off track, you have the relationship and information to know this quickly and respond collaboratively. This requires an appropriate level of communication.

Do you want the entrepreneur calling the main contact every day, or once a quarter? Probably something in between – make whatever level of communication you expect clear with the entrepreneur, and also listen to what level of communication the entrepreneur is expecting to have. If the expectations are a match then the main contact should maintain that level of communication. Should it become unsustainable by the lead contact, then a new lead contact should be selected. If the expectations between the group and the entrepreneur are mismatched, an agreeable compromise needs to be negotiated. Get it worked out and bring in the best people from the angel group for resolving the problem. John May noted that the lead angel can't shoulder all the load – figure out solutions with all angels in the group. Carol Sands shares that in high conflict situations that require special needs, they bring in the right person from the group for the particulars of the situation based on that person's strengths. Know and use the diverse skills of your group to your advantage rather than pushing for the lead investor and/or board member to handle every situation.

If a difference in communication expectations is not addressed upfront it is likely that hard feelings and an impaired relationship will result. Undoing this later is much harder; so address how conflicts will be handled at the very beginning and keep the communication open and constructive between the entrepreneur and the group.

Company and Portfolio Measurement and Assessment

The metrics you employ to track each company and your overall portfolio influence your relationship with the entrepreneur. If you are tracking revenues and deemphasizing profit margin, the entrepreneur may come to understand this either directly or indirectly and put more emphasis on the areas you track. If the areas you track are in alignment with the stage of growth the company is in, then all may work well. However, if a portfolio-wide metric is applied equally to a start-up and a later stage company, then each may under perform. Catherine Mott advises that choosing the key metrics to assess your investments is a "company by company" consideration. To properly choose your metrics, some questions may help:

- What metrics drive the business in the way you see needed?
- Do these metrics measure the progress in the current stage of growth?
- Are your metrics appropriate for the industry?
- Do you and the entrepreneur agree on the metrics? If not, why?
- Are the metrics for the investment aligned with those agreed upon by the angel group to be used based on the company type and company stage?

The lead contact should gather metrics on an agreed-upon interval and then report to the angel group the metrics data as compared to expectations and the business plan. Any differences above a certain threshold can be highlighted with known explanations. Paul Sciabica emphasizes the importance of tracking milestones, and reporting on a quarterly basis how the company did versus what the management said they would do. Catherine Mott offers that companies rarely meet milestones since these are only projections, and it takes a strong stomach to work through the rough stages of company growth.

If the company is not meeting metric expectations, the angel group should discuss the issues and the lead contact should address the discrepancies with the entrepreneur, understand how the entrepreneur is addressing the shortcomings, and make revisions to metric expectations if needed. Catherine Mott commented that an A+ management team will navigate the obstacles and nimbly overcome shortcomings in performance. If the company is far exceeding the metrics, expectations may need to be revised, though care should be taken to not devise or communicate any new metrics in a way that could be disincentives for performance.

Typical performance metrics used by angel groups include burn rate, cash on hand, revenues, customer quantity, income, etc. What is most important is to select metrics that are appropriate to the type of investment, the particulars of the company and its stage of growth.

Board of Directors

A Board of Directors (BOD) at the angel investment stage typically consists of two company seats, two investor seats, and one independent seat for a total of five Directors. Catherine Mott says that a "value-added" board is very important and people should be selected with industry experience. Where possible, the angel group should help the entrepreneur find the best person for the independent board seat. As mentioned, most commonly the person who leads the investment for the angel group will take the angel group board seat, yet there will be exceptions based on expertise and industry relationships.

In earlier stage investment deals, particularly larger ones, the BOD is very active, conducting monthly meetings as well as meeting between BOD meetings as needed. Directors participate in working on the business plan, helping with client contacts, consulting with the CEO, raising debt and connecting with VCs when needed. If a company gets into a troubled situation, the angel group director may meet or speak on the phone with the CEO every week to help the CEO lead the company out of trouble.

In smaller angel investments or where the angel group is a smaller collective share holder, the angel group director is typically less involved with the company, though continues to monitor the company and advise the CEO. Evaluating the money value of time (vs. the time value of money) leads the angel group director to monitor his or her time use and balance investment and involvement.

Stephanie Hanbury-Brown pointed out that, at a minimum, the directors should attend all board meetings and ensure good corporate governance practices are used. It is very important for the BOD to critically review and ultimately approve the annual budget, and hold management accountable to perform according to the budget. The BOD should adjust compensation and use incentives to motivate the management to reach the agreed upon milestones.

The angel group director should report on the angel's interest based upon an agreed format. Some groups will utilize a quarterly report from the Director to the investors as a standard form of communication, and other groups will let the company perform the main communications to the investors. Either way, it is critical for the angel group director to ensure that angel investors are apprised of the progress or problems at the company, and that the director looks to the angel group for specific resources when the company needs help that the group members can provide.

If the angel group director fails to make the meetings frequently, or fails to communicate effectively with the angel group, a new director should be selected from the group. In some cases this change will be welcomed or at least expected by the current director, who may be overworked or distracted by other responsibilities. In other cases, where the director is unaware of his or her failings, the group may need to build more of a case for the change and handle the internal relationships with care for the long-term health of the group. Regardless, the group should not let a negative performance by a director go unaddressed, and it is advised to speak with the director before too many board meetings are missed or communication on company performance is absent for too long (or give the director an opportunity to improve performance before being replaced).

Carol Sands says that during the different stages of the company, the angel group may want to change the person taking the board seat. Some members will be better suited towards working with the BOD and CEO during the start-up or growth phase, while others will be more helpful and attuned to the end-game to exit. When members with different skills have an interest in the company, they should actively discuss among themselves who and when the changes will be expected. It is also common for one member to serve on the BOD throughout the group's investment and draw on the expertise of others without the other members taking the board seat.

The largest investor entity usually takes the chair position on the board, or less frequently, another investor who does the best job leading meetings and BODs. If the angel group is the largest investor, it should seek the chair position to maintain control of calling and running the meetings.

The group should balance the number of boards on which each member serves based upon the bandwidth for each investor. If members of the group have additional professional endeavors and positions, their time and availability to serve on multiple boards will be limited. If on the other hand members pursue the angel investing as their primary career, they will be able to serve on multiple boards as VCs do. Yet, Catherine Mott advised that it may be necessary to limit the number of boards an investor serves on if she or he is over-stretched.

Board Logistics and Issues

Board meetings are typically held monthly, for two or more hours, called and organized by the chair.

It is preferable that all members attend in person, which is made simpler when groups invest in geographically local companies. For board members who cannot physically attend meetings, participating via conference phone is acceptable, especially since the board is usually five to seven people. Arranging meetings with a conference phone for the one or two directors who cannot be present is preferable to having less participation. However, fully teleconferenced meetings are not recommended as the dynamics of interpersonal relationships are a key aspect to building a strong relationship with the CEO and amongst board members. An exception is when there is an urgent issue and then a teleconference is preferred to waiting until directors can meet in person.

Directors are compensated by and per the mandates of the company. There are two factions of opinions re: compensation. One is that members of angel groups who serve on boards should not receive any additional compensation because all active members are encouraged to have an interest in serving as a board director and service should balance out over time. The other seemed to be that many expected their group's BOD representative to receive an annual stipend of 5% of the CEO's cash salary…..taken in cash/options/warrants or a combination.

John Huston of Ohio Tech Angels fund believes that this is a growing trend, "In our experience, compensating the angels results in greater attendance and attentiveness……and they are less likely to balk at writing the annual portfolio company overview for our annual report.

Catherine Mott emphasized that D&O insurance is critical for all group members who will serve on a BOD. It is not worth the risk or responsibility of becoming liable for the actions of the company to be without this critical safety net. For example, if employees are not paid and the company goes bankrupt, the BOD can be liable for the unpaid salaries – just one of many reasons that make D&O insurance essential.

Dealing with Problems

When problems arise in the company, the angel board member should quickly arrange a frequent meeting schedule with the CEO. It is important to provide the best knowledge available from the angel group to help the CEO manage through the problems. The angel board member should at a minimum meet with the CEO weekly to track the problems and arrange for additional meetings with respective experts from the group. The meetings should only be as long as needed, and then the angel member needs to get out of the way and allow the CEO the time and room to act on the advice.

The paths for start-up and young companies can be rough, with many unexpected twists. If the due diligence has been effective, the team leading the company will be able to navigate through the obstacles, many times with angel input, successfully. If however the CEO fails to rise to the challenges, it is up to the BOD to take charge and replace the CEO. This obviously should not be done rashly, nor should it be delayed until the company is on the brink of bankruptcy. The BOD will need to conduct sensible and insightful evaluation of the situation and the CEO. Additionally, having a pool of potential replacement candidates will help in the decision making process. If it is decided to replace the CEO, this change should be undertaken with both sensitivity and directness to provide for the best transfer of leadership. Whenever possible, keep a positive relationship with the Founder/CEO that you are replacing by offering a different position in the company if appropriate and communicating that the BOD and new CEO will do their best to fulfill the Founder's vision.

Follow on Fundraising

Angels are an important connection to follow on investments and angel groups typically maintain tight relationships with VCs. Some angel group managers speak with VC contacts weekly, staying up to date with the VC funds' investments and available capital. James Geshwiler emphasizes keeping strong relationships with VCs; select VC firms of an appropriate size, not too large as they will not be interested in your investments and not too small that they wouldn't have the capital to lead a follow-on round.

The group as a whole should have several VC firms to choose from when looking for follow-on funds for portfolio companies. The angel group can then match the company with a VC firm that will be of most value to the company and bring industry expertise. James Geshwiler recommends calling VCs with deals that are right for them – he further encourages angels to be specific and not shop around, pitting one against the other, unless you are turned down by the selected VCs. When the angel group is talking to different VCs, someone in the group should keep track of who is talking to which VC firms.

Paul Sciabica said that at NY Angels some members are VCs, and that it was common for companies to be recommended between the group and the VC companies and visa versa. Having VCs in your group can facilitate follow-on funding, though this can be limiting, thus relationships with outside VC firms should also be formed.

When follow-on fundraising and resulting dilution occurs, the angel group can protect its investment by bringing in an aligned VC firm as the lead investor. If the angel group loses its board seat, it may be able to maintain observer rights, or at a minimum, keep in close contact with the VC board representatives. When bringing in VC firms for the follow-on funding, it is imperative for the company and the angel investors to have knowledge of the VC firms or complete due diligence on the VC firms. Watch out for previous practices of poor disclosure, negative past relationships with companies, or weak communication amongst syndicated investors.

The angel group also needs to advise the CEO and/or CFO on the best financing to obtain at each stage, whether to seek out debt, debt/equity or equity. The range of experience and contacts within the angel group should facilitate the best available financing.

Exits

Stephanie Hanbury-Brown emphasized the importance of having a strategic vision with a road map to the exit. This road to the exit should be planned from the beginning of the angel group's relationship with the company, with milestones built into the journey. This plan can be, and will likely need to be, amended to match the market dynamics as they change over the life of the investment. It is important for the angel group to know the different options – acquisition, IPO, management buyout, etc. – and work with the CEO to select the best option and facilitate the process.

James Geshwiler recommends that the angels and entrepreneur also need to be cognizant of a positive way to fail, and discuss with the CEO upfront when it would be time to close down the company, rather than to languish into oblivion. This can be after a certain number of financing rounds, failure to meet certain milestones, or other warning signs. A bad way to fail is to not give up, dragging out the company through new rounds that only delay the end. If the company strategy is not working, and management and the board have exhausted their ideas and resources, or if the market has shifted away from the company's business, then it is better to fail well and close down operations.

Successful exits are of course those that bring a positive return. John May advises that knowing the expected size of the market, company, and the upside potential at the beginning of an investment will help the angel group set expectations and exit at the appropriate time using the best strategy. CEO performance, monitoring the company, mentoring the CEO, tracking milestones, responsive markets, and a bit of luck are all elements leading to positive exits.

When it is time to enact an exit strategy, the angel group should help introduce good deals for the exit. If the entrepreneur has not been through an exit before, then the angel group should pay special attention to mentor the entrepreneur and guide the exit process if the angels are still the lead investor. If the group is not the lead investor any longer, it can still bring in deal ideas and make connections to facilitate the exit.

Summary

Communication tops the list of essentials for successful post-investment monitoring. This includes communication from the angels to the entrepreneur, within the angel group, and from the entrepreneur to the angels. Angels and angel groups should also be communicating with VCs and potential exit entities continually, so when the right time comes for follow-on funding with VCs or the exit, the appropriate people can be accessed quickly.

Keeping close track of the company's progress, helping the entrepreneur address shortcomings, offering solid mentoring to the entrepreneur, showing the CEO alternative financing options, introducing follow-on and exit partners, and when needed making the hard decisions of replacing the founder, board member, or pulling the plug on the company, will all contribute towards the success of your investment portfolio.