Joining Angel Organizations – A Win-Win Opportunity

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Angels invest time and money in startup companies. For most, making money is not the primary motive for investing. These angels have "put away their nuts" for retirement and are investing their "mad money" in entrepreneurs. They do so for a variety of reasons…give-back to their communities, the opportunity to work with entrepreneurs, to stay engaged in their retirement years and to work with fellow angels in building enterprises, to name a few. Return on investment is an important metric of their success, but not normally their primary motive for engagement.

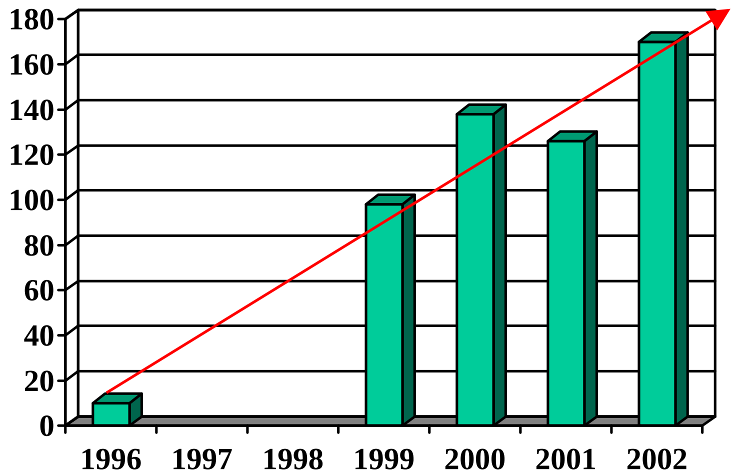
Until the mid-90s, most of us would admit that angel investing was too much work. We are looking for opportunities to travel, read, play golf and slow down. Angel investing required us to read hundreds of business plans, searching for a gem. Once we suspected we had found one, we spent many hours validating the business plan doing due diligence on the entrepreneur and the company. After we were committed to invest, we found ourselves helping the entrepreneur in finding additional angels and then shared the results of our due diligence with them. And then after closing the deal, we normally serve on Boards of these companies or in a variety of advisory roles.

Because the investing process is so time-consuming, our preferred deal flow came from trusted sources…other angels and knowledgeable service providers in our communities who had first-hand knowledge of the opportunity. We were pretty quiet about our involvement in angel investing. Publicity resulting from speaking engagements, for example, resulted in a slew of business plans arriving on our doorsteps within days after the event. Reading 100s of business plans is not our activity of choice (see travel, golf, etc. above). Until recently, most angel investors did not "hang out a shingle" announcing their interest in investing in startup companies. Consequently, entrepreneurs found it very difficult to locate potential angel investors for their promising ventures.

With angels hiding from entrepreneurs, angel investing was a very inefficient process. For years, Professor J. Sohl of the Center for Venture Research, University of New Hampshire, has referred to this disconnect, the information gap between qualified entrepreneurs and the angel investors who might be interested in investing in their companies, as the greatest impediment to angel investing.

<u>Angels Join Organizations</u>
In 1994, Hans Severiens and his colleagues in Silicon Valley formed the first formal angel organization, the Band of Angels. (Other informal networks of angels formed earlier to investing in early stage companies in several regions of the country, but the Band is acknowledged by most as the earliest formal organization.) Since 1994, the formation of angel organizations has expanded rapidly. According the Prof. Sohl, there were at least 170 organizations of angels in the US in 2002.

Number of Angel Organizations in the US



There are three flavors of angel organizations:

<u>Angel Funds</u>

Angels pool their monies in Funds and make investments by voting for those companies in which the fund will invest. Managers screen deal flow, lead due diligence efforts using member expertise, where appropriate, and tee-up companies for consideration for investment by the members. For their efforts, managers are compensated with a small fraction of the funds collected and a preferred return on investment (a "carry" of 5 to 20%) once the capital is returned to investors.

<u>Angel Networks</u>

Angels make individual investment decisions in Networks, that is, some angels may invest in one deal and another set of members may invest in the next deal.

- In some Networks, managers are retained to lead the organization and perform many of the duties described above for manager-led Angel Funds. Managers are compensated through member dues and by a "carry" on each deal in which members invest.
- Elected members manage Member-led Networks. Members are recruited to screen deals and to lead due diligence efforts. Other members are responsible for finances, membership recruiting and communications. Often administrative assistance is provided by local service providers, entrepreneurship centers or is hired by the Network. Dues pay for this administrative support.

There is no standard model for these Networks and Funds, consequently operations vary from organization to organization around the country. However, these organizations have changed angel investing substantially, as follows:

1. Angel organizations encourage deal flow by promoting the organization and easing the process for applying for funding. Knowing a member is no longer required for entrepreneurs to approach most angel organizations. The gap described by Sohl above is disappearing.

2. Angel organizations have adopted rigorous, standardized processes for screening deals, for performing due diligence on candidate companies and in design and utilization of term sheets for investment. Investing through angel organizations is usually handled in a professional, reproducible manner.
3. Organizations of angels actively recruit qualified accredited investors to join their Networks and Funds. In many communities, a single angel organization has emerged for all angels, providing "one-stop shopping" for entrepreneurs seeking equity investments. It is not longer necessary to approach angels one at a time, a very inefficient process for entrepreneurs looking for angel investments.

A Win-Win Opportunity

I've been an angel investor since 1980, having invested in over 25 start-up ventures during the intervening years. I am an angel investor because I enjoy assisting entrepreneurs in build businesses. Like most experienced angels, I have experienced the exhilaration of the successful exit and the agony of business failure. I can share that I am no longer interested in investing as a lone angel investor. I will only invest as part of an angel organization.

What attracts me to angel organizations? Angel organizations promote deal flow and encourage entrepreneurs to apply for funding. Should individual entrepreneurs approach me for consideration, I refer them to my angel organizations. I see a variety of opportunities through my membership and can pick and choose those in which I wish to invest. Screening and scrubbing deals with other knowledgeable angels is always a learning experience for me. A group of angels studying a business opportunity brings together an amazing array of business skills and experiences. Within our group of angels, we can usually find members with appropriate exposure to most business verticals, which is most valuable when looking at investment opportunities. By dividing up the work, much of the pain and uncertainty of due diligence is eliminated. I listen carefully to my fellow angels and then usually make up my own mind about the opportunity presented by each investment possibility. By working with a group of angels I can find all the rewards of angel investing with much less of the pain. Furthermore, I find that I have developed many new friendships with astute entrepreneurs and businesspersons who are members of the angel organizations with which I am affiliated. I have found that joining angel organizations is a real win-win situation for me, less work and more fun.

Mr. Payne is an exited entrepreneur, having built an electronics company that he sold to E. I. DuPont in 1982. Since that date he has invested in over two dozenhigh tech and no-tech startup companies. Mr. Payne has consulted with the Kauffman Foundation (Kansas City) as an Entrepreneur-in-Residence since 1995 on a variety of learning programs for entrepreneurs and their investors.