What Every Angel Should Know
Before Writing Their First Check

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Consider the temptation. The young entrepreneur is charismatic and smart. The new product is very cool. And the technology behind it is ground breaking. With all that, investing in this company seems like a slam dunk.

Maybe, maybe not. But before you invest, make sure you're evaluating not only this particular opportunity, but also how it fits into your bigger "angel strategy."

Experienced angel investors caution those just starting out not to make the same mistakes they've made. As an angel investor and executive director of the Angel Capital Association (ACA) - the world's largest angel professional association, I hear a lot of good advice. Bill Payne, who has made 60 angel investments, comes to mind. "Most of us who have been doing this for a long time highly encourage newer angels to do what we say and not what we did," says Payne, who is a member of ACA and the Frontier Angel Fund in Montana. "Most of us started writing checks and later asked, `what is my real strategy?'"

To avoid learning the hard way, it's important for angel investors to have a strategy before writing their first check. That starts with understanding these five critical factors:

- The risks of angel investing.
- Deal returns and the need to diversify.
- Your own risk tolerance.
- How much to invest in total as an angel and how much in each deal.
- What you care about and how that applies to angel investing.

Always remember, investing in early-stage companies is risky. Out of every 10 angel investments, investors experience five business failures and an additional three to four exits that will bring only a modest Return on Investment (ROI). Just one or two investments of out 10 provides most of the portfolio return on investment, with a 10-30X ROI expected on these few successes.

With a small fraction of investments providing the bulk of the reward, angels need a significant number of diversified investments to optimize ROI.

Based on feedback, experience and best practices developed by many of ACA's 12,000 member angels, here are some guidelines:

First, decide what percentage of your investment portfolio should be in angel investing. In general, most investors designate three to 10 percent, although some invest more or less.

Payne, who teaches workshops on angel investing for the Angel Resource Institute, says, "There's no right answer, it's just whatever the investor feels comfortable with".

Of course, the more money one has, the less impact that three percent to 10 percent of angel investment has on risk for the overall portfolio. It's important to note, however, that 60 percent of those who meet the government's definition of an accredited investor are at the lower end of the net worth scale with $1 million to $2.5 million. That implies smaller checks.

Experienced ACA angels also recommend that angels initially plan on investing in 10 different companies. Understand that many of those will require multiple investments. Therefore, split your total angel investment pot into 20 equal shares - and stick to those amounts.

Remember, most of these companies and investments won't work out. Since this is such a high-risk asset class, the more companies we write checks for, the greater chance of achieving good returns. There are too many stories of investors who wrote one $250,000 check and didn't have any angel money left when their company failed.

Figuring out how much of your portfolio to dedicate to angel investments and understanding the total number of investments you'll need to make will help you determine the size of each investment. Many angels write checks in the $5,000 to $50,000 range.

Spreading investments out is also important. Investing in one to two companies per year makes sense - as does waiting a good six or seven months after getting involved to make that first investment. This gives you the chance to learn from more experienced investors.

"New angels should approach check writing with some trepidation," Payne says. "Get involved with the group you joined. Get involved with due diligence teams. Go to angel investment workshops until you're comfortable with the process and have realistic expectations. Then get into a more steady state of investing".

In addition to knowing how much to invest and how many companies to invest in, it's important to know *what* kinds of companies to put money into. Here is where people turn inward to think about what is important to them.

Although every angel is different in what they care about, many select companies based on a combination of these factors, some of which are altruistic or non-financial:

- Understanding, experience, or affinity with that industry or market.
- Helping build companies, jobs and innovation in their community.
- Supporting companies that the angel has kinship for, such as other women or graduates of the same university.
- Opportunity to mentor entrepreneurs.
- In the case of retired investors, continuing to practice business skills.

Writing your first check - and every one after that - can be extremely exhilarating and rewarding. But before you sign the dotted line, have a strategy and take the time to consider the broader implications.