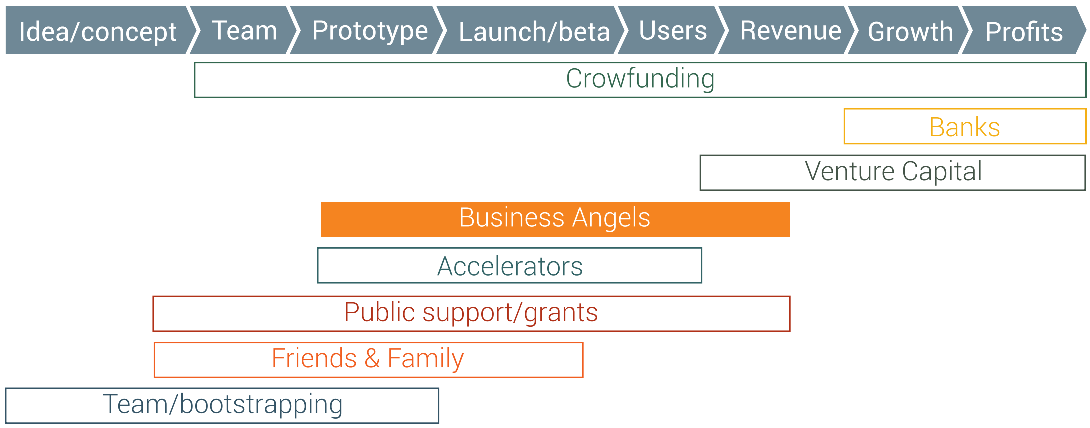
Chapter 8:

Business Angels

Who will invest in your company after you've bootstrapped? Many founders conclude that business angels (private investors who invest their own money in startups) are next. This is how business angels differ from VC funds that manage and invest other people's money. In this chapter we will investigate the best ways to catch a business angel and how to avoid the most common mistakes entrepreneurs make when looking for business angel investments in their company.



When do business angels invest?

Business angels are typically the first investors in startups and invest much earlier than venture capitalists. Unlike with venture capitalists, you don't need massive existing revenue or millions of users for getting a business angel interested in your company. However, most business angels don't invest when you only have a business idea in your head or down on paper in a business plan. They want you to have taken the first steps.

This is especially true for projects with a high degree of technology risk and still in the research and development phase. In many cases, the business angel doesn't have expert knowledge about your technology and will have a hard time evaluating risks. Therefore, many angels prefer not to invest when you are too far away from the market (typically more than a few months before launch) and haven't demonstrated your technology actually works.

Case study: Franco Gianera - entrepreneur turned business angel

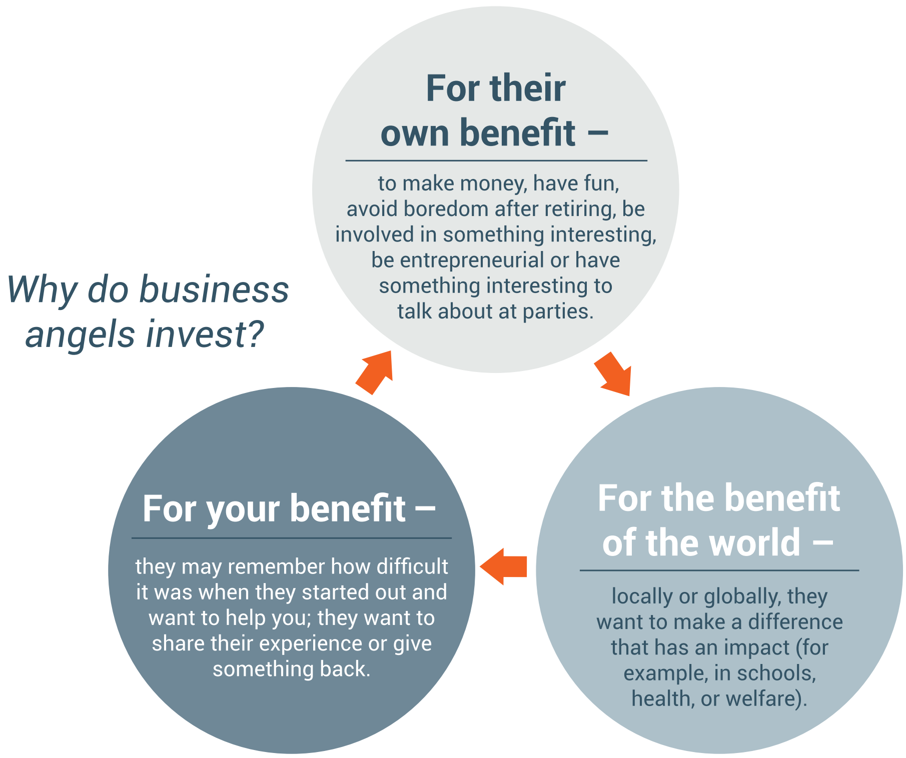
A former business consultant for Andersen, Franco Gianera left a CIO position at Adecco to follow his entrepreneurial dreams by co-founding Buy Vip (the Spanish premium clothing retailer bought by Amazon for €70 million in 2010). Today Franco works as an angel investor with investment into a variety of startups (for example, Smarto, Spotlime and Marchetti Atelier). He explains:

Throughout the course of my career, I have acquired a quite varied mix of competencies. Business consulting strengthened my managerial skills and while with Adecco I gained an international perspective and network. I now want to make the most of this wealth of experience, participating in the lives of tech startups that operate in sectors I know.

At this moment, I'm investing on a 'spot' basis: I select companies I like, with teams I like, operating in industries where I have some expertise. I also provide mentoring and advice. In the future my goal is to invest in a more structured way, but for now I invest on an ad-hoc basis when I meet interesting startups.

Why do business angels invest?

The reason business angels are willing to take higher risks than other types of investors by investing earlier in the process can be explained by looking into the reasons they get involved in startups. This understanding will help you pitch your business proposal in the right way.



Here's an example. In one company I invested in, one of the business angels is worth €200 million. Why would a business person with a net worth of €200 million invest in a startup which only has the potential to earn them an additional €5 or €10 million? For most people (myself included) a €5 – 10 million profit would be a great reason to invest. But if you're already worth €200 million, you would easily make €10 million per year if you invest your equity passively in the stock market or other asset classes. So why invest in risky startups? Because the financial gains are not the real motivation for his investments in startups.

There are three main reasons for business angels to invest in startups and getting rich is rarely the main motivation.

Business angel: Why do I invest in startups?

Tommy Andersen is a tech entrepreneur and business angel who has invested in early-stage startups within multiple industries. He explains:

So why do I invest in startups as a business angel? Well, primarily because I want to give back to the startup community and pay it forward. Of course, I also want to make a good deal and hope the company I invest in will become immensely successful and provide a solid return on my investment, but I know of the risk of investing in early-stage companies, and that I would most likely get a better return on investment if I invested in other assets. Angel-investing isn't for the faint of heart and I recognise that.

Finding business angels for Recon Instruments

When I helped Recon Instruments secure seed funding, I reached out to several potential business angels in my network. During that process, I targeted angels who had previously invested in tech startups and thus knew the risk of investing in an early-stage technology company like Recon Instruments.

This way, I could focus on those who were most willing to take risks, and not waste my time on angels who either don't invest in technology companies or only invest later when the company has a less risky profile. I also tried to target angels who had a personal interest in skiing. I assumed they would easily grasp the value proposition of Recon Instruments (ski-goggles with built-in heads-up display).

Til: 'Nicolaj Højer Nielsen'
Emne: RE: INSEAD - Recon Instruments (skiing + angel investment)

Dear Nicolaj

Looks fun and I hope potentially profitable. Please send me the exec summary.

Regards
Michael

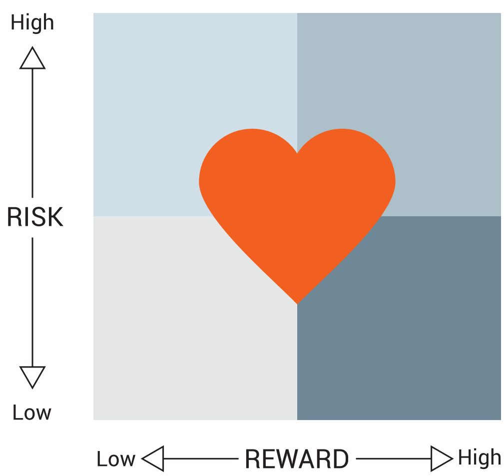
The response above from one such business angel sums up the thinking of many business angels when they evaluate investment opportunities: it has to be fun – and 'potentially profitable'. The message is this: you rarely convince a business angel to invest if you're only offering profit to them.

Key note: Business angels don't only care about money!

You need to understand why angels invest before you can get them to invest in you.

Most entrepreneurs, when seeking funding, make the mistake of thinking that business angels invest mainly to make money. Of course, that's one of their reasons but many business angels are rich already or know they could increase their wealth by investing on the stock market or in other asset classes (for example, land or property). You will increase your chance of a successful pitch to business angels if you understand why they're interested in startups – and it's rarely only for financial gain!

What do business angels invest in?



So which type of investment cases are business angels looking for? Are they looking for the very high risk and high reward cases that can bring in hundreds of millions of euros just like VC funds?

No. Business angels invest all over the place, both in 'the next Google' and also in businesses perceived to be low risk/low reward. Some business angels even invest in cases where they believe the actual risk is far higher than the potential reward justifies (high risk/low reward), but they still want to invest for other reasons than the financial outcome.

Different types of business angels

One reason why business angels invest so differently is that they are not a homogenous group but a very diverse mix of people with only their interest in investing in startups in common. Business angels are not just serial-entrepreneurs who have become multi-millionaires!

It's important for entrepreneurs looking for financing to understand the differences between the different groups of business angels, which is the reason they make investment decisions so differently from each other.

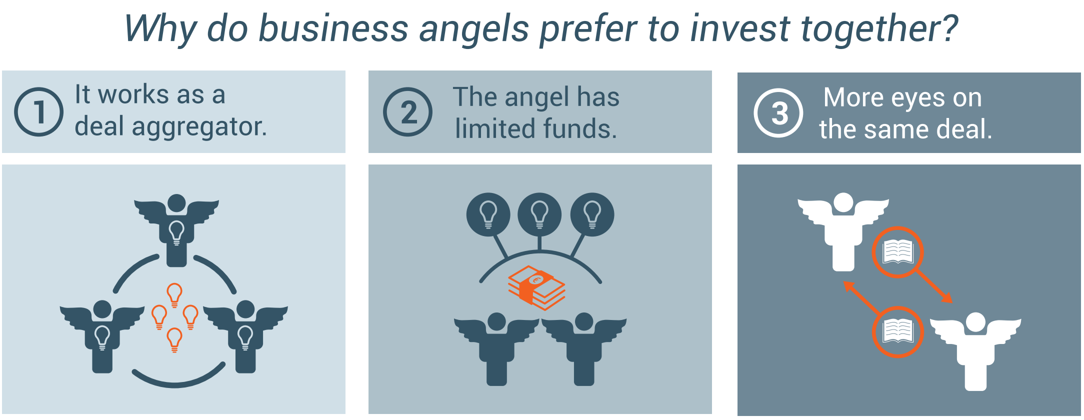
In simple terms, there are three types of business angels:

	NEW ANGELS	BA NETWORKS	SUPER ANGELS
Role	Typically passive but often wants to be involved on an ad-hoc basis; you have the chance to get valuable know-how	Varies but one angel often acts as lead and is typically very active while other investors are more passive	Typically actively uses their own network and personal brand to help make the startup a success
Alone or in consortia	Usually invests alone but you can pool them together to reach your funding goal, e.g. use 3-5 different investors	Most prefer to make consortia with other angels from same network: spread risk, more power	Invest alone or with other investors they trust (both private and institutional investors)
Investment size	Typically, less than €50,000 per person per round	Varies, but a typical investment round comprises of €100,000-500,000 invested by 2-5 angels together	Varies, up to €1 million per company, but more often €100,000-250,000 per investment round
Industry focus	None, but much harder to convince investors if the technology is so specialised they don't understand the problem or solution	Varies, but normally at least one person in the consortia has the industry know-how necessary to convince them	Experienced entrepreneurs who typically invest in the same industries as those in which they made their own money
How to find them	Your extended network, i.e. friends of friends; typically don't consider themselves business angels but have equity from successful corporate careers or startups	BA network web pages; you can upload a deck and ask to pitch in front of the angels; better chance of success if you are introduced to one of the angels beforehand	Articles and public information on people who have built successful companies, and invested in startups; better to be introduced via mutual contacts

Business angel networks

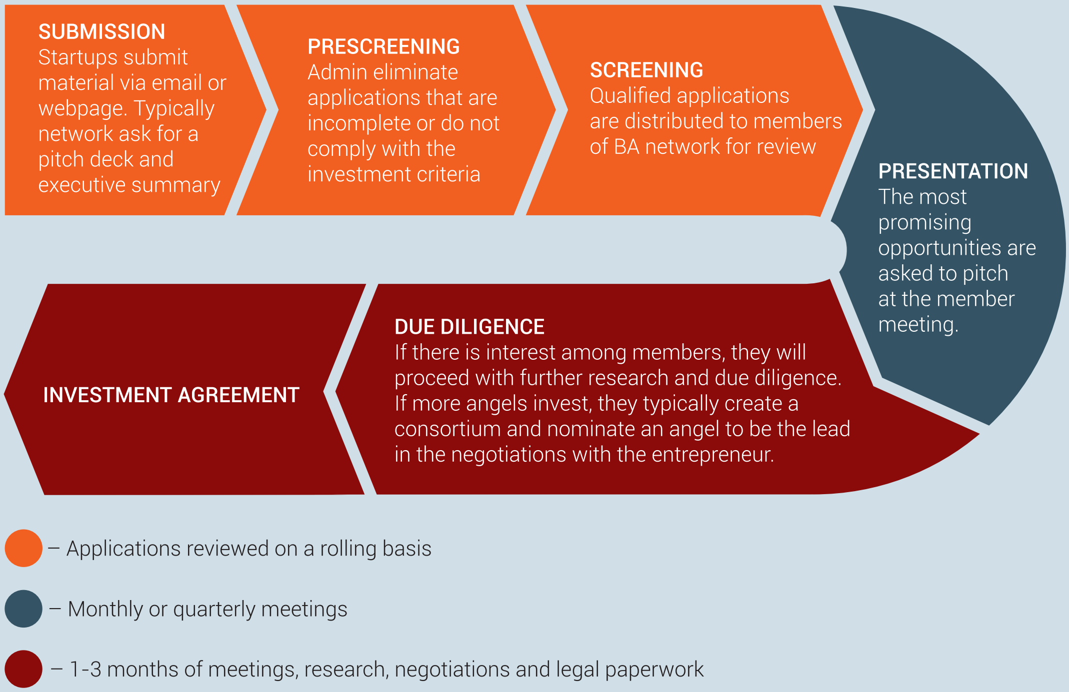
Some business angels prefer to invest in collaboration with other angels. This is called 'syndication' and is often done via business angel networks all over the world, where a group of angels meets informally on a regular basis to discuss potential investment opportunities.

So why do business angels prefer to invest together instead of alone?



1. **It works as a deal aggregator.** By being part of a network the angel gets access to startups seeking capital outside their personal network and gets a number of investment opportunities with limited effort.
2. **The angel has limited funds.** One of the key differences between business angels and other types of investors is that the amount of money most angels have to invest is limited. Being part of a business angel network (and investing with other members) enables the angel to spread their investments over several different startups and mitigate some of the risks.
3. **More eyes on the same deal.** Angels (unlike venture capitalist funds) don't have a large team of people to help analyse the deal; they are most often alone. But by engaging in the business angel network they can discuss the potential deal with other members and co-invest with them, thereby limiting the perceived risk of investing in the company.

Typical investment process in BA network



Business angel networks are made up of a broad range of people including senior executives, lawyers, accountants, bankers, entrepreneurs, and people with 'old money'. What they have in common is entrepreneurship and desire to invest some of their equity into startups.

They're likely to be looking for a good financial return of typically at least three to five times the money they invested if they're looking at an early-stage company. However for the majority of members they are honestly interested in s and the financial return is only a minor part of the reason they invest and are members.

Most of them are also experienced in business angel investments. They have done several deals (alone or in a network) and even if they haven't, they quickly learn the dos and don'ts from other network members. That's why entrepreneurs approaching members of these networks will quickly realise that negotiations with regards to investment terms and valuation can be relatively tough. These business angels bring a lot of experience to the table and know from other deals what a 'fair price' is.

To locate your local business angel network simply do a Google search in your local language for something like 'business angel network' AND the name of your country or city (if you live in a larger city). Alternatively, go to the website of the European Business Angel Association (www.eban.org) and search for members in your home country.

Case study: How Spotlime got funded via an Italian business angel network

Francesco Rieppi explains how he used funding from a BA network to grow Spotlime, a mobile ticketing app for last-minute events in Milan, Italy:

In 2013 I worked in Berlin and I used to go back to Milan only once or twice a month. Having worked in Berlin on the case of an e-ticketing platform, I saw a huge, untapped potential in the Italian events sector due to its high unsold shares. After building a minimum viable product that scored a good conversion rate, I quit my job and flew back to Milan where I started to contact clubs and events managers and signed the first deals. In early 2014 the beta version of Spotlime was published on the app stores with a daily selection of the coolest events in Milan.

In 2014 we won a competition and joined the Mind The Bridge Startup School in San Francisco for three weeks. We never joined an accelerator programme in Italy and we didn't really need it. We were four co-founders with diverse backgrounds and complementary skills, ranging from marketing to design and computer engineering, so we covered all the skills needed to build and manage the platform.

Instead, we got a seed investment of €200.000 from IBAN (an association of Italian business angels) and one of the co-founders of Fastweb. At Spotlime we had cross-boundary skills and lots of experience in the ticketing business, which was crucial in getting funded by the angel investors. I think a good pitch matters more than any business plan at this early stage. You have to transmit your vision very clearly and 'sell' it to the investor, showing traction and the strength of the team.

Super angels

Not all angels prefer to invest via formal business angel networks. This is especially true for the so-called 'super angels'. These are high net worth individuals who have typically earned their money via their own ventures (exits) and decided to invest a significant portion of their proceeds in new startups.

Some have investment as their main job (operating like a micro-VC fund), while others maintain jobs (often as CEOs of new startups) while operating as business angels on the side.

Super angels are different from typical angel network members in that:

1. They believe (often rightfully so) they have a huge deal flow directly via their own network so they have no need to source deals via business angel networks.
2. They often have relatively high net worth and are willing to fund the entire investment round themselves in early-stage startups. They don't see a need to syndicate via networks (if they want to syndicate, they often have huge professional networks they can co-invest with).
3. They often invest in the same industries in which they have made their own money. They know who to call to check the validity of a business idea or team. Many feel they don't need to get more eyes on the deal from the members of a business angel network. They are confident investors and can do the deals themselves.

Case study: SimpleSite got a €2 million investment from a super angel

Business angel investments are often viewed as small and used to start the business almost from scratch. But you can also find business angels with much deeper pockets who invest later in the process. SimpleSite bootstrapped at first, and then after proving their business model, got a huge investment from a local super angel.

Morten Elk started SimpleSite in 2003 with the goal of offering easy web-building tools for micro-businesses. Its business model is the software as a service (SaaS) model, in which they advertise online and get clicks from interested users. Some of these create a free website and some eventually become paying subscribers. SimpleSite grew organically until 2012 when it had annual revenue of €4.5 million, 29 employees and a net early-stage of approximately zero (it invested all potential profits into future growth via online marketing).

Morten Elk explains their rationale for taking in a business angel as investor:

The key thing to understand about our business model is that we effectively 'buy' customers with a given lifetime value through marketing. To have profitable growth, we must, on average, pay less for the customers than the lifetime revenue they give us (minus variable costs, naturally). In 2012, it was clear we knew a few things very well:

1. We knew how to calculate the lifetime value (LTV) and acquisition costs per customer (CAC).

2. We were making very good business in a few markets and we had proved that by translating to more languages we could address more markets with exactly the same 'money machine'. So that was a tremendous growth opportunity.

3. We knew that to fully exploit that opportunity, we would need extra short-term funding to translate to more languages (a fixed investment) and start marketing in those markets.

We got in touch with a local investor, Kaare Danielsen, founder of Jobindex – the job advertising platform Kaare built from scratch that got listed on the Copenhagen Stock Exchange. I lived in the same student hall as Kaare when I was studying, but we'd never been closer than that. But we knew each other because we were both entrepreneurs living in Copenhagen and sometimes attended the same events. I was therefore comfortable reaching out to Kaare and started by pitching to him via email.

Kaare invested €2 million in SimpleSite; money that enabled us to get off the ground with international scaling much faster than if it had been self-funded, and enabled us to grow the business from €4.5 million in revenue in 2012 to close to €10 million in 2016.

I believe Kaare only dared to invest such a large amount because we knew our business model and metrics extremely well, and the funding was clearly to be used for a non-speculative scaling of a model with known metrics, performance and profitability.

From the investor point of view, that obviously lowers risk and makes it easier for the startup to close funding on comfortable terms. So although not all funding-seeking businesses can obtain the kind of clarity about metrics and business model we had, it really helps if you can.

New Angels

One of the biggest mistakes founders make when looking for business angel financing is to only focus their attention on angels who invest via business angel networks, and the super angels they know from the media (and TV shows like *Dragon's Den*). What they miss is an important group of business angels – the group I call 'new angels'.

New angels are people who don't perceive themselves as business angels and are therefore not members of business angel networks or other trade associations. Most of them don't advertise themselves as 'investors' but are interested in entrepreneurship and make early-stage investments just like other business angels.

Unlike members of business angel networks who have typically invested in five or 10 companies, new angels have maybe only invested in one or two. In most cases, they invest smaller sums than the other types of angels.

Despite the fact they invest in fewer deals and often with smaller sums, they are still a very important group of business angels for one simple reason: there are many more new angels than there are members of business angels' networks. If you aren't approaching new angels, you miss out on a good chance of securing funding for your startup.

You normally find these 'new angels' via your extended personal network. LinkedIn is a good starting point: look up people you know either directly or with mutual friends, who you know have money to invest (based upon their corporate career and/or own companies), and who you believe are interested in entrepreneurship (they have started or invested in other companies). New angels may be right under your nose, such as old classmates or a former boss.

Case study: I wish I had known this about business angels

Dan Eisenhardt, co-founder of Recon Instruments, explains:

We used business angels to fund the first few years at Recon Instruments. The vast majority of them were not part of any formal networks and none of them were famous or considered super angels. We found the angels via our extended networks, and they were often either successful entrepreneurs themselves or had successful corporate careers, and a common theme was a deep interest for startups and skiing.

Business angels don't invest because they like the PowerPoint and financial model you put together. They invest because they can connect with the idea, like you as a person, and believe you have what it takes to implement the solution you are selling to them.

Understanding these fundamental motivations helps you curate investor candidates, and once you have the right people selected you can focus on the in-person pitch more than the wordsmithing and graphics of the investor presentation. Those things are critical to get right as well, but on the day it all comes down to you as a founder.

Can you explain the value proposition in clear and concise terms? Can you articulate a strong vision and a believable story to get there? Can you continue to convince new investors to put money in to grow the business? Putting yourself in the angel investor's shoes, before presenting a pitch around these themes, will help you get them over the line.

How do you raise €200,000?

One challenge many founders face is that the amount they are looking to raise is more than an individual angel is capable of investing. This is most often the case with new angels, but most angels (whatever their type) typically invest less than €50,000 per round.

So how do you get your hands on the €200,000 you need?

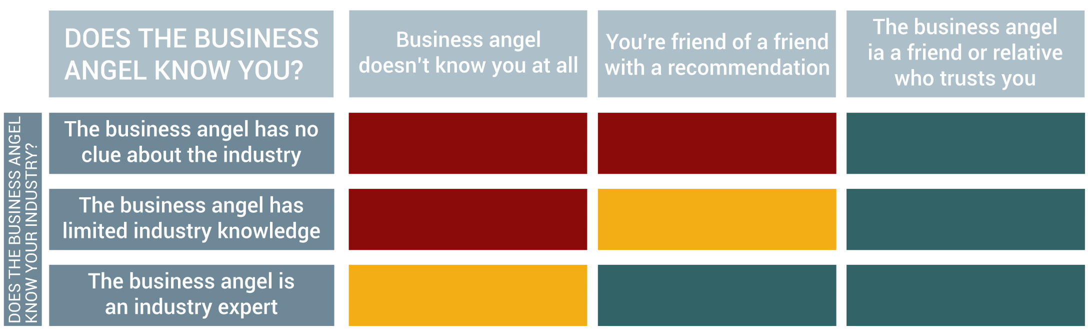
You could chase the few big angels that have those funds, or you could go to business angel networks that syndicate funds. Most founders do this and overlook the third option – syndicating the investment themselves. Instead of asking one angel or angel network for €200,000, you get five angels to put in €40,000 each.

This syndication can also work to solve another classic problem with getting investors on board: the first angel is always the most difficult to land. Having the first on board will make it a lot easier to get the rest to sign – they're now more willing because they aren't the only one who thinks this is a good business opportunity.

Which angels should YOU start chasing?

With so many potential business angels – across all three types – that could all be interested in investing in your startup, which ones should you focus your attention on? I suggest you use the two main criteria for selecting the angels you should target, since these factors determine their likelihood-to-invest in a startup:

1. Angels who already know you
2. Angels who already know your industry



1. Angels who already know you

Early-stage investing is all about trust. At the early stage of development, you and the company don't have much to show. Maybe the product isn't even ready. Perhaps all you have is a few PowerPoint slides. Maybe you're still looking for key people to complete your team. And chances are you don't have any customers yet. All in all, your projections about future revenue and market size are crystal ball outlooks not verified by real customer data.

It takes a lot of trust on the part of a business angel to invest in such a company. They may accept that there's a real problem and your product is better at solving that problem than your competitors. What they worry about is you. Do you have what it takes to pull it off and beat the bad odds for early-stage startups where the vast majority fail? Personal trust is not something you build overnight.

In an ideal world, you would have already created trust with the investor through personal and/or professional relationships. That was the reason I invested in Recon Instruments. The co-founder and CEO, Dan Eisenhardt, is one of my close friends and I have the deepest respect for him personally and professionally. I didn't hesitate when he asked me to invest in his new company back in 2008.

In most cases, though, you won't be friends with the potential business angel. The next best alternative is to get a recommendation from a friend of a friend who can vouch for you. Look up the potential investor on LinkedIn, see if you have any mutual contacts and ask one of them to make an introduction. Note that this only works with people the angel actually trusts; second or third level connections aren't good enough.

2. Angels who already know your industry

The second important criterion is knowledge about the industry you are targeting.

Unlike VCs, angels often invest more or less alone. They don't have a team to help analyse the deal and the market. They depend on their own market knowledge and the information they get from their network of personal contacts.

If you're pitching a startup in an industry the angel understands, it's much more likely you will get a 'yes'. The angel either understands the problem you are solving directly or can confirm it by making a few phone calls. There is a good chance that this person will invest.

In the alternative scenario, where you are pitching a technology/industry the angel doesn't fully understand, it's very unlikely they will invest. They can't confirm your product is unique or validate that there aren't 20 other competitors doing exactly the same. The more technical/nerdy your innovation is, the harder it will be for outsiders to evaluate it. Chances are they have plenty of other investment opportunities they understand better and will simply decline your proposal and move on because they don't understand your business case in detail.

The biggest mistake startups make when contacting angels:

Jesper Knudsen, partner at Accelerace (the startup accelerator), explains:

The biggest mistake I repeatedly see founders make is failing to understand the investors to whom they pitch; they fail to investigate what the investors know about the product/industry of their startups. The result is that the founders are totally unprepared when meeting the potential investor and therefore miss the opportunity to target their pitch to what that specific investor knows and is looking for.

I strongly advise founders to prioritise spending time to research the investor's background – including the investor's existing portfolio – before establishing contact. Actually, I always recommend you call a founder in one of the investor's portfolio companies to learn even more and maybe use them for a warm introduction – entrepreneurs tend to be willing to help each other. By doing your homework you get a much better understanding of whether your startup fundamentals meet the criteria/interest of the investor. At the end of the day, it's very unlikely the potential investor will decide to invest if they don't understand the space your startup is operating in, simply because they can't properly evaluate the risk/reward balance.

You as a founder should also carefully evaluate if you really want an investor who has no industry or domain knowledge since it's unlikely they'll be able to contribute know-how or a network, and there's a risk they won't provide the expected value for you in the form of 'smart money '. Remember that on average a startup exists many years after receiving funding. Until the day of the great exit you will have to work closely with each other – through ups and downs – so pick your investors wisely.

! Key note: Spoiler: *Dragon's Den* isn't real!

Many first-time entrepreneurs base at least some of their knowledge of business angels on the popular TV show *Dragon's Den* (*Shark Tank* in the US and Australia). Here, a few entrepreneurs pitch their business ideas in front of a group of business angels (typically, famous super angels) who then – based on the pitch – decide if they want to invest or not.

It never works like this in the real world. Ever. Business angels need to evaluate not only the idea but also the people behind it and the traction (how far they've come); in other words, all that's needed to build the necessary trust in the business and founders, on which all angels build their investment decision. This can't be covered in 15 minutes. It makes great TV, but it's not real!

I am not suggesting the deals made on TV are fake – they are real, and it makes sense for the angels to do the deals on stage, given the huge publicity it gives them which more than pays for the additional risk of investing in unknown companies. But in the real world you can't get funding after a 15-minute meeting with the business angel!

What can angels offer you?

One of the big mistakes many entrepreneurs make when looking for business angel investors is only to look at the 'dilution' factor – how much equity the business angel investor will get, and how much cash they will pay for that.

The money/dilution is only one part of the equation when choosing from where to take your funding. You need to find out what the angel can and will do for your company, besides investing money.

Any business angel will claim you should accept their proposal because they bring in 'smart money'. That is, they not only come in with funding for your business, they will also help you succeed by providing experience, networks etc. This may well be true. If you choose the angel carefully, you will get both money and a person who has done it before, someone who is dedicated, and who can add more value – in other words, *smart money*.

But let's be realistic. Just because you call yourself an angel or you have money doesn't mean you're smart. Even if you are smart, that doesn't mean you're willing to use that smartness on a weekly or regular basis in the service of the company. You could be dumb, you could have earned your money just by being lucky, or you could be involved in so many businesses you don't have time to help the startup on a regular basis.

Key note: Do your homework on the angels!

One of the dangers for entrepreneurs is that angels promise a lot to startups to get the deal and then they don't deliver. You need to do your due diligence on the business angel before deciding who you want in your company – like the investors who check you out before they invest. Call some of the companies they have invested in and ask whether they keep their promises, add value, and do whatever they say they will do. If not, you need to question whether this is the right source of financing.

When you have checked them out, get on paper what you expect from them, both in terms of time dedication and specific tasks. Make an agreement about what will happen if they don't deliver on their part of the deal.

Take-away points

Most business angels are driven by more than money. If the only reward you offer is financial, you'll lose a lot of potential business angels. You need to understand what drives an angel and what you have to offer against what they're looking for. Look at what they've invested in the past.

Not even business angels invest in business *ideas*. You need to show you can do it and you've got what it takes to keep on doing it. So before you knock on the door, you need to get going yourself. Get a team and get working on converting your idea into a business.

Personal trust is one of the most important factors determining whether a business angel wants to invest. Look for angels who know you already, or who know the industry, because they'll be more comfortable analysing the risk/reward of your startup, even if they don't know who you are.

Do your homework and your due diligence. Call companies the angel has invested in. Did they get what was promised? Get all your agreements down on paper – including those not about money.