Business Nuggets

Bite-size chunks of business expertise

UNIVERSITY OF WARWICK
SCIENCE PARK

Flying with Angels

By Tom Blount, Access to Finance

Most high-growth technology businesses will raise external finance at some point in their development. For many, this means selling equity to business angel investors, either through an angel network or more informally via contacts and friends.

Too many entrepreneurs enter this process with unrealistic expectations; for example they do not realise the process of raising equity can take in excess of three months or their valuations are too high to ever offer an investor a reasonable exit. Much of this misalignment between fund raisers and angels comes about because entrepreneurs fail to properly consider their investment proposition from the angels' perspective.

Not all business angels are the same but most measure their angel activities against three axes: the business case, the philanthropic case and the personal case. Consequently, entrepreneurs who review their investment pitch against these axes will find their propositions much more attractive to the angels they approach.

The Philanthropic Case

Most business angels see their investments as an opportunity to do some good for society. Some see it as a chance to support young entrepreneurs, others have a desire to improve the industry of their home town whilst others invest in areas that have particularly affected their lives, such as medical advances. Properly researching angels before the pitch can help to identify which angels will be most responsive to the proposition. Sometimes the philanthropic motive is unique to one angel but occasionally it describes features common to many angels. Most, for example, won't make large investments more than 90 minutes' drive from their home both for convenience and because they are seeking to support their own community.

The Personal Case

Having made money through selling or running one or more businesses, many angels now have 'portfolio' careers. Some combine several board roles with their investment activities in addition to charitable and social activities whilst others have spare time on their hands. Therefore, some angels invest only money (possibly as an EIS tax break), others may want a board role, whilst some may want to use their experience and cash to drive forward the investment in an executive role. Understanding the personal expectations of an angel and the relationship they hope to have with the company can improve pitches enormously.

The Business Case

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It doesn't matter how good the philanthropic and personal case is; the basis of every good angel investment is a sound business case that offers the angel the opportunity for significant capital growth. Angels will only invest if they think they can make more money from an angel investment than they could from investing in the stock market or placing money on deposit. The returns from any individual investment must also be large enough to cover the losses the angel will make across their portfolio since more than 80% of their angel investments will fail. In reality, therefore, an angel expects to see 5>10 times their original investment returned to them in 3>8 years. For the entrepreneur, this has several implications, not least around valuation and a clearly defined exit.

A good match between business and angel relies on meeting both the firm's and the investor's expectations on all three of these axes. There is no point in a company distorting itself to try and suit individual investors' requirements but thinking about those requirements before pitching will pay dividends.

The Business Support team of the University of Warwick Science Park is staffed with Access to Finance specialists and manages a Business Angel network called Minerva.