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Angel Investors

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Topic Relevance by Timeline

Summary

- Angel investors are wealthy individuals who use their personal assets to invest in startups, typically in early stages before venture capitalists.
- While angel investors have typically invested more heavily in earlier stage startups, this paradigm has been shifting in recent years.
- Angel investors are likely to take smaller percentages of equity than a venture capitalist, or use debt-convertible notes, and they may want board representation.
- It is vital to have investors whose goals are aligned with the company's.
- There are six key points investors are listening for in a business pitch: concept, market size/growth, management team, business model, exit scenario, and valuation.

Introduction

Capital is the rocket fuel of entrepreneurship. In order for any company to succeed and make a grand idea into a successful business, it will have to find funding to achieve its potential. There are numerous ways for startups to acquire the financing they need to continue growing. These include crowdfunding, angel investors, venture capital, business incubators and accelerators, competitions, loans, grants, and various government programs. Depending on the situation of the company, there is an appropriate time for implementing each of these options. In this section, we will discuss who angel investors are, the benefits and drawbacks of pursuing this funding avenue, and considerations for selecting and winning over the right angel investor.

Who Are Angel Investors and What Is Their Role?

Angel investors are wealthy individuals who use their personal wealth to invest in startups. They are typically people who have previously run startups or held a senior executive position and are now retired. Angel investors must meet certain

requirements set forth by the Securities and Exchange Commission (SEC) in order to be allowed to invest: to get accreditation, an investor must have a net worth of \$1 million (in addition to their primary residence) or have an annual income of at least \$200,000, or \$300,000 if married ([Hudson](#)). Angel investors have begun to play a prominent role in healthcare as the medtech sector has been experiencing a marked downturn. Just in 2017, angel investors provided more than \$23.9 billion in funding to all industries, which was a 12.9% rise from 2016; of the \$23.9 billion in funding, 19% (or \$4.5 billion) was invested in the healthcare industry (including the biotechnology and medical technology sectors), which was more than venture capital funding ([“Angel Investments Rise in Valuation in 2017”](#)). Generally speaking, angel investors look for smaller markets that are potentially untapped by venture capitalists. In addition, they usually seek to invest in companies at earlier stages—at the seed or startup stage ([Wikipedia contributors](#)).

Advantages of Angel Investors

With a plethora of funding options existing for startup companies, it is important to consider the pros and cons of pursuing any route in trying to obtain investment. We will start by considering some of the advantages of partnering with angel investors before moving on to some potential disadvantages.

One of the main advantages of working with an angel investor is that it is “less expensive” than other funding avenues. What does this mean? An angel investor would often not take (as much) equity of the company as a venture capitalist would (see the chapter [“Equity Allocation in Startups”](#)). This might seem contradictory to how investors typically think, but in fact it aligns with the interests of an angel investor. The reason for minimizing taking equity out of the company is that it keeps the startup’s strategic options open, as they will have more equity to offer later on in other funding opportunities, such as venture capital rounds ([Ganti](#); [Yock et al.](#)).

Angel investors typically look for a 10x return on their investment, which they expect to manifest over a timeline of five years; after that, they will push startups to pursue venture capital funding ([Cremades](#)). Because they invest in companies at earlier stages and expect less return on their investment compared to venture capitalists, their strategic fit is often mission driven. Angel investors typically select their investments based on their interests, expertise, and ability to guide an early-stage company through development ([Wikipedia contributors](#)). Another benefit is that because they

are both personally *and* financially invested in the company and most likely have previous experience in the industry, they will be able to provide sound advice ([“Getting Started with Angel Investing”](#)).

Since angel investors invest at an early stage, they are also inherently willing to take on more risk than other funding options ([Ganti](#)). In addition to their original investment in the company, angel investors are willing to provide bridging loans in order to help a company mature to the point where it can pursue additional funding avenues. Bridging loans are short-term loans that last from a few weeks to a couple of years and which provide interim financing pending the arrangement of a larger and longer-term financing agreement. At that point, the company will use funding from the new financing to pay back the bridge loan. Bridging loans can be arranged quickly with little documentation, but unfortunately they usually come with higher interest rates as these loans inherently carry greater risk to the angel investor.

Disadvantages of Angel Investors

This leads to our discussion of some downsides when choosing to work with an angel investor that are important to consider when choosing the financing that best aligns with the interests of the startup company.

The primary consideration is that the typical amount of funding is small. The standard investment is around \$600,000. Because of this, companies will usually pursue angel investors only at the very early stages of the company ([“Getting Started with Angel Investing”](#)). A more well-developed startup may require multiple angel investors to be able to get enough capital for their project. This may become challenging because angel investors often want board representation. If angel investors have voting rights, the startup may be dependent on their agreement for making critical decisions. Having multiple angel investors requires the startup to manage the expectations of all these individuals, and balancing various interests and priorities may become difficult ([Yock et al.](#)).

Another potential challenge is that angel investors will not typically invest in multiple rounds of funding for the same company. As previously discussed, they may provide bridge loans as interim funding but will expect the company to pursue additional routes of financing, such as venture capital.

Interfacing with Other Funding Avenues

Angel investors often partner with other groups and organizations, which provide unique opportunities to not only obtain funding but to build a larger network of contacts.

While angel investors have typically invested more heavily in earlier-stage startups, this paradigm has been shifting in recent years. For example, angel investors have begun syndicating with venture capital to do expansion funding. Usually, expansion funding is the realm of the venture capitalist, where they provide second-stage financing. Venture capitalists are private investors who finance later-stage startups in exchange for equity, or ownership, of the company (see the chapter “[Seeking Venture Capital Investment](#)”). Often labeled Series AA, B, C, D, etc., these funds are given to companies that have completed first-stage financing and have proven that they are achieving early business targets, such as product development, marketing, inventory, sales, revenue, and so on ([Yock et al.](#)). In addition, angel investors have been partnering with crowdfunding platforms like Kickstarter to gain access to later-stage startup companies ([Ganti](#)). Crowdfunding is when a group or an individual raises funds by collecting small amounts of money from many people, typically over the internet. Kickstarter is a public company based in New York that maintains a crowdfunding platform. As shown in Figure 1, from 2011 to 2012, there was a 7% decline in early-stage startup funding (a decrease from 40% of total angel investor funding to 33%), and a 14% increase in later stage deals (25% to 39%) ([Yock et al.](#)).

Figure 1
Percent of Total Angel Healthcare Funding in Early-Stage vs. Late-Stage Startups.

Legend: Years are shown on the x-axis. Percent of total healthcare funding is shown on the y-axis.

Angel investors are trying not only to broaden their opportunities in later-stage startups but also to work with earlier-stage groups to provide seed funding for prototypes and proofs of concept. Angel investors often interact with friends and families to fund these groups, because of the laws governing capital requirements, which ensure that financiers hold a certain percentage of their assets so that they do not take on excessive leverage.

How to Find the Right Angel Investor

After deciding to pursue funding from an angel investor, the next step is finding the right angel investor. This requires an extensive amount of research and due diligence. Because angel investors come early in a startup company's journey, it is vital to have investors whose goals are aligned with the company's and who can potentially add value. The various aspects to consider include the investor's personal history, prior investments, current portfolio of companies, interests/expertise, style of mentorship, criteria for investing, and network (see the chapter "[Conducting Insightful Market](#)

[Research](#)"). Figure 2 contains some questions that may help in finding the angel investor who is the best fit for the startup ([Cremades](#)).

History/Personality	What is their background?
	Where did they obtain their money from?
	What interests do they have?
	What prior investments has this investor made?
	What previous groups has the investor worked with?
	What style of mentorship/guidance do they prefer?
Investment Criteria of Angel Investor	At what stage of startup development do they typically invest?
	How much do they generally invest?
	How many rounds of financing do they usually invest?
	How long on average will they partner with the company?
	How many companies are they invested in at the same time?
	What connections does this person have in healthcare, the medtech sector, and business?

Figure 2
Questions to Ask an Angel Investor at the First Meeting.

The first step is to find out more about the history of the angel investor. It is important to understand how the investor's personality will mesh with the company's culture, especially as they often become board members with voting rights. In addition, an investor's background may be an indicator as to the bias or opinions the investor might have on the field or sector that the startup is focusing on. It is crucial to gain insight into whether the investor has experience or expertise in the particular area of the startup and whether they can add more value to the company than another investor.

Understanding an angel investor's history will also give an idea of their track record for success. Beyond understanding the investor, it is important to ensure that the goals of the startup company are aligned with the investment criteria of the angel investor. This will help in securing funding and will facilitate a smooth working relationship (see the chapter "[Startup Company Formation and Management](#)"). Finally, it is important to consider the network that the investor maintains. Leveraging an investor's network may become important for connecting with additional resources, guidance, and mentorship. As we will discuss in the next section, the angel investor's network will become invaluable for securing additional funding with other angel investors or venture capital firms ([Cremades](#)).

Tips for Approaching Angel Investors

It is preferable to use connections to access investors rather than blindly contacting individuals or submitting online submissions. Doing so can negatively impact the startup's ability to be funded.

Where do these connections come from? Referrals can come from anywhere, which is why it is important to establish and maintain a strong and robust network. Other entrepreneurs can give guidance regarding angel investors they sought and individuals with whom they succeeded or failed. References may come from individuals providing services to the startup, such as lawyers and consultants. Finally, as already mentioned, angel investors the team has previously worked with may be able to refer others. It is important to cultivate these networks early and to work hard to maintain them. One approach is to go to angel investors early for advice, well before asking them for funding. If the team has followed their advice to good effect and have developed the company further, the investors will have more trust in the team and would be more likely to invest ([Wikipedia contributors](#)).

There are multiple tips to keep in mind when contacting an angel investor. It is important to be assertive but respectful. Oftentimes, there will be a limited amount of time to discuss key aspects of the product, so it is important to have the "elevator pitch" ready. There are six key points that all investors are listening for. The first is the concept: what sort of novel technology or service will the company provide? The second is the current market size as well as the potential for future growth. Third, investors will be interested to learn more about the current management team, their credentials, and their track record of success in order to assess if these individuals can

take the company to the next level (see the chapter “[Building a Successful Startup Team](#)”). Fourth, investors will be keen on understanding the business model, including the projected costs and need for funding. Providing this information in the context of a range of sales, revenue, and cost estimates helps build credibility with the investor, because they can see the team has considered various nonoptimal scenarios for the company as well. Fifth, all investors want to know how they will make their money back; that is, what is the exit strategy? And finally, investors want details regarding the valuation of the company, which will be relevant when structuring a financing deal. Having these details handy will foster trust with the investor as they can see the team has done due diligence regarding the future of the company and they will be more likely to invest in the team and their product ([Skyler Fernandes](#)).

Conclusion

In this chapter we discussed another common route of funding: angel investors. These are wealthy individuals who use their personal wealth to invest in startups, and they have started to play a major role in financing healthcare and medtech startups in recent years. Angel investors are willing to take on more risk than other investors as they typically invest in earlier-stage startup companies. For this reason, it is vital to find investors whose goals are aligned with the company’s and who can potentially add value as the company grows. However, this paradigm has been shifting in recent years as angel investors have begun partnering with venture capitalists and crowdfunding platforms to gain access to later-stage startup companies as well. Though angel investors are likely to take little to no equity in the company (in order to maintain the valuation of the company for later rounds of funding), they will often want board representation; because companies might need multiple angel investors, juggling the expectations of all of them may become challenging. To get funding from angel investors, there are some key points the business pitch should cover: concept, market size/growth, management team, business model, exit scenario, and valuation.

Resources

There are many resources available in most major academic centers to assist in connecting with angel investors; many of them are affiliated with business schools. For example, at the University of Pennsylvania, the Penn Wharton Entrepreneurship group has resources for entrepreneurs, including funding and mentorship opportunities. For

finding angel investors in particular, the Wharton Alumni Angels of Silicon Valley group hosts Angel Day, which is an annual pitching and networking event in San Francisco. Wharton also has the Wharton Alumni Angel Network, which contains a list of investors that may provide between \$50,000 to \$2 million of funding for startups ([“Penn Wharton Entrepreneurship - Resources for Entrepreneurs”](#)).

The website AngelList provides services for offering startup jobs, finding startup jobs, investing in startups, and finding investors. It also has filters to organize investors based on region; for example, one can find investors interested in funding startups specifically in Philadelphia ([“AngelList”](#)).

Corporate Finance Institute (CFI) Education has a helpful comparison of different investor classes [available here](#).

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