



Angel investors are changing.
Here's what they're looking for, how they operate,
and (because the devil is in the exit strategy)
what they expect for their money

THE PHRASE "ANGEL INVESTOR" CONJURES UP A VISION OF some kind of saintly benefactor willing to take a flier on some whimsical notion of a business that has little chance of success. Nothing could be further from the truth. Angels invest for the same reason other people do: to make money. They hope that some of their investments will reap them high rewards in return for the high risks they are taking. They are well-off people—often former company builders—who are willing to put anywhere from \$10,000 to half a million or more into promising start-up companies.

By Jim Melloan
Photographs by Chris Mueller

ANGELS

According to the University of New Hampshire's Center for Venture Research, there were 225,000 active angel investors in the U.S. last year. But until recently, angels have been difficult to identify. That's because individual angels generally like it that way, if only because they aren't terribly interested in having thousands of entrepreneurs flooding their e-mail boxes with business plans or getting buttonholed every time they attend a cocktail party. "Staying under the radar allows them to pick and choose their sources for their quality deal flow," says Jeffrey Sohl, director of the Center for Venture Research. "People find them anyway, but the harder to find them, the better."

Now, however, angels are forming groups, at least in some measure to become more visible to people with ideas. Angel groups are generally local organizations made up of 10 to 150 accredited investors interested in early-stage investing. In 1996 there were about 10 angel groups in the U.S.; now there are more than 200. The reasons for this growth seem clear. Investors benefit from a group's organizational structure, which can sift through hundreds of business plans and select a few entrepreneurs to present their opportunities to the group as a whole at regular meetings, which are generally monthly. And entrepreneurs are able to identify local entities that can evaluate their plans. Even if they don't make it to a presentation, they can usually get some feedback on what they need to do to improve their plans and businesses to increase the odds of getting funding down the road.

The groups themselves are getting increasingly organized. Just last year 46 investor groups formed the Angel Capital Association. The association, which now has 89 member groups, wants to establish best practices for angel groups, collect data, establish benchmarks, and encourage individual angels

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to join groups.

The operational details of angel groups vary greatly. Most take executive summaries or business plans by e-mail; sometimes the groups' websites have a template for entrepreneurs to fill out. Usually a staff or screening committee will select a group of businesses for further investigation, and out of that bunch a few will be invited to present before the entire angel group. (See "Mr. Cashman, You're On," page 100.) In some groups, individual members make their own investment decisions after the presentation. Other groups operate with a fund that is the primary investment vehicle or that supplements the individual investments.

What are angels looking for? Simple, says Jeffrey Sohl: high-growth companies, meaning companies that appear likely to grow at 30% to 40% annually and then either be bought or go public. By his estimate, 10% to 15% of private companies fit that description. The problem, he says, is that "about 80% of the entrepreneurs think they're in that 10% to 15%." Many angels and angel groups are flooded with business plans that don't even feature a way for angels to make a profitable exit. These won't pass the first screen.

Last year, according to the Center for Venture Research, 18.5% of deals that got through early screens and were presented to investors attracted funding, up significantly from 10% in 2003, which is about the historical average, and getting dangerously close to the 25% that were funded during what Sohl calls "the crazies of 2000." Sohl fears that if the rate continues to rise, it could represent a flood of inexperienced angels getting into bad deals. On average, each firm that received angel money in 2004 got \$469,000. The lion's share went to high-tech companies, and the single biggest category within high tech was software. Technology is where the growth is, and it's where most angels made their money, so they're investing in what they know. Another reason angel money tends to go to technology companies: Businesses with assets, such as manufacturing companies, can get collateral-based loans from banks.

The best time for an entrepreneur to seek angel funding, says James Geshwiler, managing director of the Boston-area CommonAngels and chairman of the Angel Capital Association, is when a business is at what he calls the go-to-market stage. "They have a working prototype, they can show it to us, we can see how it could actually work in several different places, and they have some initial discussions and initial partnerships going on," Geshwiler says. "Still, the world

Angels in America

is their oyster." This go-to-market moment is also, he observes, a good time for angels to caution entrepreneurs on what not to do. Two common pitfalls, he says, are wanting to sell directly to consumers—as opposed to selling through channels the angels are familiar with but the entrepreneur may not be—and entering a burdensome partnership with a big corporation. (For more on how to present a business to angels, see "Do Not Say, 'I Just Want the Money,'" on page 96.)

Although angel groups are now the most visible sources of angel funding, Sohl estimates that they are doing just 15% to 20% of all angel deals. Individuals quietly investing still represent the bulk of activity. In addition, there are investment firms that do angel investing, including VC firms that specialize in early-stage deals.

On the following pages are profiles of well-respected, expert angel investors in all these categories. In sum they represent the broad universe of angel investing today—and more specifically, that part of it where an entrepreneur's inquiry is welcome. We've aimed for a variety in structure, geographical distribution (most angels invest in firms close to home), and operating and investing style. Six of the funding sources are angel groups, two are firms that do angel investing, and one is an individual who's been an angel for a long time.

Negotiating the terms of a deal will always be tricky, and disagreements about operations can be difficult to hash out. More than one business owner has suggested that angels work on finding a more accurate name. But all parties want to see the business succeed. If it does, the business owner may well be interested in completing the circle—hearing pitches, looking to fund the next generation.

Inc. Online Profiles of another 16 outstanding angel investors and groups, and a national index of angel investors, can be found on our website at www.inc.com/keyword/angelgroups.

THE MEDIA ALCHEMISTS

New York Angels *New York City*

THESE ANGELS ARE MUCH MORE Wharton than MIT—they're management types, as opposed to techies. Most of New York Angels' companies are further along than is typical for angels, and as you would expect out of New York, the group's portfolio has a lot of media businesses. The New York Angels prefer to see innovative applications for existing technologies, as opposed to brand-new technologies. A good example is Adapt Media, which pioneered selling advertising on scrolling displays atop taxicabs. "It was a weird medium that hadn't been tried before; would anybody actually buy it?" says the group's director, Chris Saxman. The group's website has a one-page submission form. (Don't forget the \$150 filing fee.) Firms that look promising to Saxman go to a monthly screening session; survivors are invited to present at the full group's monthly breakfast meeting. Investments are strictly the decision of individual members; a typical deal will attract four to eight members, each kicking in \$25,000 to \$100,000.

FOUNDED 2004 | MEMBERS: 54 | TOTAL INVESTED: \$3.1 MILLION | COMPANIES FUNDED: 12 | www.newyorkangels.com

THE ACHIEVERS' NETWORK

CommonAngels *Lexington, Mass.*

ENTREPRENEURS WHO APPROACH CommonAngels can be assured that the group's members have been on the other side of the table: They've founded 118 companies (mostly high tech), sold 104 of them, been CEO of 93 of them, and taken 34 of them public. To apply for funding, send managing director James Geshwiler an executive summary. If the firm sounds promising, he'll have a group of experts in the technology in question grill management; if the deal gets past them it will go to a group of generalists. Firms that survive those three cuts present at the CommonAngels' monthly meeting. In 2000, about 20 members came up with close to half of a \$3.2 million A round for Bitpipe, which distributes literature from IT companies over the Web; many members continued with two subsequent rounds. When Bitpipe was sold last December, members got from two to five times their money back.

FOUNDED 1998 | MEMBERS: 60 | TOTAL INVESTED: \$27 MILLION | COMPANIES FUNDED: 27 | www.commonangels.com

THE OLD HAND

Bob Geras *Chicago*

BOB GERAS OPENED his own investment house in 1978 and has been Chicago's most active angel ever since. He has invested in all kinds of tech companies—software, biotech, medical devices, nanotech, telecom—as well as insurance firms, banks, oil drillers, motels, and real estate. Geras is tough; bring a business to him and you'll probably get a lower valuation than you would elsewhere. The tradeoff, he says, is that you'll end up with a working product that people are buying, and doors will open for you when you're ready for follow-on investors. Last year Geras funded 11 deals, and he says he looks at each of the seven or eight that cross his desk every week. No website, but he doesn't mind us telling you he can be reached at bob@vcbob.com.

ANGEL SINCE 1980 | TOTAL INVESTED: MORE THAN \$28 MILLION | COMPANIES FUNDED: 82

ANGELS

Do Not Say,
"I Just Want
the Money"
And other keys
to presenting
yourself before
potential investors



Be able to describe your business—what it does and who it sells to—in less than a minute.

Have a handle on who the competition is, why your solution is better, and how you are going to gain market share.

Avoid unrealistic "hooky-stick" projections that show your product or service suddenly rocketing. It won't.

Emphasize the likely exits for investors.

Answer all questions honestly; don't try to hide information that doesn't support your case.

Have respect for your prospective investors. Understand that those who do invest are going to be involved with your company for a long time. Often one or more of your investors will take a seat on your board of directors. They know things you don't. Don't tell them you "just want the money."

Prepare yourself. Many groups offer free coaching to entrepreneurs who have passed their initial screens and are about to present before the entire group. —J.M.

THE PROFESSIONALS

The Angels' Forum *Palo Alto, Calif.*

THIS SMALL GROUP is composed of successful former Silicon Valley executives who now do angel investing full-time. They meet weekly, not monthly, and most of each meeting is taken up with tracking the progress of firms the group has already invested in. "We see, feel, touch our new portfolio companies about every 48 hours," says Angels' Forum founder Carol Sands. "When you're dealing with very early-stage startups, 48 hours is a really long time." Entrepreneurs can approach Angels' Forum by filling out a one-page "Snapshot" form downloadable from the website. The odds, of course, are long: The group gives preference to firms referred by members, and does four to six deals a year out of the 3,000 submissions it gets. The group's tech focus draws it to cutting-edge developments, including, for example, an intriguing new idea for fighting obesity. Recent research suggests that one way fat people may differ from skinny people is in the degree to which their stomach walls vibrate. Thin folks' stomachs vibrate sufficiently to absorb the nutrients they need and send the rest on to quick elimination; obese people's stomachs are less efficient in that way. IntraPace, a recent addition to the Angels' Forum portfolio, makes a pacemakerlike device that sends pulses to the stomach to shake things up.

FOUNDED 1997 | MEMBERS: 22 | TOTAL INVESTED: \$20.7 MILLION | COMPANIES FUNDED: 83 | www.angelsforum.com

THE ANGEL-LIKE VCS

Silicon Alley Venture Partners *New York City*

SAVP IS A VENTURE capital firm that specializes in early-stage companies in the New York area; it will put in anywhere from \$250,000 to \$1.5 million as a first round. Like New York Angels, SAVP is interested in applied information technology rather than new core technologies. Managing partner Steve Brotman says his company tends to invest in "corporate dropouts from industry versus university spinouts. It's not coming out of a lab, it's somebody coming out of JPMorgan." Companies in the firm's portfolio include Critical Mention, which searches and monitors TV broadcasts, and GameTrust, which sets up tournaments for online games. Brotman says that 85% of SAVP's A-round companies get to a B round of \$5 million or more from a later-stage VC in an average of 18 months. Part of the reason, he says, is that those VCs like the institutional-quality full due diligence SAVP conducts on the companies it backs. Executive summaries can be submitted to bplans@savp.com.

FOUNDED 1998 | FOUR PRINCIPALS | TOTAL INVESTED: \$40 MILLION | COMPANIES FUNDED: 18 | www.savp.com

THE VC-LIKE ANGELS

The Washington Dinner Club *Vienna, Va.*

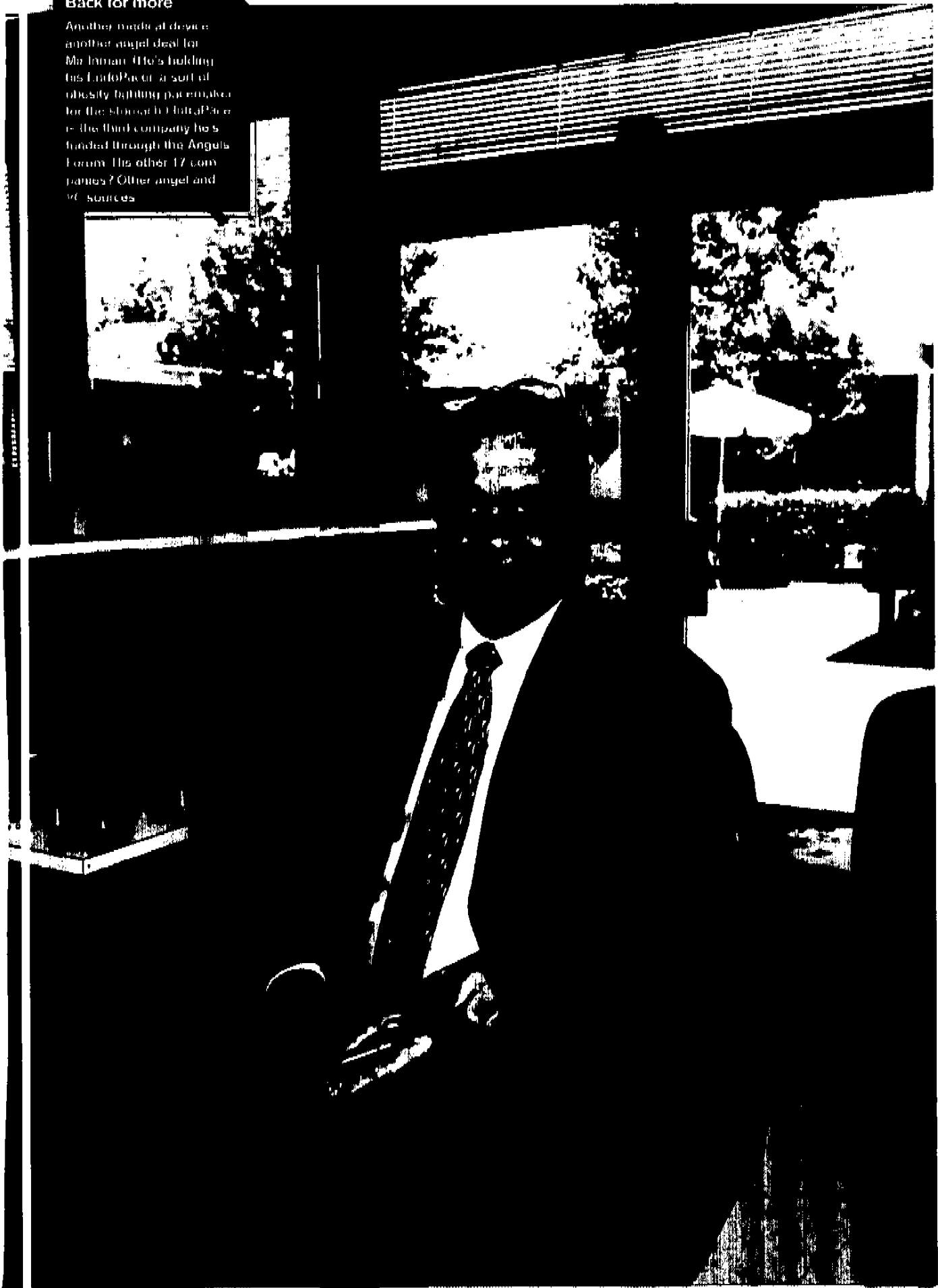
LIKE VENTURE CAPITAL firms, this group raises money in discrete funds. The Washington Dinner Club is the name of the third LLC formed by John May; the fund is almost fully invested, so the group is now starting its fourth fund, Dinner Club IV. The Dinner Club tends to invest in the sectors that are thriving in the Beltway area: information technology, defense, homeland security. May calls the winnowing process "a hundred to ten to two"—out of a hundred business plans submitted via the website in a month, 10 merit a meeting with a screening committee; from those, two are selected for presentation at the group's monthly meetings. (Yes, dinner is served.) Afterward, members vote on whether the fund will invest. Individuals then have the option of putting in more of their own money. A club member who had invested in an A round for Matrics, a maker of radio frequency identification chips, introduced the Dinner Club to the firm in 2001; it ended up being one of two angel groups in a \$14 million VC-led B round, and last fall got four and a half times its money back when Matrics was sold to Symbol Technologies for \$230 million.

FOUNDED 2000 | MEMBERS: 75 | TOTAL INVESTED: \$28 MILLION | COMPANIES FUNDED: 12 | www.washingtondinnerclub.com

Back for more

Another medical device, another angel deal for Mr. Inman. He's holding his LinfoPower, a sort of obesity-fighting pacemaker for the stomach. LinfoPower is the third company he's funded through the Angels Forum. The other 17 companies? Other angel and VC sources.

PHOTOGRAPH BY [unreadable]



ANGELS

**"Money Is Not
Just Green"
What angel
investors know
and entrepreneurs
need to**



Some entrepreneurs out there are extraordinarily independent. They want to do it all themselves. Those people never come to angel groups, or if they do, they say, "My way or the highway," and that usually means the highway.

—James Gashwiler, *Common Angels*

What you really need is a good CEO.

You can find a CFO or a controller or whatever. And then you need a good VP of sales with a hundred-day mentality. That's a guy who's interested in getting deals closed quickly.

—Bill Weaver, *Chicago angel*

I want to see somebody who's going to lay himself down in front of a freight train if that's what it takes. I don't want to have to worry about somebody seeing that the going gets a little bit rough and then they say, Well, sorry, you've got a write-off, and I'm going back to work for my uncle.

—Bob Geras, *Chicago angel*

Entrepreneurs fail to understand that not all angel investors are equal. Money is not just green. There is what we call smart money and obnoxious money.

And obnoxious money will cost you time and energy.

—Carol Sands, *Angels' Forum*

Entrepreneurs are always entranced with their own idea.

—Bill Weaver

We have some very high-level biotech execs in our group, and scientists. But each area is so complex, and they're such niche ideas, we get plans in and we go, huh?

—Geoff Maletta, *Angel Healthcare Investors*

Sometimes the best thing you can do for somebody is just tell him, Don't try it.

—Bob Geras

THE RING LEADERS

Keiretsu Forum *San Francisco/East Bay, Silicon Valley, Santa Monica, Westlake Village, Long Beach, Hawaii, Calgary, Chicago, Boston, and Dallas-Fort Worth*

THE LARGEST ANGEL network in North America derives its name from the vast Japanese conglomerates that emerged after World War II. Keiretsu Forum combines individual and regional autonomy with the sharing of research and due diligence. All members make investment decisions on an individual basis. Companies apply online to the chapter nearest them. A company that earns a commitment from one chapter may travel to other chapters to make pitches for additional funding and will find that those chapters have already pored over all the research Keiretsu has done so far. The group will invest in anything; 30% of the portfolio is in real estate. At the San Francisco chapter, the largest with 150 members, about 50 applications each month go to an industry-specific prescreening committee. From those, seven to 10 are selected for presentation before a 30-member screening committee. Three to five are then selected to present before the full members' meeting, which founder Randy Williams calls "the Big Show." One thing big about it is the presentation fee companies must pay at this point—\$3,000. Williams says the fee defers costs and serves as a filter system: Most of the companies that present have revenue.

FOUNDED 2000 | MEMBERS: 356 | TOTAL INVESTED: \$44.4 MILLION | COMPANIES FUNDED: 66 | www.keiretsuforum.com

THE COMMERCIAL KEEPS

Technology Tree Group *Houston*

THE FEDERAL GOVERNMENT SPENDS billions of dollars a year on scientific research. Here's a group of angels, organized as an investment firm, that is dedicated to turning some of the thousands of concepts paid for by the government into companies that make money. Last December, Technology Tree signed an agreement with NASA to build companies to develop ideas cooked up in the agency's labs. It has a similar deal with the U.S. Department of Agriculture and is pursuing other federal agencies as well. The group also invests with technologists who have received federal Small Business Innovation Research grants. Mike Fitzgerald, CEO of Technology Tree, says the group is starting to assemble management teams to run the companies it is forming, so he's got a proposition unique to this list: If you're an entrepreneur with a track record building businesses but don't currently have a company or a new idea, send Technology Tree a resumé.

FOUNDED 2003 | MEMBERS: 16 | TOTAL INVESTED: UNDISCLOSED | COMPANIES FUNDED: 4 | www.technology-tree.com

THE WORLD-CHANGERS

Investors' Circle *Brookline, Mass., San Francisco*

THE OLDEST ORGANIZATION on our list has a funky combination of loose structure and social activism. The website defines the group as a "national network of early-stage private investors who seek financial, social, and environmental returns on their investments." Though members are scattered across the country, "ethos holds us together," says chairman and CEO Woody Tasch. Applicants submit business summaries to the website; the up to 60 that are approved by the staff each month can get circulated, for a fee of \$350, to the members nationwide. From there, any number of things can happen. Often the member who has the best combination of proximity to the company and experience in dealmaking will lead a group of members to invest. An affiliated professionally managed fund, Commons Capital, serves members who don't have the time or deal experience to invest individually. Alternative energy is an important category for this group. Investors' Circle also supports localizing the food supply chain; hence its support of the Farmers Diner, a Vermont restaurant that gets most of its food from nearby farms and is planning to expand to a national chain of diners that do the same thing for their local agricultural communities.

FOUNDED 1982 | MEMBERS: 130 | TOTAL INVESTED: \$100 MILLION | COMPANIES FUNDED: 163 | www.investorscircle.net