SOURCES OF CAPITAL: ANGEL INVESTORS OR VENTURE CAPITALISTS?

Perkins Coie LLP

Angel investors and venture capitalists are primary sources of private equity investment for start-up and emerging companies. Angels typically invest "seed" money or early-stage capital, while venture capitalists typically invest later-stage capital prior to an initial public offering (IPO) but after a business has an operating history. Prior to the dramatic cooling off in 2000 of the hot IPO market and related strong returns on private equity investments, angel investment had increased significantly and had begun to compete with venture capital for attractive deals. Although the capital raising environment has been less hospitable in recent years, emergine companies continue to look to angels as a potential source of financing.

The chart below compares typical characteristics of angel capital (AC) with venture capital (VC). The comparisons should be viewed as generalizations, not absolute distinctions. Characteristics of a venture investment may appear in an angel deal and vice versa. The specific terms of an angel or a venture investment will depend on the particular circumstances of both the investor and the enterprise being financed.

	Angel Capital	Venture Capital
Size/timing	Smaller amounts invested by individuals (e.g. $20,000 to $100,000), but angel groups or clubs may lead to larger investments (e.g. $100,000 to several million dollars)	Larger investment, from $250,000 to several million dollars, with a typical investment in the $5 million range
	Invest in earliest financing rounds; contribute "seed" money for "true" start-ups	Invest in later financing rounds after "seed" financing, but prior to IPO
	Traditionally, longer time horizon. AC is often a bridge between start-up and VC financing	Typically look for liquidity within 5 to 7 years; often sell position as part of or shortly after an IPO
Organization/ type of investor	Wealthy individuals or cashed-out entrepreneurs who invest their own money, often in industries they are familiar with; investment driven by economic profit, but also may be motivated by "psychological" benefits (e.g., satisfaction of entrepreneurial interests, connection to founders or product)	Professional investment firms that invest other people's money; motivated by economic factors and fiduciary duty
Investment requirements	Strong management/entrepreneurial team	Strong management/entrepreneurial team; some venture capitalists will invest despite management team gaps if they believe they can attract good managers to the company
	Frequently invest in an "idea" or in a particular person; may not require established product or operating history, but generally require persuasive market analysis and strategy; attracted to prospect of dominant market position	More likely to require established product, market and operating history; attracted to prospect of dominant market position
	May rely on analysis of business plan, less detailed projections and own business instincts in making investment; may require clear exit strategy	Typically require or undertake detailed analysis of operating history, financial performance and projections; generally require clear exit strategy

	Expect a high return, but may be motivated by additional factors; lower goal regarding return on investment may permit higher valuation for Company.	Generally expect 10-to-1 return or greater in 5 to 7 years
	Some angels take an active role in the company (e.g., as a member of Board of Directors or employee), while others provide only occasional advice	Typically require one or more seats on the Board of Directors; active oversight of management
	Usually take smaller, less dilutive equity position (e.g., less than 20%); majority control remains with the entrepreneur	As a consequence of investment size and return expectations, usually take larger equity position that may be more dilutive of entrepreneur's ownership
	May be less rigid on preferred stock terms or even take common stock; often will agree to lend "bridge" debt that is convertible into future preferred stock on favorable terms (e.g., warrant coverage), which can provide the flexibility of deferring an outside valuation of the company's securities	Expect "market" preferred stock terms
Value added	Often provides bridge to subsequent financing; access to capital is limited to angel's wealth; typically do not provide structured management expertise, but may have valuable experience and give informal advice to help build the company; may work in conjunction with an institutional VC firm	Generally provide greater access to future capital infusions; often provide structured management expertise and access to knowledge about the company's specific industry, product and management; provide expertise in IPO & M&A processes
Accessibility	Angel networks are typically local, informal and based on personal contacts; matching can be difficult or time-consuming without knowing key players; invest close to home	More visible, easier to locate and identify; heavily concentrated in high-technology regions (e.g. Pacific Northwest, Bay Area, New England/Route 128); may ignore certain geographies
Ongoing Relationship	May lack expertise in advising a start-up through financing stages	Clusters of VC firms create synergy of lawyers, accountants and investment bankers; venture capitalists often are experts in highly specialized process of taking start-ups public; consequently, growth through different stages may proceed more efficiently
Speed	Once angels have been introduced to company, financing often occurs quickly; negotiation of investment terms often marked by flexibility and speed	Due diligence period may be required before or in parallel with negotiation of terms; speed of investment and negotiating flexibility depend on VC firm and bargaining position
	If not coordinated, conducting diligence with and negotiating with multiple angels can add cost and time to the process	Customary reliance on lead VC for diligence and negotiations results in efficiencies