

Starting an Angel Organization

By Kevin Wiley

Susan Preston, Entrepreneur-in-Residence with the Kauffman Foundation and founder of Seraph Capital, an all-women's angel investment forum, recently visited Anchorage to discuss national trends in angel investing and to find out if Alaska has what it takes to launch a full-fledged angel network. The workshop, titled *The Power of Angel Investing: Starting an Angel Organization*, is part of a series of educational seminars put together by the Kauffman Foundation in their effort to enhance entrepreneurship in the U.S.

Twentyfive Alaskans attended the event, including angel investors, economic development professionals and a variety of entrepreneurs.

“Forming angel organizations is important to a healthy local economy because earlystage investing dollars for entrepreneurs come primarily from angel investors,” says Sue Preston. According to the Center for Venture Research, a think-tank that tracks angel investments in the U.S., angel investors put some \$29 billion into 50,000 ventures in 2005, most of them early-stage companies with little or no chance of traditional lending sources.

While many of these investments come from ‘lone wolf’ angels, a growing number are forming packs such as Seraph Capital, which bring angels together into organized networks. Such networks allow for a number of benefits to the lone wolf strategy. First of all, by opening a formal organization and effectively putting a sign on the door saying “Open for Business”, the angel groups are seeing enhanced deal flow compared to individual investors. While many of the ventures that come across the desk aren’t worth the risk, the sheer volume of new deals allows for a greater possibility of identifying worthy ventures.

A second key benefit is the ability for angels to participate in a greater number of ventures by pooling funds, thus spreading the individual’s dollars around into more companies than otherwise possible. Statistically, it makes a lot more sense (read: cents) for an investor to put \$10k into 10 deals with 10 other folks than it is for that same investor to bet a \$100,000 on one company.

Lastly, and perhaps most importantly, participating in an angel group allows people with diverse professional backgrounds to share in the due diligence process. Many parts of an investment opportunity have to be reviewed before money is committed, and if several folks each take their part in understanding the benefits and risks of a new venture, then the likelihood for a successful exit is enhanced significantly.

So what does it take to get an angel group up and running? The first step is performing a community assessment to decide whether there are enough wealthy individuals to become involved in a group and if there is a strong enough entrepreneurial culture to

sustain interesting deal flow. The group that met with Sue Preston on November 2nd in Anchorage answered both questions with a resounding “YES”.

The next step is identifying the best investment structure for the organization, i.e. group voting on investments vs. individual decisions. While group vote investments can carry less active angels into more deals, getting a network of wealthy, risk-taking individuals to come to a common decision can be a bit like herding cats. Most angel networks prefer to screen deals and perform due diligence together, but to invest as individuals (albeit together) in a deal. Each angel can put in as much or as little as they want into a venture and the organization itself doesn't carry any liability related to the investment itself.

Membership structure is also a key decision that has to be made relevant to forming a sustainable angel group. Membership structure helps determine how many people should be involved in the group, how to admit potential members and whether or not members have to make a certain number of investments each year. These decisions will ultimately determine the culture and investment focus of the angel network.

Developing an organizational structure encompasses two key decisions. First, should the group will be member or manager-led? A manager-led group puts an expert at the helm, but inevitably costs more to run. The member-led group engages more angels in the process, but it can be difficult to sustain interest, especially in the day-to-day operations. Determining whether or not there should be a pool of money known as a sidecar fund that co-invests alongside the individuals of the group is another organizational issue. In such a structure, the angels are required to put money into the fund, which is automatically triggered to co-invest should certain criteria be met. This is a great way for less active folks to get investing, but requires significant legal expertise to organize and run.

Legal structure also has to be addressed, considering pros and cons related to the various types of corporate structure, whether to be for profit or not-for-profit, etc. Tax considerations, liabilities, membership structure and governance should all be addressed when considering an appropriate legal structure.

As with any organization, an angel group must consider how it is going to financially sustain itself. Most common are membership dues, but sponsorships from service providers and revenues from events and programs are becoming important, as well. In the U.S., angel groups expend anywhere from \$25k to \$250k to operate each year, depending on the culture and activity of the group, so it is critical to lay out a budget to determine what is possible to support.

For those interested in getting a group going, Alaska InvestNet (AIN), a not-for-profit committed to fostering the private equity markets of Alaska, can help with some of the operational issues associated with running an effective angel organization. Recruitment of new members, deal sourcing and screening procedures, coaching of entrepreneurs,

training of angel members and optimizing due diligence processes are some of the issues AIN focuses on.

To learn more about AIN or to hear a podcast interview with Susan Preston, visit www.alaskainvestnet.org.