Earth Angels: A Primer on angel investment

Angel investment is a form of business financing to enable rapid growth and scale by start-up businesses. Most do not have sufficient cash flow or assets to secure business loans from lending institutions. The investor provides funding in exchange for stock or convertible debt in the company. The investors are known as "angels" because they invest in risky, unproven business ventures. Angel investors typically engage after investment by the business founder and “friends and family”, and before venture capital.

Angel investing occurs globally. According to the Angel Capital Association, the North American professional association of active accredited investors, there are more than 14,000 angel investors and over 250 angel groups in North America. Currently there are ten angel investing groups in Michigan. Northern Michigan Angels (NMA) in Traverse City is among the top three in terms of membership size and the only angel group north of Grand Rapids. NMA members invest in start-up companies state-wide, but with a focus on Northern Michigan for community economic growth that creates jobs. Members have industry knowledge to assist these businesses.

NMA has invested over $5M in more than thirty Michigan-based startup companies since its founding in 2012. Among those startups are GoSili, Atlas Space Operations, Promethient, HealthBridge, Geotix, and Naveego, all based in Traverse City, MI.

How does it work?

Angel groups proactively seek businesses for investment in a variety of ways. Networking with other angel groups is common, as well as solicitation via the internet and engaging with incubators such as 20Fathoms in Traverse City and venture funds/family offices such as Boomerang Catapult. Each angel group has criteria for startup companies of interest. Examples include significant market opportunity and growth potential; a well-defined strategy to secure market share; proprietary intellectual property for competitive advantage; and strong management with relevant experience. It is not unusual for Angel groups to receive over 100 inquiries for investment each year from start-up companies.

Investment candidates that meet screening criteria are invited to present their business opportunity to angel group members. Before the meeting, information about the business is made available to investors through a private propriety platform.

Entrepreneurs typically have 30 minutes to present and answer questions about the investment opportunity. Each company will indicate their "ask" – the amount of money they need and the intended use of that money. Following the presentation angel group members in a private discussion verbally highlight significant positives as well as concerns about the company and its prospects. Member's diverse business experience and knowledge is extremely valuable in this discussion.

For angel networks versus angel funds, each member decides how much money they would consider investing in each company. A team made up of members will conduct due diligence on the business and post results in a secure data base. This information is available to angel group members for review in making their final investment decision. Funds are then collected and pooled into a special purpose entity that wires the funds to the company and becomes the shareholder of the company.

Who are angel investors?

Angels invest in start-up companies, for a variety of reasons. Most are hoping to see the company be successful and receive a significant return on their investment. Many also enjoy opportunities to mentor founders and have a desire to see local economic impact through job creation. The investor receives an equity stake (ownership) in the business either through investment in preferred stock or debt convertible to stock. Angels are typically accredited investors as defined by the SEC with more than $1 million in net worth excluding the value of their primary residence or who earned more than $200,000 per year in each of the two most recent years.

What are the pros and cons of angel investing?

Angel investing is high risk. Technologies can fail, customer acquisition assumptions may be overstated, entrepreneurs may be great inventors but lack the skill set to be business leaders, and cash management skills may be lacking. Many of the causes for business failures are not obvious before investments are made.

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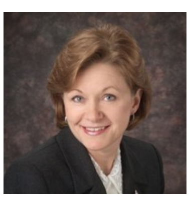
In his book, "*Angel Investing*", David S. Rose summarized rough outcomes for angel investments:

- 50% fail completely
- 20% eventually return the original investment
- 20% return 2-3x the original investment
- 9% return 10X the investment
- 1% return 20X or more of original investment.

On the plus side it is fun to learn about new technologies and innovation in a wide variety of industries. Industry statistics show that diversity in an investor's portfolio results in the highest probability of receiving greater then 1X return.

Engaging with other angel group members who have a broad range of functional and industry expertise and who support the mission of the angel group is a big attraction for becoming an angel investor. Frequently, new friendships are formed.

Successful entrepreneurs that continue to grow revenue and profits of their company may become candidates for investment by venture capital firms, acquisition, merger or initial public offering on a stock exchange. Typically at this point, angel investors will exit and, hopefully, achieve their sought after returns.



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