A GUIDE TO INVESTING **AS A BUSINESS ANGEL**

How to invest £20,000 to £2m in early-stage companies

(Plus some Dos and Don'ts from the 'old hands')

Envestors LLP is private investor network helping 'Business Angels' invest **£20,000** to **£2m**, either individually or as part of a syndicate, in early-stage, high-growth potential businesses.

envestors

matching **entrepreneurs** with **investors**

Envestors LLP is authorised and regulated by the Financial Services Authority

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TANAKA BUSINESS SCHOOL

INTRODUCTION

BUSINESS ANGELS ARE INDIVIDUALS PREPARED TO INVEST THEIR MONEY, AND OFTEN THEIR TIME, INTO STARTUP OR EARLY STAGE BUSINESSES.

They are willing to risk investing at this stage in the hope that the success and growth of the business will dramatically increase the value of their equity stake. Most are looking for explosive growth in a company. However the considerable upside in this risk-reward equation is balanced by the danger of losing all of their investment should the company fail.

Many people are aware of the concept of Business Angels, but most do not fully understand the processes involved in becoming one. There are many misconceptions about Business Angels such as ‘they are wealthy and invest big sums of money’. In fact average angel investment amounts are around £25,000 with investment levels starting as low as £10,000.

Angel investment is not for everyone. Despite the attractive potential gains up to 40% of investments result in a total loss. Furthermore it can often be difficult to extract your capital, especially in the businesses showing slower growth than projected.

Figures show that in 2004 there were 453,000 startup businesses in the UK[1], and it is estimated that 50,000 of these were looking for funding. There are also estimated to be approximately 18,000 active Business Angels in the UK who invest up to £500m a year into early-stage ventures. In addition to these figures, there are many more potential investors who would be interested in these investment opportunities if only they knew how to source deals and get involved.

If the US market is anything to go by (and it usually is) the UK angel investment industry is at a formative stage and has the potential to grow enormously.

At Envestors, we believe there is a great opportunity to facilitate the process of matching investors with suitable early-stage businesses that require funding. We believe this matching process could be greatly improved by better understanding and transparency in the marketplace. This guide is aimed at individuals interested in angel investment and wanting to take positive steps towards becoming a successful Business Angel.

[1] Barclays Small Business Survey 2004

PART 1 - BACKGROUND TO THE OPPORTUNITY

Something that has been baffling economists and financiers ever since the publication of the Macmillan Report in 1931[2], is how to tackle the 'equity gap'. This gap is the difficulty businesses face in raising equity finance of between £100,000 and £2m.

One of the main causes of this equity gap is a shortage of finance from individual private investors i.e. 'Business Angels'. In October 2004 Envestors commissioned a report from Imperial College and Cranfield Management Schools entitled: "Business Angels: Why and how they should be encouraged to spread their wings".

The aim of the report was to consolidate some of the extensive research that has already been made into the equity gap and to gain a clearer picture of modern thinking from current Business Angels. Many of its conclusions are distilled into this more manageable 24-page booklet.

A key finding of the report is the lack of awareness and understanding of the investment process from the perspective of both Business Angels and the entrepreneurs seeking finance. The team at Envestors aims to simplify this investment process.

WHAT ARE THE RISKS AND RETURNS OF BUSINESS ANGEL INVESTING?

Research by Mason & Harrison[3] found rates of return from 128 exited investments to be as follows:

IRR (Internal Rate of Return)	
More than 100%	10%
50% - 99%	13%
25% - 49%	13%
0 - 24%	24%
-ve IRR	40%

2 Committee on Finance and Industry (Macmillan report) 1931 Cmnd 3897 HMSO

3 Mason C.M. & Harrison R.T. (2002c).Is it worth it? The rates of return from informal venture capital investments. Journal of Business Venturing, May2002

The table on the previous page shows that nearly 40% of businesses show a loss on investment and the majority of these fail within two years. However potential returns are equally spectacular - Business Angels often talk in terms of capital gains multiples, and the good investments reach multiples of 10 - 20 or more.

Most angels look to diversify their risk, and take a portfolio approach to their investments. Some will fail, some will grow a little, but hopefully one or two will show a spectacular return and make the effort worthwhile.

A further benefit of a portfolio approach is to provide greater flexibility with your capital.
One of the challenges of angel investment is to realise your investment. By investing smaller amounts, there is less risk of a single large illiquid investment (although small investments can be just as illiquid).

Most investments are time consuming to select and set up, and there is usually an ongoing requirement for investors to look after their investments (there is a strong correlation between active angel involvement and businesses survival). For many this is the attraction of making an angel investment. For others it can be an unwelcome distraction to their day-to-day activities. The ongoing involvement of the investor should be discussed up-front with the business during initial negotiations.

Many investments will require further capital injections, and as a rule of thumb you should allow a further 30-50% for follow-on funding. A decision not to provide follow-on funding could leave your investment diluted by other investors, or result in the company going into liquidation with the subsequent loss of your investment.

Envestors aims to increase the number of successful investments and reduce the percentage of failures for its investor club members, through careful screening and due diligence preparation.

PART 2 - EVALUATING DEALS

SOURCING AND APPRAISING DEALS

A good first step towards becoming an angel investor is to register with a reputable Business Angel network and start receiving details of businesses looking to raise finance.

The quality of the angel network is important. It is estimated that more than 50% of registered investors never actually sign up to deals and much of this is because of the poor level of services offered by some investment networks.

How do you recognise the good angel networks? Look at their track record and check what they **really** provide for their investors. If in doubt select ones that are regulated by the Financial Services Authority (FSA), such as Envestors.

A good angel network should perform ALL of the following functions for potential investors:

- Provide a steady source of quality deals
- Offer a degree of matching based on your specified investment preferences
- Ensure a level of due diligence is performed on both the deals and the entrepreneurs behind them
- Be able to guide and advise investors in the investment process
- Keep investors regularly updated on new and current opportunities with communications such as newsletters
- Provide investors with the reassurance that the equity requirement is part of balanced funding package
- Provide investors with advice on valuation.

Potential investors should be prepared to see a lot of deals. Some Business Angels turn down 90% - 95% of the deals they look at.

TIMELINE TO RAISING FUNDS

Business Angels do not like being rushed into an investment, and yet early-stage businesses invariably leave their fund raising efforts until the last minute. As a Business Angel, you should allow at least four to six months to get yourself into a position to make an investment.

A typical time line of events looks like this:

Initial introduction of a deal through a reputable Business Angel network	**Week 1-2**
Initial business plan and financials reviewed	**Week 2-4**
Meeting with the company founders/directors	**Week 4-8**
Follow on meetings/clarifications	**Weeks 8 –10**
Negotiation and agree terms	**Weeks 10 – 14**
Initiate legals	**Weeks 14 – 18**
Finalise legals	**Weeks 18 – 22**

HOW TO VALUE A BUSINESS

A key part to the assessment of an investment opportunity is the valuation. This determines the size of equity stake your investment will buy. Normally the entrepreneur will push for a high valuation (increasing the value of their share, and also reducing the equity stake your investment will buy). The Business Angel will tend to push for a lower valuation, notwithstanding the recognition that the entrepreneur must remain motivated to make the business a success.

THE DIFFERENCE BETWEEN PRE-MONEY AND POST-MONEY VALUATION:

Make sure both you and the business are talking about the same percentages:

- Investing **£500,000** at a pre-money valuation of **£1m** would give you **33%** of the business (i.e. post-money valuation of £1.5m)
- Investing **£500,000** at a post-money valuation of **£1m** would give you **50%** of the business (i.e. pre-money valuation of £500,000)

DIFFERENT VALUATION MODELS:

There are a number of methods for valuing a business, including the Price/Earnings (P/E) model, Discounted Cashflow model, Net Asset Valuation model, Sales Multiples model, and Sweat Equity model. For further information, visit **www.envestors.co.uk** and download the Business Valuation Tool, which provides examples of the Price Earnings and Sweat Equity models, as well as further information on the other models.

An investor will refer to other investment opportunities, either in the past or currently being reviewed as comparable for valuation. The angel will be seeking the best deal for a given quantum of money. However at the end of negotiations, the valuation is down to whatever the investors and entrepreneurs agree upon.

EXAMPLES OF VALUATIONS

Sector	Stage	Investment closed (% of co.)	Pre-money valuation	Post-money valuation
Human resource management solutions company	Pre-revenue startup. Revenue expected within 3 months of funding.	£150,000 (33%)	£300,000	£450,000
Vending machine company	Established for 12 months. Revenue in Y1 of £320k. Not at break-even.	£300,000 (34%)	£580,000	£880,000
Software company	Blue chip client base. c £200k turnover	c£450,000 (41%)	£650,000	£1.1m
Software solution for merchant banks	Seed, pre-revenue startup. Revenue expected within 12 months of funding. (Financed by investors known to the mgt team).	£300,000 (29%)	£750,000	£1.05m
Medical device company	Pre-revenue. Management team with startup track record. Confirmed initial customer.	c£400,000 (32%)	£850,000	£1.25m
Retail food product	Established for 24 months. Selling in 30 food stores. Revenue in Y2 of £750k. Nearly at break-even	£250,000 (24%)	£800,000	£1.05m
Communications	Profitable Annual sales >£3m Sales growth 100% Market leader	c£500,000 (12%)	£3.75m	£4.24m
Restaurant	Profitable Turnover >£800k 2 successful outlets and more planned	c£250,000 (25%)	£750,000	£1.0m

It should be noted that the above table does not include dividends or fees paid to directors/angels, which over a period of time can exceed the original investment amount

USING RATCHETS

Differences in valuation can be covered by the use of ratchets or options, either giving the management/directors more shares if they meet targets, or giving the investors more shares if the management/directors fail to meet targets.

A traditional way of bridging the valuation gap is to issue options to management exercisable only upon an exit (e.g. sale or flotation of the company), which give management a larger share of the proceeds if the exit price meets expectations or forecasts.

Using options is a more tax efficient way of implementing a ratchet structure, however there are potential tax issues. (In all cases, careful tax advice should be taken because of the new employment related securities legislation brought in 2003 which can lead to income tax liabilities upon grant of options and exercise of ratchets.)

Ratchets can be complicated and therefore expensive for lawyers to deploy unless their components i.e. the point at which the ratchet comes into force, are specific. As a general rule they are best avoided unless there is a stalemate.

HOW TO DEAL WITH ENTREPRENEURS

A common issue faced by investors is that some entrepreneurs see them as a threat looking to take control of their business. It is important to convey the right message in initial meetings with the entrepreneur and point out that you might have more than just funds to bring to the deal.

An investor might need to secure mechanisms for protecting their investment with corporate control structures (for instance shareholder/board/IPR ownership arrangements), but should leave day-to-day management control to the directors of the business.

In general there is a certain etiquette that needs to be observed:

- Decline quickly. If, after requesting further information, you decide the proposition is not for you, decline quickly to avoid both parties wasting time.
- Sign Non-Disclosure Agreements (NDAs) or confidentiality letters with caution. Some are over-stringent and the investment seeking process can become over complicated by signing hundreds of NDAs. Many Business Angels do not sign NDAs.
- Ask the directors to send a stamped addressed envelope so that you can return all documentation if you are not interested.
- If requesting further information, be clear as to your intentions. Some directors believe, unrealistically, that a request for more information is a clear sign you want to invest, so you need to manage their expectations accordingly.

PART 3 - CLOSING DEALS

HOW TO GET THE LEGAL PROCESS RIGHT

Before entering into the legals, very often heads of agreement (non legally binding and 'subject to contract') are drawn up, with only the confidentiality clauses and those relating to any exclusive negotiation period being legally binding. Heads will later save the expense of explaining the deal to accountants and lawyers who draw up any subsequent formal documentation.

Any offer may also be 'subject to due diligence' i.e. investigations about the company's financial and legal state.

The legal documentation can comprise the following:

- **Memorandum**, which sets out the formal powers of the company (e.g. to borrow money, to carry on its business) and the company's authorised share capital.
- **Articles of Association**, dealing with the company's internal regulations (e.g. proceedings at shareholders and board meetings) as well as incorporating shareholder rights (voting, dividend etc) and minority protection.
- **Shareholders Agreement**, which annexes the business plan sets out the relationship between the shareholders. This covers areas such as who should be the directors, non-compete undertakings and, warranties about the existing business, amongst others.
- **Subscription Agreement/Investment Agreement**, (sometimes combined with the shareholders agreement) which sets out the terms of the 'share subscription', including pre-conditions for the investment (e.g. the current owners to sign service agreements, the transfer of all intellectual property and goodwill to the company and confirmation of bank finance), and any options or bonuses to be awarded to the managers if they are successful.
- **Service Agreement**, i.e. the employment contracts with the managers/directors, incorporating non-competition restrictions to protect the goodwill.
- **Disclosure Letter**, giving up-to-date details of the business and its potential liabilities so that investors will not have to enforce any warranties given by the existing owners.
- **Employment Contracts**, with more junior managers and staff.
- **Other contracts**, for key suppliers or customers.

In certain situations, (such as smaller deals under £50,000), the above might be dealt with only by a Letter of Agreement/Conditions of Investment Letter. These letters may be drawn up with little involvement from a Lawyer, if any. The advantage is that this process is simply quicker and cheaper; the disadvantage is that these documents may not incorporate proper legal protections for the investors.

The above is based on information provided by Ron Norman, Director at Tax & Legal Consultancy Ltd. As well as being a seasoned Business Angel himself, Ron sits on a number of investment committees and is Secretary of the British Business Angels Association.

WHAT ARE THE PROS AND CONS OF SYNDICATION?

Syndication is where a group of investors pool resources to co-invest together. Usually the transaction is led by a lead investor.

Syndication can enable you to:

- Pool money to invest in larger deals otherwise out of reach
- Build a diverse portfolio of investments
- Share the costs and burdens of due diligence
- Learn from more experienced Business Angels
- Provide a stronger negotiating position on valuation
- Share contacts and investment expertise
- Have greater influence in board meetings as part of a collective shareholder voice
- Increase the ability to add further follow-on funding rounds to existing investments, if required.

It can also be more fun, if investing with the right people.

However, syndication can lead to:

- More time being spent on obtaining unanimous agreement on the terms of the deal
- More hassle in closing a deal if one person falls out at the last minute
- Less direct involvement in the investment
- Frustration if the syndicate is poorly led

HOW TO GET TAX RELIEF (ENTERPRISE INVESTMENT SCHEME)

The Enterprise Investment Scheme (EIS) can be an important benefit for most investors, although not all businesses qualify for EIS. There is a 72-page booklet on the EIS, which you can download from http://www.inlandrevenue.gov.uk/pdfs/ir137.pdf.

SUMMARY OF **TAX BENEFITS** FOR THE INVESTOR UNDER EIS:

- **Income tax relief at 20%** on the amount invested in qualifying investments of up to £200,000 per annum per person (£400,000 per couple)
- **Further income tax relief at 40% for any losses** made on the disposal of EIS shares,
- Any gain arising on the disposal of shares after three years are **free from capital gains tax**
- **Inheritance Tax** relief and
- **Deferral of capital gains** (no limit) on any other assets, by reinvesting all or part of the gain into an EIS company within one year before, or three years after, the gain accrued.

Example of Income Tax relief under EIS:

For every £10,000 invested, an investor is only risking £4,800 under EIS.

Initial investment		**£10,000**	A
Tax relief	20%	£2,000	B
'Real' initial investment		£8,000	C
In the event of the company failing totally			
Further tax relief on		£8,000	=C
Tax relief	Up to 40%*	£3,200	D
Total at risk		**£4,800**	A-(B+D)

*Further tax relief for total loss of captial is at the marginal rate of tax. For higher rate tax payers this will be at 40%

Due to the interaction of the above loss reliefs, an investor may be eligible for income tax relief of up to 52% of their original investment in the event of a total loss.

For **corporate investors** there are similar tax incentives through the Government's Corporate Venturing Scheme.

OUTLINE OF THE **KEY RULES OF EIS**:

- Investors must be UK tax payers
- Shares must be held for at least three years
- Dividends may be received as long as they are at a normal commercial rate and not deemed excessive
- An investor cannot be 'connected' with the EIS company, i.e. he or she cannot own more than 30% of the shares, directly or indirectly
- Your spouse may be able to get EIS relief, but only if your combined stake in the company is less than 30%
- Individuals who are paid directors or employees of the EIS company at the time of the issue of shares are normally disqualified from claiming EIS relief
- Qualifying investors can in certain circumstances be paid for their work, provided the total remuneration package is 'normal and reasonable'
- Schemes that involve guarantees or exit arrangements will not attract tax relief i.e. shares have to be straight ordinary shares

HOW TO **RECLAIM EIS RELIEF:**

A company in which you have invested should provide you with an EIS 3 form, usually three months after the investment has been made. You will need to enter the total EIS investment amount on your tax return (section 15.4 of the 2004 tax return). This will come off your next tax bill.

LIMITATIONS OF EIS:

On the whole, it is a highly valued incentive for an investor to seek tax relief under the EIS. However, the following should be noted:

- If you are a non-UK taxpayer you will not be eligible for EIS tax relief.
- You will not be eligible for EIS tax relief if you make a quick ‘in-and-out’ investment i.e. you do not hold the shares for at least three years
- EIS does not allow you to have more flexible investment arrangements e.g. convertible shares or a form of loan repaid over a certain period.
- The company must ensure it abides by all the requirements to comply with EIS regulation, or else the investor will not be able to claim EIS tax relief.

The above information on EIS is based upon information provided by Chris Lane, Partner, Kingston Smith Chartered Accountants. Previously the company secretary of the National Business Angels Network, Chris has provided ‘pocket CFO’ services on a pay-as-you-go basis for a number of early-stage ventures seeking finance.

PART 4 - POST INVESTMENT

HOW TO REALISE YOUR INVESTMENT (EXIT)

Most Business Angels expect to exit within three to five years. However, getting your money out is one of the biggest challenges facing Business Angels. Many Business Angels have their money tied up in investments with little prospect for a successful exit. As part of your evaluation of the business, a Business Angel needs to be convinced by the directors of the business that there is a genuine desire and ability to exit within a set timeframe.

The main routes for an exit are:

- Another company buying your equity (i.e. a trade sale)
- The company itself buying your equity
- The directors buying your equity
- A flotation on AIM, OFEX or the main stockmarket itself

Research conducted by Mason and Harrison[4], showed Business Angel divestments to be as follows:

Written off as a loss	**40%**
Trade sale to another company	**26%**
Sold to other shareholders (including management buy-outs)	**16%**
Sold to a third party	**10%**
Floated on the stock markets (AIM, OFEX, LSE/Official List)	**8%**

HOW TO MAKE A LIVING FROM BUSINESS ANGEL INVESTMENT

There are a few people who manage to make a respectable living out of being a Business Angel investor. The trick seems to be to build a portfolio of at least ten investments, either solely or leading a syndicate.

You can then take a Non-Executive Director role and get paid for a couple of days per month (perhaps at £600 per day), provided you can demonstrate to the company that you can add value in this capacity. As well as helping to nurture the company towards success, you can keep an eye on your investment. This is permitted under EIS rules and therefore provides income as well as potential capital growth.

[4] Using data from the European Commission-Enterprise Directorate, 2003

PART 5 - TOP TIPS & MISTAKES

TOP TIPS FOR INVESTING AS A **BUSINESS ANGEL**

The following section is taken from information from various experienced Business Angels. Particular thanks go to Michael Anderson, who is a serial Business Angel.

DUE DILIGENCE ON THE **PEOPLE:**

- **Check the people**. Most seasoned Business Angels 'bet on the jockey and not the horse' and rank the people bit as the most important.
- E**nsure the director understands the obligations of taking on a Business Angel**. They need to have the right 'attitude'.
- **Ensure the directors have enough 'skin in the game'**. They should have some significant personal investment to deter them from walking away at the first sign of trouble.
- **Ensure the directors understand the commercial basics**. Check they comprehend fully where they are creating their margin and what the key revenue drivers are.
- **Ensure there is a well-rounded management team**. If they haven't got one in place yet, what are they doing about it? Do they recognise their skills gaps and know how to fill them?
- **Ask why they (and/or existing shareholders) are not putting in any money themselves**. And/or why they cannot find people within their own contact base who could invest into the business, even if it is only £20,000. Directors are less likely to let down people they know.
- **Hold the directors accountable for the financial forecasts**. One seasoned investor insists upon having the right to dismiss the management team if the financial targets in the business plan are not met. After all, that was the basis upon which the investment was made! A bit draconian perhaps, although ratchets could be used to claw back shares in the business if targets are not met (see section on Using ratchets).
- **Keep directors' salaries under control**. Firstly, ensure the directors are not earning more than they were in their previous roles or jobs without good reason (you do not want to be financing their high-flying lifestyles). Secondly, ensure that any increases in directors' salaries are performance related.
- **Ask for warranties**. Warranties are signed assurances from the management team e.g. there has been no change to the business's financial situation since obtaining management information. They provide the basis for legal recourse if information is misleading or has been deliberately withheld.

DUE DILIGENCE ON THE **BUSINESS:**

→ **Quickly weed out the 'lifestyle' from the 'entrepreneurial' businesses**. You are looking for scalable businesses with the potential for explosive growth.

→ **Invest locally**. Most Business Angels invest within 50 miles or two hours drive of where they live or work so they can attend board meetings easily (and keep an eye on the cash).

→ **Speak to customers** - if you can, to check there really is a demand for the product.

→ **Check the exit**. Is there a realistic and credible exit plan as well as a genuine desire to exit? Too many investors have their funds tied up in investments they cannot realise. (See How to realise your investment (exit) section, above).

→ **Ensure you can smell the revenue**. The sales cycles can be much longer than anticipated, especially with technology startups.

→ **Discount 'low-probability revenue streams'**. Some financial models include multiple non-core revenue streams which are unlikely ever to come to fruition. Check the model still makes sense without them.

→ **Check there is adequate insurance**. For example key man insurance for the main directors as well as business interruption insurance.

→ **Ensure intellectual property (IP) belongs to the company not the individual**.

→ **Ensure there is enough 'headroom' in the financials**. If they are under-capitalised from the start, they could get into the vicious circle of requiring further funds when targets are not achieved, and then being distracted from the sales process to raise further funds, which gets them into deeper trouble.

→ **Invest in what you know**. Or make sure someone in the syndicate knows enough to have insight.

→ **Ensure the business has explored alternative sources of finance** - other than just debt and equity. For example, could they access grants or soft loans, or use other sources of finance e.g. factoring or leasing?

→ **Check there are no significant 'black holes' with overdue creditors or accrued liabilities**.

DUE DILIGENCE ON THE **DEAL:**

→ **Ensure you have access to good dealflow**. An intermediary such as Envestors will ensure you have the breadth of choice to find the right kind of opportunity, as well as the reassurance that the deals have been scrutinised by experienced professionals.

→ **Work with an experienced Business Angel if you are new to the game**.

→ **Allow time**. It will take longer than you think to source, review and close the right deal.

→ **Handle desperate cases sensitively**. Some companies get into financial difficulties and appear to require funds immediately to avoid closure. These can prove interesting opportunities in spite of the fact the company's funds may have been mismanaged. You have to handle these cases sensitively and manage the directors' expectations carefully, as negotiations can get heated and declining after showing initial interest can be unpleasant.

- **Allow for follow-on funding**. No matter how hard directors try, often they fail to meet sales targets and/or costs are higher than expected. Experienced investors allow for follow-on funding of up to a further 50% of their initial investment in order to save them from having to tear up their ticket. (But never let the directors know of its availability!). Follow on funding can also be needed where there is good news and growth exceeds forecasts.
- **Protect yourself against a 'down-round**. If someone invests after you at a lower valuation, an investor can provide an option to protect himself by getting extra shares to compensate for this. This would need to be detailed in the Shareholders Agreement or the Articles.
- **Make sure you do not buy in at too high a valuation**. Many directors are blind to the risks associated with their ventures and insist the risks are minimal. The earlier the stage, the higher the risk, but the more you should get for your money. Striking a balance between your perceived risk and the directors' believed certainty is difficult in an area where there are no hard-and-fast rules on valuation. See section on How to value a business.
- **Be aware of the danger of heavy dilution in follow on funding rounds.**
- **Look at the other investors**. Are they investing for (a) loyalty reasons e.g. family and friends, who may be more generous with the valuation and less demanding of an exit or (b) financial reasons i.e. for sheer profit. The latter is better than the former, although the former is still a useful measure of confidence in the directors.
- **Get a board position**. Many investors believe it is essential for the directors to allow an investor to have board representation in order to let them have some say as to how the business (and their cash) is being managed.
- **Spread your risk**. If you're reading this you should know about portfolio theory; better to do ten smaller deals than 1 big one. If you do not have the financial resources to do ten £50,000 deals, then syndicate.
- **Add value where you can**. Share business and industry contacts.
- **Tight and simple service agreement**. (i.e. directors' contracts of employment) Include a non-compete clause to ensure they do not wind up the business and start up a competing business the following week.
- **Establish how involved you are going to be at the outset.**
- **Simple corporate structures**. Be suspicious of complex corporate structures with several different companies under a holding company, especially if the directors wish you only to invest in a subsidiary.
- **Ensure you have minority protection** - such as pre-emption rights i.e. the right of first refusal of any new share issue and 'tag along' rights i.e. if a majority shareholder sells their stake, you have the right to join the transaction and sell your minority stake on the same terms. This should be detailed in the Shareholders Agreement or the Articles.
- **Insist upon regular management information**. If not produced, some Business Angels insist upon having the right to get an external inspection of the accounts at the cost of the company.
- **Remember, it is caveat emptor ('buyer beware')**. You need to do your own due diligence to such a level where you are satisfied the directors have a reasonable chance of success. Also, you need to be aware of fraudsters. Most are fairly obvious ('I know the King of Country X and have $10m in a bank account …') but others are more subtle.

TOP MISTAKES MADE BY BUSINESS ANGELS

Much of this section is adapted from presentations given by Jon Moulton. Jon is a Managing Partner of Alchemy and has made over 40 personal investments. He frequently gives advice on the "Habits of Consistently Bad Investors". Overall, Jon Moulton has made more money from this 'hobby' than working.

BEFORE MAKING AN INVESTMENT:

- **Don't put up with weak arguments.** Walk away if the directors can't provide clear answers to tough questions on the market or the finances.
- **Don't fail to check thoroughly the backgrounds of the directors.** Beware of fraudsters. Is the Finance Director really on board?
- **Don't allow the legal process to get ahead of the due diligence.** Some directors start the legals before you have made your decision.
- **Don't allow too much legal spend.**
- **Don't miss out on the tax breaks**. Make sure you get your Enterprise Investment Scheme (EIS) tax relief.
- **Don't fail to get proper anti-dilution or EIS protection**. Through pre-emption rights in the Articles of Association or the Shareholders Agreement.
- **Don't invest in what you don't know**. Unless investing with someone who does.

AFTER MAKING AN INVESTMENT:

- **Don't accept poor management information**. Insist the directors provide you with current, up-to-date financial information. Don't accept over-optimistic projections.
- **Patience is a mistake**. Do not delay action if you think things are going wrong.
- **Don't get bullied by controlling shareholders**. Ensure you maintain your minority rights.
- **Don't fail to visit**. Explain beforehand that as an investor you want to keep an eye on what your hard-earned cash is being spent on.
- **Don't just talk to the CEO**. It is amazing how the directors can always find reasons why sales targets have not been met or why costs have exceeded budget. It's also amazing how much more you can learn from talking to employees.
- **Don't exit too late**. Don't allow greed to run.
- **Don't waste money on over-optimistic float processes**. Some directors like the vanity of floating on a stock market, whether AIM, OFEX or even the Official List. Seek advice, seeking a flotation can be costly and counter-productive.
- **Don't accept earn-outs for the directors and not you**. When selling the business, ensure the directors do not receive future earn-out payments from the buyer, without you getting some benefit.

Don't forget to keep the legal documentation!

PART 6 - ABOUT ENVESTORS

Envestors LLP was formed in April 2004, with the aim of matching entrepreneurs with investors. Envestors has four equity partners, see below, and works with a growing number of associate partners:

Oliver Woolley MBA
Oliver raised private equity and bank debt to start his own venture in the food industry – including a retail catering business in central London and organic sausage shops in the south-east. In 1997 he sold the business and moved on to advising entrepreneurs. Oliver has an MBA from Imperial College, specialising in entrepreneurship.

Nick Taylor FCA
After qualifying with Price Waterhouse, Nick worked with private and public companies in the retail and manufacturing sectors. Most recently he was co-founder of The Sportscard Credit Card Company, which was listed on AIM and later sold to on-line bookmaker UK Betting Plc. He is also co-founder and director of an established private restaurant group and has investments in four other ventures.

Bob Taylor MBA
Bob has worked extensively in the oil industry, initially in Africa as a field seismologist, and then in oil trading and broking roles in London. After a 15 month career break to ride a motorcycle around the world, he worked in project finance for an investment bank in Asia. Bob has a degree in Geology from Durham University and an MBA.

Scott Haughton MBA
After 16 years working in senior sales and marketing roles for multi-national blue chip FMCG corporations, including Mars Confectionery and GlaxoSmithKline, Scott left to set up a family leisure concept. In doing so, he secured funding totalling £680,000, including venture capital backing, Business Angel investment, bank debt and DTI Small Firms Loan. Scott has a degree in economics and business and an MBA.

WHY USE ENVESTORS?

Our overall objective is to help investors maximise the return on their portfolio of investments in early-stage ventures.

We also aim to maximise your enjoyment and minimise the pain (as well as the risk) of investing as a Business Angel.

The benefits of investing through Envestors can be summarised as follows:

- **Good deal flow:** We get up to 60 business plans a month, of which we will work with approximately six to ensure they are up to our investment standards
- **Investment ready:** Before presenting any opportunities to investor members, we ensure businesses are fully ‘investment ready’ in terms of having a complete business plan. We also ensure the directors understand the investment process and the obligations of accepting external investment
- **Due diligence preparation:** We produce a standardised Envestors Information Pack for each investment opportunity which can include some or all of the following; an executive summary, a full business plan, detailed financial projections, historic audited accounts, an investor presentation and credit checks on the company and the directors.
- **Syndication opportunities:** You will have the opportunity to co-invest with other experienced investors
- **Post-investment mentoring support:** Once an investment has been made, we can provide follow-on support to monitor and mentor the investee company to increase the chance of a successful exit
- **Meeting the businesses:** As well as receiving a bi-monthly newsletter featuring investment opportunities, you will be able to hear businesses present at our regular investment presentation events
- **Investment ‘matching’:** We will proactively seek opportunities which match the investment criteria you provide in the Investor Registration Form
- **Links with accountants, lawyers and banks:** We work with a number of professional service providers who have done this before and who charge accordingly
- **Tax relief:** Where appropriate, we ensure businesses are eligible for tax relief under the Enterprise Investment Scheme
- **Authorised and regulated by the FSA:** Envestors is regulated by the FSA to provide corporate finance advice. Many operators in the Business Angel space are not regulated

WHAT DOES ENVESTORS CHARGE?

Investors: Rates for 2005 are as follows:

Individual Investor Member: £150 per year (plus VAT)
Corporate Investor Member: £375 per year (plus VAT)

- Bi-monthly newsletter (a hard copy through the post, not just an email) each containing up to eight investment opportunities, as well as providing details of syndication opportunities with other investors.
- Invitation to six free members-only investor presentation events each year, where you can meet other investors and hear 15 minute presentations from up to five companies seeking investment
- Pro-active search for investment opportunities.
- Access to online bulletin board of investment opportunities

HOW TO FIND OUT MORE?

Investors, if you are interested in investing upwards of £20,000 in early-stage ventures, please fill in our Investor Registration Form at **www.envestors.co.uk/investors**, or email us at **investors@envestors.co.uk.**

Company seeking investment, if you are a company seeking investment of up to £2m, please submit your proposal to **www.envestors.co.uk/funding** or email **funding@envestors.co.uk**.

With special thanks to: Michael Anderson, Chris Lane, Ron Norman, Jon Moulton, Helen Reynolds, Paul Gardner and Sarah Wadham.

THOUGHTS/NOTES...

envestors

matching **entrepreneurs** with **investors**

Envestors LLP is authorised and regulated by the Financial Services Authority

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