Bachelor thesis

How do angel investors protect themselves against expropriation?

A case study on the possible protection measures of angel investors

Mylene van Dartel
s558285
Business Studies
m.vandartel@uvt.nl
Tilburg University and Tilburg School of Economics and Management
Yaping Mao
June 10, 2010

TABLE OF CONTENT

INTRODUCTION ... 3
CHAPTER 1: The business angel profile ... 5
CHAPTER 2: Selection criteria ... 7
CHAPTER 3: The angel his contract ... 10
CHAPTER 4: The post-investment period ... 12
CHAPTER 5: Case study Money meets Ideas ... 14
5.1 The business angel profile ... 15
5.2 Selection criteria ... 15
5.2.1 Case 1: The game platform ... 15
5.2.2 Case 2: Industrial foundation ... 16
5.2.3 Case 3: Medical supply ... 17
5.2.4 Money Meets Ideas selection criteria ... 18
5.3 The period after the selection ... 19
5.3.1 The angel his contract ... 19
5.3.2 The post-investment period ... 20
CHAPTER 6: Conclusion ... 21
CHAPTER 7: Limitations and suggestions for further research ... 23
REFERENCES ... 24
APPENDIX 1: Interview KplusV ... 29

INTRODUCTION

Angel investors are wealthy individuals cited by researchers as the most important source of capital for start-up firms. (Morrissette, 2007). They play a leading role in financing entrepreneurs beyond their own resources. (Wiltbank 2005) Angels invest at a critical time, after friends and money has run out, but before venture capitalist will invest (Berger & Udell, 1998). In doing so, they fill a funding gap that otherwise would endanger both start-up survival and the venture capital industry (Ibrahim, 2008; Szerb et a.l, 2007). Many entrepreneurs and their high potential ventures are impacted by angel investors at a very early point in their development. (Wiltbank, 2005). Companies such as Google, Amazon.com and Apple relied on angel investments and might not have attracted enough venture capital without them (Ibrahim, 2008).

Despite the importance of angel investors, current research is much more focused on the venture capitalist market. In contrast to the formal venture capitalist markets, angels invest in a market that is much more private. As a consequence it is difficult to find and survey angels; they do not have reporting requirements other than private tax returns (Wiltbank, 2005).

Previous research questions the risk the angel investor is taking (Mason & Harrison, 2002). Business angels invest in start-ups firms that are rife with uncertainty, information asymmetry and agent costs in the potential opportunism of the entrepreneur (Ibrahim, 2008). Resulting from this I would like to know how angel investors protect themselves against possible expropriation.

These paper proceeds as follows. In the first chapter, I will make a profile of angel investors. In this first part I identify the risk in the informal investment market and the important role of angel investors. In the second chapter, the focus will be on the selection criteria of angel investors in the pre-investment period. How do angels decide which project they are willing to invest in? And why is this decision important to reduce the risk the angel is taking? Chapter 3 is about the real investment. Do angel investors make contract with the entrepreneur and what are the agreements made? In chapter 4, the attention is on the post-investment period. Questions that will be addressed here are: Do angels have an influence on the success of the start-up company? And how can they make sure they get a return on their investment? What are the cash-out opportunities? Chapter 5 is a case study. In order to add some empirical results to this study, I interviewed Hendrik van der Meulen from the consultancy

company KplusV. Together with Schretlen & Co., the investment bank of the Rabobank Group, they organise an informal investing platform called "Money meets Ideas". To get an even better insight in the Dutch informal investing activities I went to this platform on May 18, 2010. The results of this interview and the visit to the platform will be described in chapter 5. Finally, I will present the results that are based on the combination of the literature review and the case study.

CHAPTER 1: The business angel profile

Angel investors play a leading role in financing entrepreneurs beyond their own resources (Wiltbank 2005), they are regularly the first source of outside equity (Wiltbank, 2007). Many entrepreneurs and their high potential ventures are impacted by angel investors at a very early point in their development (Wiltbank, 2005).

The term ’angel investor’ originates from funders for Broadway shows (Wong, 2002), the theatre angels invested in theatre productions mainly for the pleasure. Investing in the new theatre shows was risky; the investors lost their money if the production was unsuccessful but shared the profits if it was a hit (Avdeitchikove, Landström & Mansson, 2008). Later on, William Wetzel (1983) started using the term business angel for people providing the same kind of investment for young entrepreneurial ventures.

Today the term business angel is used for individual investors that range from successful, cashed-out entrepreneurs on the hand to individuals with little or no experience with venture investing on the other (Freear, Sohl & Wetzel, 1994; Avdeitchikova, Landström & Mansson, 2008). Angels appear to be extremely diverse (Prowse, 1998), but the current research seems to have find a consensus on the definition of a business angel.

Business angels are wealthy individuals who invest their own money in start-up firms in which they have no family connection (Mason & Harrison, 2002; & Hay, 2003; Wiltbank, 2009; Benjamin & Margulis, 2005). Most often angels are middle aged and well educated man, (Freear, Sohl & Wetzel, 1994; Collewaert & Manigart, 2009; Brettel, 2003) they acquired their wealth from being an ex-entrepreneur (Macht, 2006; Maula, Autio & Arenius, 2005). The average investment size seems to differ per research paper, but the median investment is between 100.000 and 150.000 dollar (Feeney, Haines & Rinding, 1999). Although this amount is smaller than the investments of venture capitalist, angels tend to invest in approximately 20 times the number ventures (Wiltbank, Read, Dew & Sarasvathy 2007). The angel market is said to match or even exceed the venture capital market (Ibrahim, 2008; Fenn, 1997).

Although business angels invest primarily for financial reasons, non-financial motives emerge as a very strong secondary reason to invest in a start-up company (Ramadani, 2008; Leshcinkii, 2002). Business angels are not just investing money; they spend money, time and knowledge (Aernoudt, 1999). Angels expect to be actively involved in the firm (Morrisette, 2007; Freear, Sohl & Wetzel, 2002) and therefore like to invest in ventures close to where they live

(Fishback, Gulbranson, Litan, Mitchell & Porzig, 2007; Benjamin & Margulis, 2005). For the same reason angels like to invest in industries in which they have some experience (Atrill, 2009; Wong, 2002), and only invest in one or two firms a year (Wiltbank, 2002).

Angels are patient investors, the investment time is usually between 5 and 7 year (Wetzel, 1983), although the exit strategy is often included in the initial investment agreement (Freear, Sohl & Wetzel, 2002).

A current trend in the angels market is the rise of angel groups (Sarasvathy & Wiltbank, 2003). In this groups businesses angels cooperate to "consider investments opportunities, share opinions and expertise about investments, pool their capital, and negotiate investments" (Wiltbank & Boeker, 2007). Even though most angels groups leave individual investment decision to the angel, the rise of angel groups makes co-investing easier (Ibrahim, 2008). The main difference between angel group and individual angels is that they are not so difficult to find (Ibrahim, 2008).

CHAPTER 2: Selection criteria

Understanding how business angels select their investments will help to give an insight in the angel investment process. Choosing the right start-up firm to invest in, is the first step angel investors can take to protect themselves against possible expropriation, since it lowers the agency problem ex-ante.

With regard to the search for investments, business angels find their deals through a network of friends, family, and other angels and business associates (Brush, Carter, Greene, Hart & Gatewood, 2002). Mason and Harrison (2002) indicate that significant sources of deal flows are informal and only few business angels obtain information on investment opportunities from formal sources such as accountants, lawyers, venture capital funds, banks, and stockbrokers.

Angels are most often approached by the entrepreneur or by other investors in the firm. (Morrissette, 2007; Brettel, 2003; Hindle& Lee, 2002). The sharing of deals by investors is done to find co-investors and with the expectation that other good investment opportunities will be shared as well (Prowse, 1998). If the deal is found through the network of trust, angels are more likely to invest (Mason & Harrison, 2002).

Once the investment opportunity has been found, the first step the angels take is to consider if the fits with their own investment criteria (Mason & Harrison, 2002). This holds for both the investments found through the formal and informal network. Since angels do not only invest from a financial motive (Ramandi, 2008), most angels require that the new start-up firm is close to home. Also investing in an industry in which the angel has some experience, is something that happens regularly(Cohen, 2007; Aernoudt, 1999). This will help the angel to give advise and guidance to the new firm and to eliminate some risk (Mason & Stark, 2004). The majority of all opportunities are rejected at this first stage (Brettel, 2003).

After this first stage a distinction needs to be made between investment opportunities that are found though a informal and a formal network.

If the opportunity fits the investors and the investment is found through the informal network of business associates and friend, angels place less weight on financial expectations and place greater emphasis to subjective factors and “gut feeling” (Mason & Stark, 2004; Wiltbank & Sarasvathy, 2002). Consequently the angel his personal gut assessment of the entrepreneur is the most important factor when evaluating a start-up (Eyler, 2007; Cohen 2007). Angels want to

give guidance to the new firm (Aernoudt, 1999) and should therefore like the entrepreneur in order to have a chance of success. As a result it is important that the angel perceives the entrepreneur as trustworthy (Sudek, 2006); Prowse (1998) showed that angels are more willing to invest if the entrepreneur is already known and trusted by them (Prowse, 1998). This explains why most deal flows are generated from the informal network. Other characteristics of the entrepreneur that are valued highly are: management track record, realism and integrity and openness (Feeney, Haines & Riding, 1999; Kaplan, Klebanov & Sorensen, 2008).

After the entrepreneur has been approved, the business plan and the management are the essential criteria. Wetzel (1983) indicates that a lack of confidence in the management team is a common reason for business angels to reject an investment deal. Just like with entrepreneur it is important that the management team comes across as trustworthy, passionate and committed (Mason, Harrison, 2002). All pieces of the management team need to be in place (Sudek, 2006). Furthermore, angels like the management team to have a track record. Angels will not invest if the management team has a poor track record, but it might be possible to find an investor if the track record is not yet strong (MIT Entrepreneurs Centre).

Not only the lack of confidence in the management team is a common reason for rejection, the absence of a well-defined business plan also decreases the chance an angel will invest (Wetzel, 1983). This is partly because a poorly written business plan is seen as a weakness of the whole start-up (Feeney, Haines & Riding, 1999), and partly because angels are not philanthropist (Aernoudt, 1999) and they want to have information about the risks the start up firm is facing (Mason & Stark, 2004). Especially market risk should be clearly defined in the business plan, because this is a factor that can not be controlled by the angel through post-investment monitoring. Furthermore a good evaluation of the market risk gives the angel investors an insight in the knowledge of the entrepreneur; the angel can evaluate if the entrepreneur understands the deal and whether or not the entrepreneur can be relied upon as venture manager. (Mason & Stark, 2004)

For deals that are found through a formal network, the same criteria arise but in a different order. Since the angel does not yet know the entrepreneur personally, his first focus will be on objective selection criteria. The angel cannot rely on his “gut feeling” and therefore the business plan and the management team track record are more important than the entrepreneur (Mason & Stark, 2004). However if the entrepreneur does not have a connection with the entrepreneur he will also not be willing to invest.

Next to the entrepreneur, the management team and the business plan there are some less consistent themes that are used as selection criteria for investment that are found both though the formal and informal network: growth potential (Cohen, 2007; Sudek 2006) and exit routes (Attril, 2009; Lerner, 1997).

Selecting the right project is important to eliminate some of the risk the angel investors are facing. As Van Osnabrugge (2000) indicates the investment of business angels are surrounded by agency problems. Angels can bear the problem of moral hazard and adverse selection. Moral hazard occurs when the entrepreneur does not put forth the effort originally agreed upon, or when the entrepreneur has personal incentives to withhold some crucial information. Adverse selection arises because the principal can not completely observe and verify the skills or abilities of the entrepreneur at the time the investment is made. The proper pre-investment screening of the investment and performing due diligence can decrease asymmetry of information and as a consequence can lower the agency problem ex-ante.

CHAPTER 3: The angel his contract

Previous research indicates that most angel investors use contracts to protect themselves against possible expropriation (Wong, 2002). Although angels believe that active involvement (Kelly & Hay, 2003) and a localized bond (Wong, 2002) eliminate most of the risk, the contracts are still considered a protection mechanism and a mean by which mutual behavioural expectations of all parties can be clarified (Landström, 1998). The contract can reduce the asymmetries of information between the angel and the entrepreneur, and it gives incentives to the entrepreneur to behave in the interest of the new firm (Van Osnabrugge, 2000). Similar to the proper selection criteria, a good contract can decrease agency problem during the post-investment period.

In contrast to the more complex deal terms and securities used by venture capitalist, angels mostly make use of more simple contracts (Morrissette, 2007). In the contract the two main issues are financials and governance. Concerning the financial issues the contract should clarify the type of finance provided and the angel his ownership share (Prowse, 1998). Next to equity, angels can also provide personal loans or loan guarantees to firms. With regard to ownership share, angels have widely varying required rates of return. Unlike limited partnerships, business angels rarely use formal models that project the company its value on some future date to calculate the percent ownership that provides them with their required rate of return. Instead, "they use rough rules of thumb or their gut feeling" (Prowse, 1998). Usually also the exit provisions are included in the investment agreement (Freear, Sohl & Wetzel, 2002; Tingchi & Chang, 2007). The governance issues vary between the angels, and the most important items are representation in the board and majority voting rights. However researchers seem to have different opinions about how and how often the governance issues are used in the angel contracts. Wong (2002) finds that in practice angels do not receive board seats; Ibrahim (2009) indicates that only half or less of the angel rounds involve granting investors a board seat; and Prowse (1998) states that angels are very often in the board. Angels do not always require a board seat because their prima concern is the trustworthiness of the management (Hindle & Lee, 2002). Angels that do require a board seat, have two reasons to do so. First, it will provide tangible evidence to the company founders that the angel his participation will not be passive and that their stake in the success of the company transcends

the financial. Second, a seat on the board also gives the investor actual voting power, should it need to be exercised (Jensen, 2002).

The literature gives three main reasons why angels use these simple contracts. The first and most mentioned reason is that smaller investments may not justify the use of complex securities because of higher cost of implementing a more complex security (Wong, 2002). The costs associated with undertaking extensive due diligence, and the legal and professional fees to document deals are not in line with the amount generally invested by business angels. Second, strict contracts reduce the change of getting follow-up capital. Angels invest at a difficult time, when the entrepreneur is no longer able to provide the money needed, but before the venture capitalist is interested (Sarasvathy & Wiltbank, 2003). However, a venture capitalist will not be interested to invest if "it is required to unwind the non-standard angel preferences in order to strike the venture capitalist his standard deal" (Ibrahim, 2008; Berger & Udell, 1998). The simple contracts are rational from a financial perspective. Lastly, as indicated angels have a trust relationship with the entrepreneur which substitutes for the more formal contract provision (Kelly & Hay, 2003). Next to that, angels might believe that strict contracts might jeopardize the personal connection with the entrepreneur (Ibrahim, 2008).

The contracts drawn up by angel groups are more formal than those used by the traditional angels. Angel groups are in the middle between traditional angels and venture capitalist (MIT Entrepreneurs Center). The investment amounts are higher than those of the traditional angels, the investments is done later in the company life, angel groups participate less in the company which results in less informal monitoring and the connection between the entrepreneur and the angel in more formal. Together this result in more professional contract design that resembles that of early-stage venture capitals contracts (Ibrahim, 2008).

CHAPTER 4: The post-investment period

After the money has been transferred the post-investment period starts. In this period the success of the start up firm seems to be influenced by the participation, through mentoring, coaching, financial monitoring, and making connections, of the angel investors (Kelly & Hay, 2003; Wiltbank, 2005). To ensure that the angel his knowledge and business network is shared and the company stays on track, it is important that the business angel has a tight relationship with the entrepreneur. Not so tight that the entrepreneur spending more time with the angel than on the business, but tight enough that when the entrepreneur or the business gets off track, the business angels and the entrepreneur have the relationship and information to know this quickly and respond collaboratively (Eyler, 2007). Already at this moment it becomes clear why selecting the right entrepreneur in the pre-investment stage is important for angel investors to be successful. Good communication between the entrepreneur and the angel is essential in the post-investment stage (Eyler, 2007), since it decreases the information asymmetry. Angels will require frequent periodic updates on the health and progress of the company. For some, that may mean quarterly reports, but for others, weekly updates may be a prerequisite (Jensen, 2002).

Angel investors have to find an exit route for their investments in order to achieve a return (Brettel, 2003). Therefore is important that the angel investor, together with the entrepreneur, has a strategic vision with a road map to the exit. This road to the exit, with an average duration of 5 till 7 year (Wetzel, 1983), should be planned from the beginning of the angel relationship with the company, with milestones built into the journey. This plan needs to be amended to match the market dynamics as they change over the life of the investment. It is important for the angel to know the different exit options and work with the CEO to select the best option and facilitate the process (Tingchi & Chang, 2007).

Whether business angel investment is successful or not depends on angel investors his ability to exit the investment and realise capital gains (Tingchi & Chang 2007). Once it is time to cash out the investment, angels have different exit options. The most usual method for successful firm is the sale to another company (Prowse, 1998), these so called trade sales are used for successful investments as well as some that only broke even (Mason & Harrison, 2002). Atrill (2009) indicates that from all the investment done by angels, around 26 percent ends with a trade sale to another company. Selling to other shareholders, including management buyout

and selling to a third party are other exit possibilities that are used regularly. According to Atrill (2009) selling to other shareholders happens with 16 percent of the investments, while selling to third parties happens with 10 percent of the angel investments. Mason and Harrison (2002) indicate that exits through sales to other shareholders or third party shareholders are primarily used for “living dead” investments.

Where initial public offerings are used frequently by venture capitalist, this exit possibility is not used much by angel investors. In the angel market initial public offerings are rare and considered a home run, since most start up firms will not be at a stage were a public offering is feasible (Prowse, 1998). Moreover, because of the high fixed costs involved in organising an IPO, they are only feasible for larger companies that are able to justify a significant market capitalisation. Lastly, it is much easier to find a company that is willing to purchase, sometimes at a high price, smaller businesses for strategic reasons (Mason & Harrison, 2002).

Not all angel investor can exit the investment with a capital gain. In his research Attril (2009) indicates that 40 percent of the investments need to be written off as a loss. According to Wiltbank (2009) this percentage is even higher; he states that 56 percent of exited investments are at a loss, with most of them losing the whole investment. Mason and Harrison (2002) make a distinction between a total loss and a partial loss or break even. According to these researchers 34 percent of the exits take place with a total loss of the investment and a further 13 percent generates either a partial loss or break even in nominal terms.’ On the other hand, Wiltbank (2009) finds that 44 percent of the exits are at substantial gains, and Mason and Harrison (2002) add that around 10 percent of the investments generated internal rates of return in excess of 100 percent.

CHAPTER 5: Case study Money meets Ideas

The results presented in this part of the paper are derived from a personal interview with Hendrik van der Meulen, from the consultancy company KplusV and a visit to the platform Money Meets Ideas on May 18, 2010. Some additional information is also found in the interview with Hendrik van der Meulen and Ben Lacor from the Nebib organisation placed in Financieel Dagblad of April 24, 2010.

KplusV consultancy together with Schretlen & Co., the investment bank of the Rabobank Group, organises the informal investing platform Money Meets Ideas. The platform consists of several meetings per year to bring entrepreneur in contact with informal investors. Before contact is made between investors and entrepreneurs, entrepreneurs who would like to receive informal financing undergo a selection process. The entrepreneur and the business plan are screened by KplusV consultancy, Hendrik van der Meulen is responsible for this screening. At KplusV they select the entrepreneurs that get presentation training and who have the chance to present their business proposition to the informal investors. KlpusV therefore plays an important role in the pre-investment period. The consultancy company mediates in the first part in the investment process; they are the source for deal flows. Since KplusV and Schretlen & Co. are formal sources for angels to find an investment opportunity, the deal flow in this case study has a formal character.

After the selection by KplusV has taken place, three entrepreneurs have the chance to pitch their business proposition at a meeting with a group of around twenty informal investors. In this case study the three propositions are discussed as three separate cases. The investors are all clients of Schretlen & Co. and are looking for an investing opportunity. During the meetings entrepreneurs pitch their ideas and investors have the chance to ask questions. After the presentations and question rounds there is a discussion between the informal investors to determine the strength and weaknesses of the business proposals. If one of the investors is convinced by the entrepreneur and want to have second conversation, he can indicate this during the discussion and KplusV will let this know to the entrepreneurs. The rest of the investment process is determined by the investors and the entrepreneur themselves, they determine if they continue to cooperate. Money Meets Ideas does not mediate in this part of the process.

5.1 The business angel profile

The group informal investors visiting the Money Meets Ideas platform seems to be extremely diverse in background. However, it is safe to say that they fit the average angel profile already defined by the literature. Almost all visitors are male and beside from some exceptions the average age is between 50 and 60. During the discussion it became very clear that all of the participants have some entrepreneurial background, although the industry in which the angel used to make their own money varies highly. During the platform I spoke to angels that made their money in construction, but also the angels who were successful in ITC.

The average invest amount for the angel at the Money Meets Ideas platform is between 100.000 euro and 1.500.000 euro. As an exception, during this particular platform there was also one investment opportunity that required 4.000.000 euro. That proposition was looking for multiple investors, either formal or informal. The business angel invests either alone or with multiple investors, so that they can share the risk related to the investment project. According to an employee of Schretlen & Co., this happens regularly.

The investment is made for the financial return, but the angels also enjoy being involved in developing the new firm. The entrepreneurs expect them not only to invest money, but are also interested in their management experience, the entrepreneurial skills and their business network. This is the reason why angels like to invest in the industry in which they have some knowledge; they can use this knowledge to make the new firm successful.

Angels are patient investors. Most investment projects take several years to be profitable, and angels need to be willing to wait for this in order for their investments to have good results. Based on previous experiences angels indicated this period takes between 6 and 8 years.

5.2 Selection criteria

5.2.1 Case 1: The game platform

The first case was presented by two entrepreneurs. They presented a proposition for a enterprise that invests, develops and commercialises interactive educational games. The two entrepreneurs currently work commissioned by clients and they are looking for risk capital for the development of a game platform. The investor was asked to invest an amount of 100.000 euro and his management experience, in return the investor was offered a minority stake in the new firm.

Although most investors liked the idea of educational game platform, they worried about the profitability of the idea. Since a game platform is not protected by any patents, the competition will be fierce. The only way to stay ahead of the competitors is by delivering a superior product. For the investors it is hard to evaluate if the entrepreneurs are able to design such a platform. Therefore the risk an investor is taking when financing this proposition is high.

Next to the idea, the investor also worried about the capabilities of the entrepreneurs. The entrepreneurs are both experiences with game design, but seemed to lack management experience. All investors agreed that investing in the game platform would mean investing a lot of time to make sure the company stays on the road. One of the angels stated "these entrepreneurs seem to be more in need of a good management team, than of a capital investment.'' The entrepreneurs were not able to convince the investors that they are really personally involved and that they are familiar with the market the company will be competing in. A positive remark is that the entrepreneurs really seemed to be open for coaching. This was valued by the investors.

Finally one investor, who had a ITC background himself, was interested in having a personal conversation with the entrepreneurs. He was willing to invest in the game platform. The idea and his personal experience in the ITC business were decisive selection criteria. The investor was convinced his own experience would help lowering the commercial and agency risk.

5.2.2 Case 2: Industrial foundation

The second proposition was also presented by two entrepreneurs. The two entrepreneur recently graduated from the Eindhoven University of Technology and for their graduation they developed an innovative industrial foundation method, which has many advantages to the traditional methods. The entrepreneurs are looking for a capital investment of 150.000 euro for the first production and commercialisation of the new foundation method. Also they ask for the investor his management knowledge, since the entrepreneurs only have limited experience in managing a company. In return, investors were offered a minority stake in the new firm.

The proposition really attracted the attention of the investors. The main reason for this was the enthusiasm of the entrepreneurs. They were able to show their commitment to their idea and their knowledge of the construction market. The investors believed in the abilities of the entrepreneurs to bring their construction method to the market, and to make it a commercial success. A little criticism on the entrepreneur was their recklessness, investors were

wondering if the entrepreneurs would really want to make us of the investors his management experience.

The investors were also interested in the product. The industrial foundation method has many advantages in comparison to the old method, which makes it possible for the product to compete in the construction business. Moreover, the entrepreneurs already are in possession of a patent for this new foundation method. This decreases the commercial risk of the investment.

At last, five investors wanted to have a personal interview with the investors. They all believed in the proposition and the entrepreneurs, and were convinced the investment could be exited profitably. Surprisingly, the investor with the background in construction was not interested in investing in the new foundation method. He did not believe in the innovativeness of the product and was worried about the possibilities of entering a very conservative industry successfully.

Decisive selection criteria in the industrial foundation case are the idea and the personality of the entrepreneur.

5.2.3 Case 3: Medical supply

The third proposition is a very special one for the Money Meets Ideas platform. It is a spin out of a multinational firm that focuses on medical care. The spin out developed a sensor, that can be placed under a mattress, and can measure respiration, heartbeat and sores. The entrepreneur is planning on selling the sensor to nursing homes. In order to further develop the sensor and to bring it to the market, the spin out needs to attract an informal investor who is willing to invest in cooperation with the multinational and a formal investor. The investor is offered a minority stake in the company and a board seat.

In this proposition the most important selection criteria was the trustworthiness of the proposal. The fact that the product is develop in cooperation with a multinational made the project interesting for some investors: "Having a board seat in a board with a multinational and formal investor could be a very informative experience." On the other hand, for other investors it was a reason to become reluctant: "Why would a multinational choose to spin out a profitable project?"

Besides the trustworthiness of the proposal, also the trustworthiness of the project director was taken into account during the discussion. All investors were very impressed by his knowledge of the market, and of the product he developed. Next to that, his curriculum vita was

extraordinary, it showed that the director was well-educated and had experience in leading project teams. This was appreciated by the investors.

Another selection criterion in this case is the investing with two other big investors. Although the company is a spin out, the multination was a big shareholder and part of the finance is also provided by a formal investors. Some investors worried about their possibilities to contribute to the development of the project. If the investor is not able to contribute to the new spin out, he will face high agency risks.

The proposition attracted three possible informal investors. These three investors believed in the reliability of the project and the project director and they wanted the practice of investing with a multinational. Crucial selection criteria in this case are the business idea, the reliability of the entrepreneur and the investment experience.

5.2.4 Money Meets Ideas selection criteria

The personality of the entrepreneur and the business idea is evaluated in all three cases and therefore are important selection criteria in the selection procedure of angel investors.
An entrepreneur needs to be committed to his idea, and needs to be able to sell this idea to both the informal investor and the market. This means that angels expect the entrepreneur to be personally involved, they need to be willing to spend their own time and available resources and they need to be enthusiastic about their own proposal. Next to that it is important that the entrepreneur is trustworthy, self-conscious, and open for coaching and for the investors it is also crucial that the entrepreneur knows the market he is competing in. The product should be innovative; angels want the product to have some competitive advantage.

Following from the reaction of the angel investor in the discussion it is argued that an investment will not be made if the business idea is not convincing enough. The investor is not willing to invest his time in a personal conversation with the entrepreneurs if the does not believe the business idea is achievable. However if the proposal is convincing enough, the angel investor might be willing to give the entrepreneur a second chance to “sell” himself in a second meeting. Concluding, the product is to some extent more important than the entrepreneur.

The entrepreneur and the product are the most important selection criteria at the Money Meets Ideas platform. These criteria can be traced back to four kinds of risk that the investor is facing. First, the entrepreneurial risk; investors want entrepreneurs to have a vision, to know how to make money and how to deal with risks. It is important that the entrepreneur is

professional, and he needs to have some managerial skills next to their knowledge of the project. Angels are willing to provide the entrepreneur with the knowledge needed, but the entrepreneurs should be able to manage the firm on their own. Second, the technical risk; the risk an investors is taking is highly dependent on the development stage of the idea. Business angels are by definition early investors, but they need to have some certainty about the extent to with the product is indeed realisable. Entrepreneurs should be realistic about this; they need to have a proper business plan. Third, the commercial risk; what is the demand in the market and can the new products compete with the existing products? Angels ask the entrepreneur to state the competitive advantage of the product. An investment project is considered more interesting if the entrepreneur is in possession of a patent for the product. Fourth, the financial risk; how much capital is needed to get the idea to the market and what is the expected return? The amount of risk angel investors are willing to take varies highly. But all of the investors want the risk to be in line with the expected return. Also the percentage of ownership in the new firm should be corresponding to the investment done by both the entrepreneur and the angel investors.

5.3 The period after the selection

After the meeting at Schretlen & Co. the angel investors and the entrepreneur have several meeting to get to know each other and for the investors also to get to know the idea he will probably be investing in. If there is a “connection” a deal can be closed. On average the time between the Money Meets Ideas meeting and the actual deal closing takes several months. Since the cases described before are not yet in this stage of the investment process, it is not possible to use the case study to get in insight in this part of the investment process. However, during the interview with Hendrik van der Meulen some questions were asked about his experiences with the contract set up by informal investors and the exit route in angel investments. This part of the paper focuses on the answers to those questions and on the article in Financieel Dagblad.

5.3.1 The angel his contract

When a deal is closed and the money needs to be transferred to the entrepreneur, this has to be done with a notary. There a contact is drawn up, so all angel investors make use of contracts to ensure their investment. In this contract financial and governance related issues are clarified. The finance related issues include the investment amount and the required return

and most often also the investment period and the exit route. As already indicated the investment amount at Money Meets Ideas is between 100.000 and 1.500.000 euro and the investment period is several years.

Next to the invest amount, the investment period and the exit route also the governance issues are explained in the contract. All the entrepreneurs at the platform offered the informal investors a minority vote, ranging form 20 till 40 percent. This percentage is less if there are multiple formal or informal investors. The minority voting rights are an important discussion point before signing the contract. Whether or not an angel investor is in the board depends highly on the investment project; it is possible an angels receives a board seat, but it is definitely not always the case.

5.3.2 The post-investment period

After the contract is signed the post-investment period starts. The post-investment period on average takes between six and eight years. During this period the investor and the entrepreneur work together intensively. Already at the platform the entrepreneur asks the informal investor to provide the company with their entrepreneurial knowledge, their managerial skills and their network of business associates, in the post-investment period the entrepreneur makes us of these investments. The interference of the angel investors can be crucial for the success of the investment project; some entrepreneurs have an excellent idea but just miss the skills to manage the firm and to make strategic moves.

Once the investor wants to exit the investment he has multiple options. However the most used option is the sale to another company, so a merger or an acquisition. It is also possible that the investment is sold to a third party, most often a venture capitalist, or that there is an initial public offering. The last, but rare, option is that the investor is able to buy back the shares himself.

If the exit is successful, the investment can have good results. According to Ben Lacor from Nebib 60 percent of the investment break even or make a profit. Hendrik van der Meulen stated that out of the ten investments, six will be have a return below expectations, three will behave as expected and only one will be a real success. But also the cooperation seems to be a factor in determining the success of the investment, Ben Lacor indicated that 80 percent of the investors are satisfied with their investments.

CHAPTER 6: Conclusion

Angels appear to be extremely diverse; however there is a consensus on the definition of angel investors. Angel investors are wealthy individuals, most often middle aged and with entrepreneurial experience, who invest their money in start-up firms. Although business angels invest primarily for financial reasons, non-financial motives emerge as a very strong secondary reason to invest in a high risk start-up company (Ramadani, 2008). Angels expect to be actively involved in the firm, and therefore like to invest in industries in which they have some experience.

Just like venture capitalists, angel investors face the agency problem. However business angels invest in an earlier stage than do the venture capitalist and they encounter higher risks. Business angels invest in start-ups firms that are rife with uncertainty, information asymmetry and agent costs in the potential opportunism of the entrepreneur (Ibrahim, 2008). During the whole investment process the angel has opportunities to reduce these investment problems.

Choosing the right start-up firm to invest in, is the first step angel investors can take to protect themselves against possible expropriation, since it lowers the agency problem ex-ante. Selecting the right project can eliminate some of the risk resulting form moral hazard and adverse selection (Van Osnabrugge, 2000). The first step is finding a project that fits the investment criteria of the investor; most angels like to invest in an industry in which they have some experience. Literature also suggests that the geographic location of the investment project is important, however during the case study none of the informal investors seemed to be influenced by this. Once the project is considered, the most important selection criteria, both indicated in the literature and in the case study, for the angel investor are the confidence in the entrepreneur and the business idea. Which of these criteria is most important is dependent on the source of the deal flow. Other selection criteria are the management team, the growth potential and the exit route.

Angels also use contracts to protect their investments. Although the involvement in the start-up firm is considered a more important protection mechanism, a contract is a mean by which mutual behavioural expectations of all parties can be clarified. The contract can reduce the asymmetries of information between the angel and the entrepreneur, and it reduces the agency problem. Angel use simple contract, in which they clarify financial and governance issues. The financial issues include the finance provided, the angel his ownership share and the

exit route. The governance issues entail representation in the board and majority voting rights.

After signing the contract new possibilities for protection against expropriation arise. During this period of the investment the success of the start up firm is influenced by the participation of the angel investors. In this stage the relationship between the investor and the entrepreneur is significant, and it becomes clear why selecting the right entrepreneur to cooperate is so important. The communication between the investor and the entrepreneur determines partly the success of the investment and at the same time decrease the information asymmetry.

The final success of the investment is dependent on the investor his ability to exit the investment and realise capital gain. The exit route is most often already determined in the contract but it is important that the investor and entrepreneur determine the best exit possibility and that they facilitate the exit route together.

Currently, both literate and the case study show, around 40 percent of the investments need to be written of as a loss or break even. The other 60 percent are at a gain and sometimes investments even achieve better than expected. If angels were able to reduce the information asymmetries and agency problems by selection the rights project, formulating the rights contracts and by proper monitoring in the post-investment period, these results could improve. The uncertainty resulting from investing in a really early stage of the new start-up firm however is not something that can be changed. It is the risk angel investors are willing to take for the pleasure of starting up the new firm and for giving sometime back to the community in which they achieved their own success.

CHAPTER 7: Limitations and suggestions for further research

Despite the importance of angel investors, current research is much more focused on the venture capitalist market. In contrast to the formal venture capitalist market, angels invest in a private market. It is difficult to find and survey angels, since they do not have reporting requirements. As a consequence the current literature is limited and leaves us with a lot of questions.

In my paper I tried to give an answer to one of these question: How do angel investors protect themselves against expropriation? While many findings reported in this paper are interesting, the limitations of my study should be kept in mind. Due to time constraints it was only possible to evaluate the selection criteria of the angel investors at the Money Meets Ideas platform. Although this is an important part of the investment process, a more intensive insight could have resulted from following the investment process till the exit. In this study the only possibility to learn about the period after the investment is to rely on previous results. However it might be that different investment decisions were taken to reach these particular results, so there is no proven causality. Therefore, I would suggest that further research should focus on the whole investment process. Only than the result from a selection decision can be measured.

Next to the limitation in time, the sample used in the case study is only limited. As indicated, it is hard to find and survey angels. However in further research the data would become more reliable if the sample size would increase.

To conclude, this has been a attempt to examine the protection mechanisms of angels investors. The result are interesting, but it was not possible to identify the mechanisms in the investment process. More research on this topic is necessary to discover additional information about the investments of angels.

REFERENCES

Aernoudt, Rudy (1999). Business Angels: should they fly on their own wings? *Venture Capital, Vol. 1, No. 2*, pp. 187-195

Aernoudt, Rudy (2005). Business Angels: The Smartest Money for Starters? Plea for a Renewed Policy Focus on Business Angels*. International journal of business, Vol. 10, No. 3,* pp. 271-284

Amatucci, Frances M. & Sohl, Jeffrey E. (2004). Women entrepreneurs securing business angel financing: tales from the field. *Venture Capital, Vol. 6, No. 2*, pp. 181-196

Atrill, Peter (2009). Being an angel. Student Accountant Magazine, *Vol. 9, No. 3,* pp. 57-59

Avdeitchikova, S., Landström, H. & Månsson, N., (2008). What do we mean when we talk about business angels? Some reflections on definitions and sampling. *Venture Capital, Vol. 10, No. 4*, pp. 371-394

Benjamin, Gerald A. & Margulis Joel B. (2005). *Angel Capital: How to raise early-stage private equity financing.* Hoboken, New Jersey: John Wiley & Sons, Inc.

Berger, Allen N. & Udell, Gregory F. (1998). The economics of small business finance: The roles of private equity and debt markets in the financial growth cycle*. Journal of Banking & Finance, Vol. 22,* pp. 613 – 673

Brettel, Malte (2003). Business angels in Germany: a research note. *Venture Capital, Vol. 5, No. 3*, pp. 251 - 268

Brush, Candida G. , Carter, Nancy M. , Greene, Patricia G. , Hart, Myra M. & Gatewood, Elizabeth (2002). The role of social capital and gender in linking financial suppliers and entrepreneurial firms: a framework for future research. *Venture Capital, Vol. 4, No. 4,* pp. 305-323

Casamata, Catherine (2003). Financing and advising: Optimal financial contracts with venture capitalists. *The Journal of Finance, Vol. 58, No. 5,* pp. 2059 - 2085

Clark, Colin (2008). The impact of entrepreneurs' oral 'pitch' presentation skills on business angels' initial screening investment decisions. *Venture Capital, Vol. 10, No. 3,* pp. 257-279

Cohen, Shira (2007). Best practice guidance for angel groups – deal screening. Retrieved from http://ssrn.com/abstract=1291761

Collewaert, Veroniek (2009). The pre- and post investment relationship between angel investors and entrepreneurs: the scope and impact of information problems and conflicts. Retrieved from: http://www.feb.ugent.be

Collewaert, Veroniek & Manigart, Sophie (2009). First round valuation of angel backed companies: the role of investor human capital. Working paper. Retrieved from: http://www.vlerick.com/en/knowres/domains/5-VLK/g1/12561-VLK.html

Eyler, David (2007). Best practice guidance for angel groups – Due diligence. Retreived from http://ssrn.com/abstract=1291786

Feeney, Lisa , Haines Jr, George H. and Riding, Allan L.(1999). Private investors' investment criteria: insights from qualitative data. *Venture Capital, Vol. 1, No. 2*, pp. 121-145

Fenn, George W., Liang, Nellie (1998). New resources and new ideas: Private equity for small businesses. *Journal of Banking & Finance, Vol. 22*, 1077-1084

Fenn,. George W. , Liang, Nellie & Prowse Stephen (1997). The private equity market: an overview. *Financial Markets, Institutions & Instruments, Vol. 6, No. 4*.

Fishback, Bo, Gulbranson, Christine A., Litan, Robert E., Mitchell, Lesa & Porzig, Marisa (2007). Finding Business “Idols”: A New Model to Accelerate Start-Ups. *The Kauffman Foundation*

Freear, John, & Wetzel, William (1990). Who Bankrolls High-Tech Entrepreneurs? *Journal of Business Venturing*, *Vol. 5*, pp. 77–89.

Freear, John, Sohl, Jeffrey E. & Wetzel, William. E. Jr. (1994). Angels and non-angels: Are there differences? *Journal of Business Venturing, Vol. 9*, pp. 109-123

Freear, John, Sohl, Jeffrey E. & Wetzel, William. E. Jr. (2002). Angles on angels: financing technology-based ventures - a historical perspective. *Venture capital, Vol. 4, No. 4,* pp. 275-287

Gracie, Sarah (1999). Pennies from heaven. *Director, Vol. 52, No. 7,* pp. 40-43

Hindle, Kevin & Lee, Leo (2002). An exploratory investigation of informal venture capitalists in Singapore. *Venture Capital, No. 4, Vol. 2*, pp. 169 - 177

Hoberg, Gerard, Goldfarb, Brent D., Kirsch, David &Triantis, Alexander J. (2009). Does Angel Participation Matter? An Analysis of Early Venture Financing. *Robert H. Smith School Research Paper No. RHS 06-072*. Retrieved from: http://ssrn.com/abstract=1024186

Harrison, Richard, Jungman, Hannu & Seppä, Marko (2008). From Capital Investors to Knowledge Investors: The Rise of Entrepreneurial Venture-to-Capital. *Frontiers of e-business research, 2004*

Ibrahim, D.M. (2008). The (not so) puzzling behaviour of angel investors. *Vanderbilt Law Review, Vol. 61, No. 5,* pp. 1405

Ibrahim, Darian M. (2009). Financing the next silicon-valley. Retrieved from http://ssrn.com/abstract=1272957

Jensen, Mark(2002). Angel investors: opportunity amidst chaos. *Venture Capital, Vol. 4, No. 4,* pp. 295 - 304

José, Amparo San , Roure, Juan andAernoudt, Rudy (2005). Business Angel Academies: Unleashing the Potential for Business Angel Investment. *Venture Capital, Vol. 7, No. 2,* pp. 149 – 165

Kaplan, Steven N., Klebanov, Mark. M, & Sorensen, Morten (2008). Which CEO Characteristics and Abilities matter? Available at: http://ssrn.com/abstract=972446

Kelly, Peter & Hay, Michael (2003). Business angel contracts: the influence of context. *Venture Capital, Vol. 5, No. 4,* pp. 287-312

Landström, H. (1998). Informal investors as entrepreneurs. *Technovation, Vol. 18, No. 5,* pp. 321-333

Lerner, Josh (1997). Venture capital and private equity: A course overview. Available at SSRN: http://ssrn.com/abstract=79148 or doi:10.2139/ssrn.79148

Leshchinskii, Dima, (2002). Indulgent angels or stingy venture capitalists? The entrepreneurs' choice. *Les Cahiers de Recherche 769, HEC Paris.*

Macht, Stephanie (2006). The Post-Investment Impact of Business Angels upon their Investee Companies. *Institute for Small Business & Entrepreneurship*

Mason, Colin M. & Harrison, Richard T. (2002). Barriers to investment in the informal capital sector. *Entrepreneurship & Regional Development, Vol. 14,* pp. 271-287

Mason, Colin M. & Harrison, Richard T. (2002). Is it worth it? The rates of return from informal venture capital investments. *Journal of Business Venturing, Vol. 17,* pp. 211–236.

Mason, C. & Stark, M. (2004). What do Investors Look for in a Business Plan?: A Comparison of the Investment Criteria of Bankers, Venture Capitalists and Business Angels. *International Small Business Journal, Vol. 22, No. 3*, pp. 227-248

Maula, M., Autio, E. & Arenius, P. (2005). What drives micro-angel investments*? Small Business Economics, Vol. 25*, pp. 459–475

MIT Entrepreneurs centre (2000). Venture Support Systems Project:
Angel Investors. Retrieved from entrepreneurship.mit.edu/Downloads/AngelReport.pdf

Morrissette, S.G. (2007). A profile of angel investors. *The Journal of Private Equity, Vol. 10, No. 3,* pp. 52-66.

Paul, S., Whittam, G. & Wyper, J. (2007) Towards a model of the business angel investment process, *Venture capital, Vol. 9, No. 2,* pp. 107–125.

Prowse, Stephen (1998). Angel investors and the market for angel investments. *Journal of banking and fincance, Vol. 22,* pp. 785–792.

Ramadani, Veland (2008). Business angels , who they really are. *Strategic Change: Brifings in Entrepreneurial Finance, Vol.18, No. 7/8*, pp.249-258

Sarasvathy, S. D. & Wiltbank, R. (2003). Business Angel Network. *Blackwell Encyclopedia of Entrepreneurship, edited by Mike Hitt and Duane Ireland*

Schipper, Lizanne (2010, April 24). Een belegger met het nodige zitvlees. *Financieel Dagblad*

Sørheim, Roger (2003). The pre-investment behaviour of business angels: a social capital approach, *Venture Capital*, *Vol. 5, No. 4*, pp. 337-364

Stavrand, Paul (2007). Best practice for guidance for angel groups – Post investment monitoring. Retrieved from http://ssrn.com/abstract=1291770

Sudek, R., (2006). Angel investment criteria. *Journal of Small Business Strategy, Vol. 17, No. 2,* pp. 89-103.

Szerb, László, Terjesen, Siri & Rappai, Gábor (2007). Seeding new ventures-- green thumbs and fertile fields: individual and environmental drivers of informal investment. *Jena Economic Research Papers 2007-030*

Tingchi, Matthew Liu & Chang, Bryant Chen Po (2007). Business angel investment in the China market. *Singapore Management Review, Vol. 29, No. 2,* pp. 89

Wetzel, William E., Jr. (1983). Angels and Informal Risk Capital. *Sloan Management Review*, *Vol. 24, No. 4*, pp. 23–34.

Wiltbank, Robert (2005). At the Individual Level: Outlining Angel Investing in the United States. *University of Illinois at Urbana-Champaign's Academy for Entrepreneurial Leadership Historical Research Reference in Entrepreneurship.* Retrieved from http://ssrn.com/abstract=1509255

Wiltbank, Robert (2005). Investment Practices and Outcomes of Informal Venture Investors. *Venture Capital: International Journal of Entrepreneurial Finance, Vol 7, No. 4.* pp. 343-357

Wiltbank, Robert (2009). Siding with angels. Business angels investing – promising outcomes and effective strategies. Retrieved from http://www.bbaa.org.uk/index.php?id=336

Wiltbank, R. & Boeker, W. (2007) Returns to angel investors in groups. Retrieved from: http://ssrn.com/abstract=1028592

Wiltbank, R. & Sarasvathy, S. (2002) Selection and return in angel investment. Paper presented at the Babson Conference, Boulder, CO, 5–9 June, http://www.effectuation.org/ftp/Angels.doc

Wiltbank, R.E., Read, S., Dew, N. & Sarasvathy, S.D. (2007). Prediction and control under uncertainty: Outcomes in angel investing. *Journal of Business Venturing Vol. 24 (2009,)* pp. 116-133

Wong, Andrew (2002). Angel finance: the other venture capital. Retrieved from http://ssrn.com/abstract=941228

APPENDIX 1: Interview KplusV

What is KplusV?

KplusV is an organisation that advises others organisations in all kinds of problematic cases. They work together with governments and businesses on topics as climate change, new business and innovation, management and development and more.

How are KplusV and Money Meets Ideas related?
KplusV is the idea part of Money Meets Ideas. In the past KplusV has clients that had business ideas and who where looking for investors. Often it was not possible to finance the idea with money of friends and family, and the project is too risky to be interesting for banks.

KplusV got in contact with Schretlen, an investment bank from the Rabobank Group. They had a lot of clients that were cash-out ex-entrepreneurs and who wanted to do more with their money than regular investing on the stock exchange.

Through money meets ideas the good ideas get contacted with the investors money by the use of a platform. On this platform some entrepreneurs, who are selected bij KplusV get the chance to present their ideas to the investors.

The steps from idea to platform

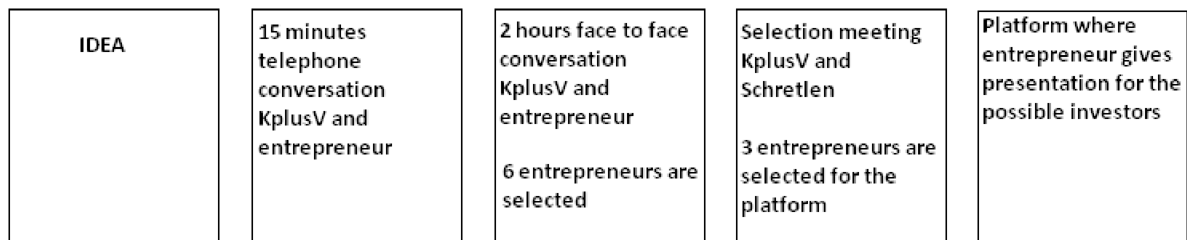

Figure 1: Steps Money Meets Ideas

First the entrepreneur has an idea that he wants to propose to KplusV. An employer of KplusV contacts the entrepreneur and checks if the idea is good for Money Meets Ideas, is it realistic and does the investment amount fit the investors of Money Meets Ideas? Next Hendrik van der Meulen has a two hour conversation with the entrepreneur. The goal of this conversation is mainly to get to know the entrepreneur, as he is the most important factor in the possible success of the new firm.
Of course also the business plan and risk of the investment are evaluated. Hendrik van der Meulen selects six entrepreneurs which will be discussed in the meeting with Schretlen. At this meeting three entrepreneurs are chosen who fit the interest of the investors. Also important is that the three chosen entrepreneurs are not in the same sector, do not have the same risk and need different capital amounts. Finally the three entrepreneurs get the chance to present their idea to the investor. If one of the investor is interested he will get the contact information of the entrepreneur are from that point the investor and entrepreneur have to arrange everything themselves.

Can you describe the average investor?

I will meet the investors at the platform in May.

The average informal investor is male and is an ex-entrepreneur. Money meets ideas has an investment criteria: between 100.000 and 1.500.000 euro.

Do you have contact with the entrepreneur? What are important characteristics?

The entrepreneur is the most important selection criteria. In a two hour conversation Hendrik van der Meulen wants to get to know the entrepreneur, he will be vital in the success of the idea. The idea is ranked second.

- An entrepreneur needs to be committed.
- He needs to be able to surround himself with talent. It is important that an entrepreneur is aware of his own weaknesses and that he finds people who can compromise for these weaknesses. This way everything gets done in the proper way and the entrepreneur can focus on his strengths.
- Following from this he needs to be self-conscious.
- He needs to be able to “sell” his idea. Often people are technical geniuses, but it is important that the product gets to the market. The entrepreneur is responsible for this.
- It is important he is open for coaching. If he has to “sell” his idea to the investors he has to be willing to get some critics.
- Trustworthy is a really important characteristic. A band of trust will develop between the entrepreneur and the informal investor.
- He needs to have vision. He has to know what he want and preferably today, not tomorrow.
- Leadership capability.

Which criteria are used to select a good business plan?

- **Industry**
- **Growth potential**
- **Market risk**

- The new firms need to have to provide capital. It is not enough if the organization is profitable enough to earn the entrepreneur a salary. The organization needs to have growth potential so that the investors can be rewarded for the risk they are taking. This can be reached with patents and advantages of scale.
- The company needs to have USPs (Unique selling points). It is important to be a step ahead of your competitor.
- The valuation needs to be right. If the investor pays 1 million for an idea with a lot of risk, which is not going to the market very soon, he might requires more shares.
- The use chances they see: tom-tom, brainwash. Sometime the law changes and this creates opportunities. Also sometimes people just have needs that are not fulfilled or an original market can be adapted.
- Additional financing. Does the entrepreneur needs more capital? Who is going to provide this?

When selecting a business idea, do you keep in mind the investors preferences?
To a certain degree. In a meeting six entrepreneurs are discussed with Schretlen. If they see a plan that perfectly suits a specific client, they have a high change of being selected. The most important thing is that is a good idea and that the entrepreneur has a connection with the investor. Therefore we do not only use the profile of investors to determine if they will be likely to invest.

Do angels use contracts?
When a deal is closed and the money needs to be transferred to the entrepreneur, this has to be done with a notary. There a kind of contract is drawn up.

In this contract the investment amount is clarified and most often also the investment period and the exit route.

Is the investor actively involved in the firm?

The investors are a very heterogeneous group of people and the extent to which they are active in the firm varies. Some of them really cooperate with the entrepreneur, others have a seat in the Board of Directors and again others only ask for financial reports.

However all investors are asked to provide "smart money". This means that the intention exist to use the knowledge or maybe the network of the investors to stimulate the growth of the firm.

What is the time period of the average investment?

The average invest period is between six and eight years. This really depends on the type of investment and the period it will take to get the idea to the market.

You can imagine that investment in an internet company takes less time than in a development of a new medicine.

What is the return on investment?

Angel investors require a higher return than a bank. The reason for this is that angels take high risks if they invest in start-up firms.

If the angels requires a compensation of for example 10 percent, but most investment fail or have of lower ROI than an angel should ask for more to get an average ROI of 10 percent.

Of course there are some non-financial motives to be an angel, but the required return is high.

How do angels exit the investment?

There are multiple options for the investors to exit the investment.

- Sometimes the new firm does not succeed and all money is lost.
- A venture capitalist might take over the investment
- There might be a merger or acquisition

- Possible there is an IPO
- It happens that the entrepreneur is able to buy back the investors shares.