Equity Financing: Partnering with an Angel Investor

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Business financing options generally fall into two categories: debt funding and equity funding. Debt funding refers to money that is loaned to a company with the expectation that it will be paid back, usually with interest, within a given timeframe. A lender does not have an ownership stake in the business and is not involved in the management, operation or strategic positioning of the firm. Debt financing can be short-term or long-term, and it may take the form of a loan, line of credit, an IOU or some other type of lending contract.

Equity financing refers to money that is derived from selling an ownership stake in the company to individual or institutional investors. The advantage to equity financing is that the money does not have to be paid back since, as long as the business makes a profit, the investors garner returns from the increased value of their holdings. The greatest disadvantage to equity financing is that it usually involves relinquishing autonomy and ceding a certain amount of control to the investors. In exchange for their investment, equity financiers expect to have a say in how the business is run and participate in important decisions that are made. While these investors often bring valuable business acumen, expertise and experience to the table, conflict can arise when the firm's management and investors disagree on key matters.

Angel Investors

Angel investors generally look for start-ups or young companies with high growth potential. They understand that it may take several years for an investment to pay off, but they expect ultimately to be well rewarded for the risk they take on. Angels usually have entrepreneurial experience, and they often like to play an active role in the businesses they invest in, serving as a member of the board, a close advisor to the principals, and/or a strategic or operational consultant. An angel's investment may range from a few hundred thousand dollars to tens of millions.

Angels generally involve themselves in industries they are familiar with, and, if they see potential in a company, they may refer other investors who then participate as part of an informal network or syndicate, thus pooling their resources and distributing the risk.

Finding Angels

In most cases, one needs to be referred to an angel investor. Thus, when seeking investors, a good first step is to get the word out among trusted connections.

The organization's corporate banker may know potential investors. Within the community, focus on business owners who might be or might become angel investors, or know other angels. Tap into local business and trade organizations and check with the local chamber of commerce or the regional economic development center to see if there is an active group of angel investors in the community.

There are a number of organizations that link angel investors with entrepreneurs, start-ups and growth companies. Angel Capital Association (http://www.angelcapitalassociation.org) is an example. This and other national, regional and local groups bring angels together to discuss deals and communicate about new business opportunities. Some of these networks charge fees while others require funding applicants to go through a screening process or even be sponsored by a member.

A list of angel networks can be found on the Inc. website (http://www.inc.com/articles/2001/09/23461.html). The list is broken down into geographic regions and industry sectors. Other resource sites include Go4Funding (http://go4funding.com) and AngelList (http://www.angel.co/investors).

Even if you are not able to connect with an angel investor via one of these matching sites, you can use them to get your business proposal before a wider audience. Another way to gain wide visibility is to create a profile on the Go BIG Network (http://www.gobignetwork.com). Go BIG allows you to search for and directly contact potential investors based on designated criteria such as your firm's investment stage, industry and geographic location.

A good fit

Equity financing is not the right funding solution for every business as it involves sacrificing a degree of ownership, autonomy and control. Owners and executives must weigh this against the possibility that their business could flounder because of insufficient capital.

On the other hand, an angel investor whom management trusts and can learn from can be a boon to an organization. Besides providing the capital, an angel investor can provide advice and know-how, and help drive the company to profitability and success.

Locating, identifying and connecting with an angel investor are painstaking, time-consuming processes that can take months or even years. Most successful investors are inundated with opportunities to invest, and it takes considerable effort—and a bit of good luck—to be invited to make a pitch. An experienced outsourced financial services provider can be invaluable in facilitating this process, not only helping to find an appropriate equity financing source, but also assisting to negotiate and structure an equity agreement that meets the needs of all parties.

About CFO Edge

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