Strategies for attracting angel investors

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Abstract

In the early stages of corporate growth, biotechnology entrepreneurs can attract funding from a particular category of investor: the 'angel' investor. This paper describes different types of angel investors and discusses the role angel investors play in providing funding, advice and contacts to early-stage biotechnology companies. Further, some of the qualities angel investors seek in the companies in which they invest are reviewed, and techniques that biotechnology entrepreneurs can employ to increase the likelihood of obtaining funding from angel investors are discussed.

INTRODUCTION

In today's biotechnology sector, the task of securing investment in the private (and public) markets seems next to impossible. Although news reports lead us to believe that there is 'plenty of money out there waiting on the sidelines', it is hard to find investors who are willing to loosen their purse strings and fund the potential medical breakthroughs of tomorrow. Investors are gun-shy, and with good reason, not only because of uncertain market conditions but also because of legislative threats to drug pricing, the poor performance of recent end-stage product candidates, the absence of a Commissioner at the US Food and Drug Administration (FDA), and a wave of mergers and acquisitions that has reduced the number of large pharmaceutical companies which are potential customers and acquirers of biotechnology start-ups.

Despite this shortage of willing investors, medical research continues to generate great ideas that, if implemented, could dramatically change the future of healthcare. We are living in a time of remarkable discovery. Significant progress has been made in unravelling the mysteries of the human body, notably the recent elucidation of the human genome, which affords researchers the opportunity to discover the proteins and structures that the genome encodes to form a living being.

Laboratory discoveries funded by academic institutions, government grants, foundations or corporate sponsorships may become key technologies that serve as the foundation for new biotechnology companies, which turn creative ideas into practical advances in medical care. But prospective bioentrepreneurs face a vicious cycle: it takes data to get dollars, and dollars to get data. Once the seed money has run out, the entrepreneur must find an early-stage investor to break the cycle.

This paper discusses what a particular type of early-stage investor, the 'angel', looks for in an emerging biotechnology company and describes some of the strategies entrepreneurs can adopt to improve their chances of attracting an angel.

UNDERSTANDING ANGEL INVESTORS

Who are angel investors? They are called angels because the funding they provide often seems heaven-sent at a time when the friends-and-family money is exhausted and the company has not yet developed the products or revenue to attract later-stage investors. Many angel investors are wealthy individuals who believe in the entrepreneur or have a close personal interest in the products or missions of the companies they support. They may have lost loved ones to cancer, multiple sclerosis, Alzheimer's disease or another illness for which there is no known cure, and they want to contribute to the eradication of the disease. Angels may invest individually or band together informally or in networks to consider attractive biotechnology opportunities.

Angel clubs and private and government-sponsored investment entities also provide early-stage capital for biotechnology companies. In the USA, most angel clubs and entities have a local or regional focus. In the Washington, DC, region, for example, these clubs and entities have promoted the development of one of the largest concentrations of biotechnology start-ups in the USA. Angel clubs in this region include the Maryland Angels Council, in which each member contributes US$100,000 to a fund that invests in biotechnology and information technology companies with the advice of an experienced venture capitalist, and The Dinner Club, a group of angels who have formed a fund that invests US$500,000 to US$1m in promising start-ups, including life sciences companies. MDBio, Inc. is an example of a private, non-profit angel investment entity in the same region. MDBio, Inc. invests up to US$200,000 in Maryland biotechnology companies in exchange for equity or, in the case of very early-stage companies that are difficult to value, royalties in future revenue streams. Government-sponsored investment entities often focus on supporting companies that are likely to create many jobs, in addition to providing a return on investment. While many angels in the UK also have a local or regional focus, start-up companies can seek help from the National Business Angels Network Limited, an angel network with a national scope that introduces entrepreneurs to angels willing to invest as little as £20,000 in start-up companies.

Trust is essential in the relationship between angel and entrepreneur

Angels seek intellectual reward and profitable 'exit strategy'

The best angels offer expertise and introductions

ANGELS CONTRIBUTE MORE THAN MONEY

'Ideal' angel investors often take the form of experienced, successful biotechnology entrepreneurs. They are locally based and have time to share their expertise with the company's management. They introduce the company to other angel investors, attorneys, accountants, scientists and clinicians who have been members of their team in earlier ventures.

Not all angels come from heaven, however. Some may be devils in disguise. Although angels can move quickly, they also can draw out the funding process by failing to follow through on their funding commitments. Inexperienced angels can give bad advice, costing the company time and money. To avoid harmful angels, entrepreneurs should conduct a little due diligence of their own to learn more about the skills, personality and track record of each prospective angel. Online searches and industry publications may shed light on the potential angel's professional and investment experience. The founders of other companies in which the angel has invested are in a position to give the entrepreneur a good idea of what he or she may expect from the angel. Finally, entrepreneurs should follow their instincts: does the angel seem trustworthy? A relationship of trust between angel and entrepreneur is an essential ingredient in a successful venture. While a heaven-sent angel provides welcome support and sound advice, interference by an angel lacking knowledge of the company's industry or products can hamper the company's growth at a critical early stage.

ANGELS SEEK INTELLECTUAL AND FINANCIAL REWARDS

What do angel investors want in exchange for their investment? Angels want involvement that produces emotional and intellectual reward. They also want an 'exit strategy'. How do they get their investment back, with a profit? Experienced angel investors have learned to be patient and to have realistic expectations about the timeline for the development of a biotechnology company's products. In information

A business plan should contain realistic projections

Angel investment may facilitate later financing

A strong management team is critical to a company's success

Patent applications demonstrate the value of a company's intellectual property

technology, concepts can be commercialised in three to five years or less, but in biotechnology it takes well over a decade to commercialise new ideas and for companies to become profitable. In the pharmaceutical field, for example, it takes an average of 12 years and over US$800m (including the cost of all of the failures) to select one drug to bring to market from the thousands of initial drug candidates. Few angel investors want to stay the course that long; they tend to prefer an earlier exit, whether through a public offering or a sale of the company to a larger firm. The early involvement of angels may facilitate later financing transactions, however, since angels often have connections with the venture capitalists who supply the next rounds of financing, or relationships with institutional investors or investment bankers that can prove essential to the company's financial growth.

So how does an entrepreneur attract the attention of the angels? Angels will not invest on faith alone. They need to see a very promising scientific platform coupled with top-notch scientists and managers, and a realistic, well-thought-out business plan. Founding entrepreneurs must pay very close attention to the people they hire and with whom they associate, since these people will be critical to the success or failure of the enterprise – and sophisticated angels are well aware of this. The founding group of scientists and business people is as critical to the success of the venture as the potential for the technology platform identified by the entrepreneur. Angels are much more likely to be impressed by a potential biotechnology breakthrough if a team of experienced scientific and business managers is in place to exploit it.

Write a persuasive business plan

Angels want to know that the entrepreneurial team has considered how to develop and launch the company's products and eventually make money, so a persuasive business plan offers more than a description of the technical details of proposed scientific developments. The business plan also should contain realistic financial projections for the company's first few years and offer an honest assessment of the technical, regulatory and financial hurdles the company will face before its products are ready for the market. Many business plans are unduly optimistic about the degree of competition the company's products will face, but sophisticated angels are rightly sceptical about claims that an entrepreneur has found an unoccupied niche in the crowded biotechnology marketplace.

Prepare a convincing presentation

The way the management team presents the business plan, in writing and in person, may make all the difference in winning angel backing. Since many angels receive dozens, even hundreds, of business plans each year, a concise plan – in most cases, 30 pages should be the limit – with an executive summary of 1–3 pages will attract angels' attention rather than test their patience. Before presenting a plan in person at a 'beauty contest', entrepreneurs should try out their presentation before a critical but friendly audience. The same principle applies to the written plan. Since a poorly drafted, unrealistic document drives investors away, entrepreneurs should ask their legal, financial and scientific advisors for a critical assessment of their plans before submitting them to potential angels.

Protect your intellectual property

All but the least sophisticated angels will want to conduct due diligence on the company and its products, embryonic as they may be. Much of the value of the company lies in its intellectual property, and angels will expect the management team to take the necessary steps to protect the company's innovations. At an early stage, and preferably before approaching investors, entrepreneurs should consult an intellectual property lawyer about filing

Overstated valuation may hurt start-up in later rounds of financing

Founders should allow angels to profit from investment

Angels expect founders to contribute capital

patent applications. A well-drafted patent application will contain broad claims that show prospective angels that the company is developing a versatile platform with many applications rather than a single product with a limited range of uses. If partners or other collaborators have helped develop the company's technology, the entrepreneur should make sure that they have assigned to the company their interests in any patentable inventions that may be embodied in the company's products. Angels feel insecure if third parties may assert rights to the intellectual property in which the angels are investing.

Invest alongside your angel

Angels also expect entrepreneurs to show faith in their business plans by investing alongside the angel. After all, why should angels put their capital at risk in ventures that the entrepreneurs themselves will not fund? Although angels are often in a position to write bigger cheques than entrepreneurs, they generally expect entrepreneurs to invest a significant amount of their own net worth in their companies. This investment is more than just a demonstration of the entrepreneur's confidence in the future of the fledgling business: angels know that an entrepreneur is likely to work harder to create a successful start-up when his or her own nest egg is at stake.

Value your company realistically

Even after the entrepreneur has found an angel, he or she faces one of the hardest steps in securing the investment: agreeing with the angel on how much the company is worth. Understandably, entrepreneurs are excited about their companies' prospects – they would hardly have ploughed their time, effort and money into their fledgling businesses otherwise – but optimism untempered by realism often leads to an inflated sense of a company's valuation. If an entrepreneur insists on too high a valuation for the company, angels will keep their purse strings drawn. Even if angels are willing to back the company, an excessive angel-round valuation will lead to trouble later on when the entrepreneur seeks venture financing and faces a lower, more realistic valuation. The angels will want to reprice their equity at the lower valuation. Keep in mind that angels deserve a chance to make some money from the early-stage companies they support. After all, that is one of the primary reasons they have agreed to invest. If the company is successful, the entrepreneur will be amply rewarded, and angels who have enjoyed a healthy return are more likely to back the company in later funding rounds by making additional investments or encouraging others in the investment community to participate.

CONCLUSION

Remember that the best angels offer companies more than a replenished bank account. Seasoned, sophisticated angels provide 'smart money' – cash coupled with sound advice on building a business and useful contacts in the scientific and investment communities. These angels are put off by entrepreneurs who are willing to accept only the money and not the added value. Angels, like everyone else, welcome respect and appreciation, and are unlikely to back an entrepreneur who offers neither. An entrepreneur who takes a cooperative approach in dealings with investors is more likely to attract and retain the most valuable of the angels – the ones with the smart money.

Funding the transformation of a technical breakthrough into a commercial success is one of the greatest challenges facing the bioentrepreneur. With the right strategies in place, bioentrepreneurs can increase the odds that their companies will end up on the side of the angels.

ADDITIONAL INFORMATION

For additional information on angel investors and on early-stage investing generally, visit the following web sites:

UK

- British Venture Capital Association URL: http://www.bvca.co.uk
- National Business Angels Network Limited URL: http://www.nationalbusangels.co.uk

USA

- National Association of Seed Venture Funds URL: http://www.nasvf.org
- National Venture Capital Association URL: http://www.nvca.com