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Business Angels: The Key to Unlocking Economic Growth

BY NELSON GRAY

In Caribbean economies, SMEs play a critical role in sustainable economic and social development. CARICOM estimates that SMEs account for more than 70% of jobs in the Caribbean region. They are therefore pivotal to this region's economic stability, and it is in this SME category that we observe the majority of high growth potential firms. This is important as innovative, high growth firms are the bedrock of economic growth. They create more jobs (including higher paid jobs), than older established companies; usually have higher levels of productivity; and, critically for the region, tend to be more export orientated. They are more likely to seek out international joint ventures and strategic alliances.

A report by the UK-based National Endowment for Science, Technology and the Arts (NESTA) highlighted that these high growth companies, perhaps just 6% of all companies started, generated the lion's share of employment growth – over 50% of all new jobs. However, innovative, high growth companies can sometimes experience difficulty in accessing finance from traditional sources such as commercial banks. As a result, many exciting new ventures fail to launch. However, Angel investors (angels) present a possible solution to this challenge

What is Angel Investing?

Angel investing is the process through which angels invest their own capital in entrepreneurial ventures. These investments are generally in unquoted companies with no family connection to the angel and where the angel may take an active role in the business, hoping to use his or her experience to help the business succeed. Angel capital is a private equity asset class in which individuals invest for high order capital returns on equity investments that support rapid value growth of commercial ventures. Angel investors are typically reasonably wealthy individuals who invest their own money, time and expertise into

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entrepreneurs whose concepts and enthusiasm excite them, and which demonstrate the potential for high investment return. The combination of finance and practical support angels provide is often referred to as "smart money." A 2010 survey of business angel-supported firms showed that many considered the business angels' contacts and know-how to be even more important than the provision of finance.

Addressing a Critical Funding Gap

While venture capital (VC) firms often gain most attention, particularly from governments, globally angels are the ones that actually fund almost all high growth business. In the US, possibly the most developed capital market in the world, formal VCs funded around 4,400 companies in 2014, while angels funded over 73,000. In Europe VCs provide an estimated 3.2 billion of funding compared to the 5 billion provided by angels. No surprise then that the EU described angels as "essential."

Angel investing, although now commonly associated with the TV series Shark Tank, has a long history. In 1874, Alexander Graham Bell used angel funding to found Bell Telephone, and five angels gave Henry Ford US$40,000 in 1903. More recently, Google, Skype, Twitter and Amazon were all angel funded. With such high profile success stories, one would think there would be a host of individuals scrambling to be angels. Unfortunately, while we hear about companies that have had mega successes, this form of investing is very, very high risk, with as many as half of funded businesses failing to return anything to their investors. Add to that the time it takes to find and assess such investments, and to help and coach the entrepreneurs after an investment is made. As a result, it can prove hard to persuade busy business people to get involved.

Organising the Angels

Trying to be an angel on one's own is difficult, as one would have to grapple with where to find the best deals, the tips and tricks of success and where to learn about new industry sectors and technologies. To address these issues, infoDev has been working with experienced angels from outside the region to help local champions establish angel groups in the Caribbean and to encourage angels to invest together and to share knowledge and the work.

The advice provided has included how to best recruit new angels, organise groups and structure pitch meetings, screen investment propositions, carry out due diligence, agree on valuations and structure investments.

"Being part of an angel group makes investing easier, and more fun. I can spread my risk by making smaller investments into a larger number of companies and do it with some colleagues I would not otherwise have the chance to work with."
Joe Matalon, Founder, First Angel Jamaica.

For an angel group to be established, the relevant stakeholders first have to find a champion. The champion will have the responsibility of: bringing together similar like-minded, high net worth individuals to convince them that being an angel investor is worth their time and money; leading the way by example, in making investments; and sometimes being the face of the group. It is also critical for the group to source a group manager before they start meetings. This manager ideally should have good administrative skills, the respect of the angel members, and skills in business and entrepreneurship. The manager can be a business development professional, a fellow angel investor, or come from a development agency. The manager is tasked with organising regularly scheduled meetings, and screening the

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entrepreneurs seeking to pitch to the angel group for funding. Before an angel group begins seeing pitches, it should first meet to discuss what types of businesses the members are interested in investing in, the group's common investing philosophy, ethical standards and important administrative issues.

Active and developing groups of angels can now be found in Jamaica, Barbados, and Belize, with a show of interest in starting groups across the Caribbean. Of critical importance for local entrepreneurs is that these angel groups are easy to find and contact; they are open to everyone with a good proposition, not just those who happen to have family or social connections; and their websites give information on their processes, the timing of their meetings and any special requirements they may have, such as the use of a specific form of application or pitch deck.

First Angels Jamaica, based in Kingston, completed their first investment in May 2015, into DRT Communications, a marketing communications consulting agency that has launched the Caribbean's first full-service media monitoring service, and are on the verge of completing several more deals. Alpha Angels of Montego Bay and the Barbados-based Trident Angels have also been actively looking at companies and anticipate completing investments soon.

"I benefited from angel funding when I started in business. Becoming an angel investor myself, and helping others, seemed the right thing to do." *Dereck Foster, Founder, Automotive Art & Trident Angels.*

Part of the success in growing the interest in angel investing in the Caribbean has been showing that it's not just about startup technology companies. Angels are willing to consider investment in businesses of all ages and stages of development (the oldest we have seen come forward in the Caribbean was started in 1940), and in all sectors. Caribbean angel groups have been looking at all sorts of companies – from software and apps, manufacturing, and services to retail (the latter perhaps motivated by the story of English angel Ian McGlinn who turned £5,000 into £150 million when he invested in Anita Roddick's startup beauty products business, the Body Shop).

While it is exciting to see the growth in availability of angel funding in the region, entrepreneurs need to carefully consider whether it is the right type of funding for their businesses. The first consideration is whether they are ready to take on what is, in effect, a long-term business partner. Angels typically invest by purchasing equity, an ownership interest in a company; will to want to provide practical help and advice, as well as funding; and will look to have a seat on the board of directors. Entrepreneurs taking angel funding must be willing to share some of the control and decision-making within the business. For many entrepreneurs, this involvement and the investor's business experience and contacts are seen as being even more valuable in helping to grow the company than the cash. Angels are often said to

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be investing "entrepreneurial capital", as most are themselves successful entrepreneurs who have "been there, done that".

"My investors are really supportive, but they don't just sit there patting me on the head like a puppy. They are pushing and demanding, but in a good way, like a sports coach pushing me to achieve more and more."
Danielle Terrelonge, Founder & CEO, DRT Communications Ltd

Angels have personally launched, run, grown, and created success through entrepreneurship. They are looking to pass on all that they have learned so that those entrepreneurs they back will succeed faster, and possibly in a bigger way. One CEO commented on the business advice they received from their angel investor: "As a young entrepreneur with limited experience of high growth companies, it was really helpful to have an investor who could tell us if things were messed up in a normal way or messed up in an abnormal way. It saved us a lot of time and worry and let us focus on finding solutions."

A second consideration is trust. This needs to be built on both sides. Will the investor really be helpful and supportive? Will the entrepreneur really use the investment wisely, and grow the business? Angel investments are long-term relationships, often lasting five years or more. All involved need to take the time to ensure they have mutual trust and respect.

"Have the right chemistry with your investor and understand their motivations. Ensure that they can give you good advice as well as cash."
Khalil Bryan, CEO, Caribbean Transit Solutions.

Thirdly, does the business have the potential to really grow and provide the level of return that angels are looking for to offset the risks they take? As founder and CEO of DRT Communications Ltd. Danielle Terrelonge says, "This is not funding for those who just want to 'do a thing'; you must be committed to creating something big, something of real value."

Angel investment is not a cheap substitute for bank lending. Angels take high risks, in illiquid investments and seek a high return in compensation for their cash and their time. The entrepreneur has to be able to convince the angel that the business is capable of growing in value three to ten times. This is a significant challenge, as few businesses are capable of such high growth.

Investor Engagement – Practical Help for Entrepreneurs

Talented and motivated entrepreneurs need to be provided with the necessary skills and knowledge about how to secure the funding they need to realise their ambitions.

With angel investing being such a new concept in the Caribbean, entrepreneurs need training and advice on the best ways to pitch their ideas, and an insight into what happens after the pitch. Few have

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an understanding of how to best grab the interest of an investor, what might be the most appropriate investment structures, how to set a realistic valuation of their company, or how to prepare for an investor's due diligence. To be credible in front of potential investors, entrepreneurs must put in the time and effort to learn the investment process.

"The biggest mistake entrepreneurs make when approaching us for funding is thinking that to get investment they just need a good idea. They must be able to show they have thought through the business model, have a solid plan for growth, and be able to show they have a great investment opportunity, not just a good business idea."
Sandra Glasgow, Angel Investor & Manager of First Angels Jamaica.

InfoDev has been assisting regionally based organisations, such as Caribbean Export, the Branson Centre for Entrepreneurship and BizTactics, to deliver courses designed to fill that knowledge gap. Improving entrepreneurs' knowledge not only helps more companies get funding quicker, but also encourages more individuals to become investors once they see the quality of opportunities available locally.

A Place for Government

Globally, governments are increasingly recognising the value of supporting the establishment of new angel groups, realising that angels who are members of groups tend to invest more capital and more often than those acting individually. Governments see the benefits that result from the profits of traditional businesses being recycled into new sectors and retained within the local economy, the resulting jobs – not just the number of jobs, but the retention of talented and educated young people in the region – and the increase in tax revenues. At a basic level, governments support angel investing by ensuring that entrepreneurs can easily establish a company and that there are appropriate legal structures available to enable private investment into companies. Bankruptcy laws need to be structured so as not to deter risk taking by entrepreneurs and investors. Entrepreneurship needs to be taught, encouraged and celebrated, from primary school through to every subject at university.

Many governments go much further. For example, New Zealand provides funding for angel education while Scotland helps to fund the running costs of new angel groups. Around half of the individual states in the US, as well as countries as diverse as Turkey, Finland, Malaysia, and Israel use tax incentives to encourage investors to consider high growth, high risk, high job creating companies as an alternative to relatively safe investments such as real estate or offshore stock markets. The UK, Portugal, Germany, Poland, and Russia operate Co-Investment Funds (CoFunds) that match the investments made by angels with public funding,

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usually on equal investment terms. These CoFunds have been described as providing "stretch funding", enabling more rapid access to the larger amounts of funding required by high growth companies. They help to increase the number of companies receiving funding, as well as address the perennial problem of angels under-investing – where investee businesses survive by a drip feed of investment in a hand to mouth fashion – by getting behind the angels and enabling sufficient follow-on investment. This additional funding also enables more companies to grow to a level at which they will become of interest to traditional VC firms, encouraging new capital into the country. Providing additional cash to carry a company further increases the probability of achieving a successful return on investment, thereby proving that local investing can be profitable and persuading more individuals to become investors. CoFunds need not cost governments more than they already spend. Many governments provide grant funding directly to companies. By channelling this funding through a CoFund, the government is able to support the company, encourage the development of a local angel community, and potently get a profit on its investment. Creating a sustainable investment community will eventually allow government to withdraw from the market and channel its funds to other priorities.

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Establishing a local investment community is not a quick fix. It takes time to bring all of the necessary players together, to build the supporting infrastructure and mutual trust, and develop knowledge and experience. Governments that make the necessary long-term commitments see significant returns, however, as exemplified by the likes of New Zealand. With that country being geographically remote, and having an economy significantly based on agriculture, the government recognised the need to diversify the economy and increase the number of new, high growth potential companies. It initiated a programme of support for angels in 2005, promoting the idea of being an angel, providing education on the technicalities of this type of investment and encouraging new angels to join groups. In 2006, they recorded four investments with a value of US$592,000. By 2013, this had grown to 116 investments valued at US$35 million.

The Caribbean has entrepreneurs with the ambition and talent to grow significant new businesses and, increasingly, the individuals prepared to fund those new ventures that will bring similar levels of success to the region.

Nelson Gray was European Business Angel of the year in 2008 and is an advisor on Angel investing to the World Bank