How to Raise Angel Funding: The Ultimate Guide

Angel funding means raising money from non-professional investors who invest their personal money in exchange for part ownership in your business. Generally speaking, angel funding is less formal and takes less effort than raising money from professional investors such as venture capitalists.

In this guide, we will discuss the following:

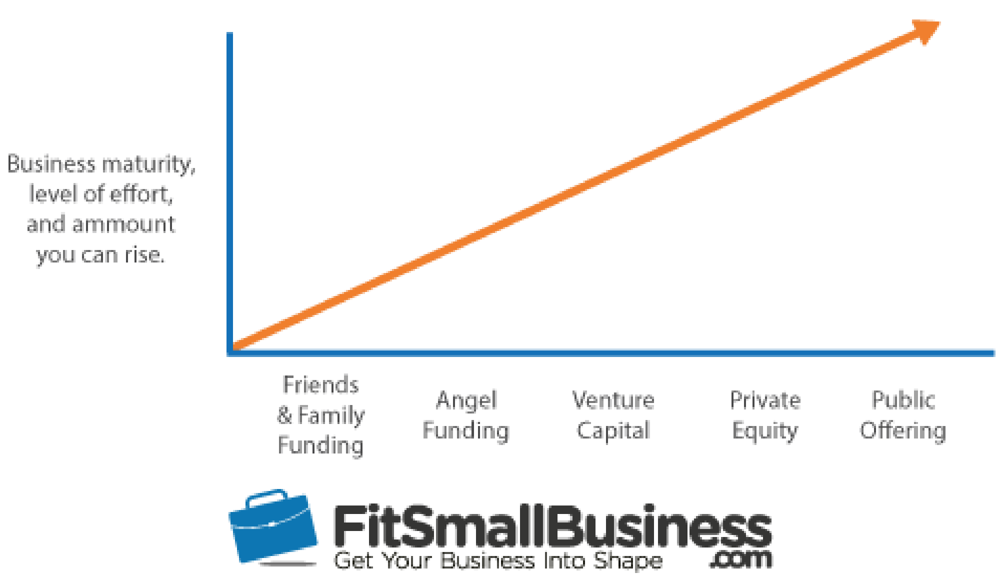
1. **What is angel funding?**
2. **Should I raise angel funding?**
3. **How much should I raise, and how much is my company worth?**
4. **How should I tell my story to potential Angel investors?**
5. **Who should I target and how can I reach them?**
6. **How do you close the deal?**

The median angel investment in 2015 was $500k and many angel investors expect around 25% annual return. If you're looking for less funding than that, you may want to consider leveraging your retirement funds through a Rollover for Business Startups or raising money on Able Lending's friends and family loan platform.

What Is Angel Funding?

Generally, as a company progresses, there is a life cycle to raising money. Many start with friends and family, then raise money from angel investors, and then move on to professional investors such as venture capitalists. More mature companies may seek money from private equity firms or do a public offering of stock.

Angel funding is typically an investment from non-professional, individual investors who are not your family or close friends. Angel investors often invest as a hobby based on personal interest. They tend to take more risk and do not get as involved as professional investors.



Angel Funding is Usually Used to Prove There's an Opportunity

While there might be a lot of reasons to raise angel funding, usually it's to prove that you are onto a real market opportunity. Generally, the money is used to bridge the gap between the business being a good idea and the business being an actual business. It might be used to create a prototype or product to get your first customer. It could also be used to create a repeatable sales process or to show that you can actually solve a complex technical problem, etc.

Angel Funding Has Fewer Formalities and Less Effort Than Other Forms of Investment

Angel funding is less formal than raising money from professional investors. Professional investors like venture capitalists generally require more formal structure in their investments, such as only investing in C corporations, requiring a board seat (or even having a board), buying company shares, or having an employee option pool.

Angel investors generally do not get as involved as professional investors. Often angel funding consists of a couple of meetings, a simple presentation, and a simple agreement that determines the equity you'll be providing in exchange for a check. You also generally do not need to provide as much detail or materials as you would for a professional investment. Also, you do not need to issue equity shares, so angel funding is more suitable for LLCs, partnerships, and sole proprietor businesses.

Be Aware that You Are Selling Part of Your Company

While raising money from family members might be loosely required to be paid back, angel investors are buying ownership (equity) in your company. You now have a new partner, so you'll need to communicate updates on the performance of your company and let the investor weigh-in on general company strategy. In addition, they'll expect a good return on their investment, as we'll talk about more in the next section.

The equity can be structured as a loan that converts into ownership shares at some predetermined event such as a venture capital raise or after a specific amount of time. We'll discuss this in more detail later in the article.

Should I Raise Angel Funding?

Now that you understand what angel funding is, you need to decide if it's right for you. It's not right for many businesses, but for those who it is a good fit for, it can be a great way to get necessary funding. Ask yourself the following questions to figure out if angel funding is a good option for you:

1. Are You Comfortable Having A New Business Partner?

Entrepreneurs often start solo or with a small team. Raising angel funding means you now have a business partner, probably a long-term one. You'll need to communicate your company's plans and results. Sometimes angel investors are entrepreneurs themselves and may want to leverage your business to boost their own, such as reselling products or licensing technology. Like all people, they'll probably bring their own opinions and expect you to listen and possibly execute these ideas. Are you going to be comfortable with this?

2. Will I Be Able To Pay The Investment Back Plus A Healthy Profit?

A lot of small businesses generate enough income to create a nice lifestyle and pay the bills but not much more. Investors expect to not only get paid back but also make a healthy profit on the investment. The nerve! The average angel investor gets back 2.6 times their investment after 3.5 years.

That means your company needs to a) grow quickly and generate enough cash to pay back the investment at greater than 25% interest annually or b) your company becomes valuable enough to sell equity to another company or professional investors. If your company doesn't have a shot at this sort of trajectory in the next few years, angel investment is probably not for you. For example, a startup in the tech industry or a business with a product new to the market may expect this kind of growth, whereas a traditional restaurant or retail store may not.

3. Can I Convince Someone To Back Me?

Unlike other funding that requires lots of documented proof, angel funding largely relies on your ability to tell a good story and get someone else excited about your company. Can you do that? Is there an exciting story to be told? Are you the type of person who can get others excited? Do you have a good track record? Here's a good article by Paul Graham, the founder of leading business incubator, Y Combinator, on how to convince an investor to invest.

What If I Can't Answer Yes To These Questions?

If you can't answer yes to all or most of these questions, then angel funding is probably not for you. That's okay. Most businesses don't raise angel funding. If your business is at a later stage, you may opt instead for venture capital or a small business loan.

How Much Should I Raise And At What Valuation?

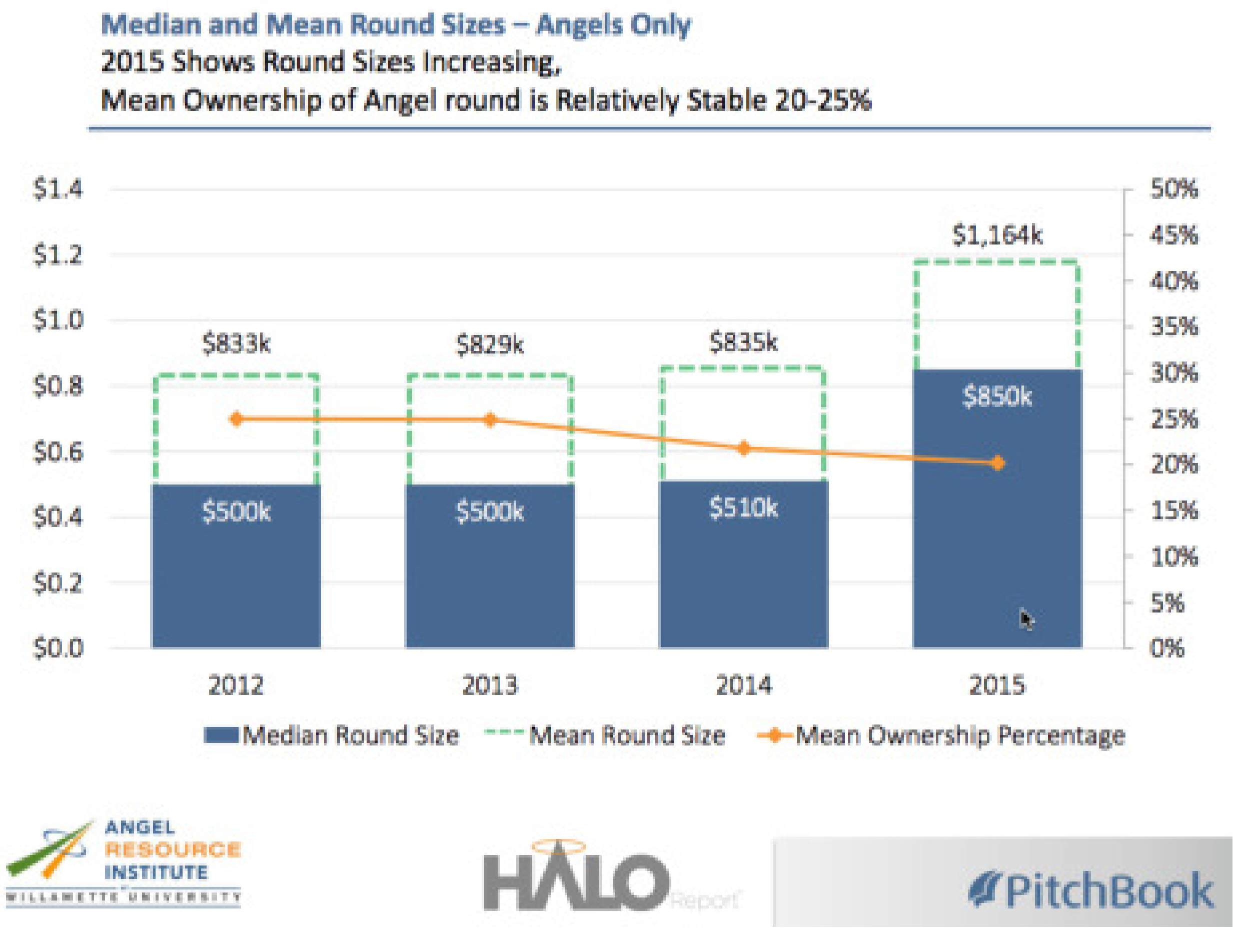
The nontechnical-yet-correct answer to how much you should raise is as much as you can reasonably deploy profitably in a reasonable time frame. However, the actual answer is a bit more complicated. You need to factor in your valuation, how much you can deploy profitably, and how much of your company are you willing to sell.

Usually, a young company is raising angel funding to do one or more of the following things:

1. Create its first product;
2. Get its first customers; or
3. Scale its operations.

You'll need to raise enough money to get to your next corporate milestone, e.g. initial product, initial sales, etc. If you raise too little, you may run out of gas too soon. If you raise too much, you'll be selling part of your company at a lower than necessary valuation, which means you'll own less than you could have.

To give you an idea of what others have raised, the angel Resource Institute at Willamette University estimates that the median angel round was $850k in 2015. This is a pretty big jump from previous years.



Source: Angel Resource Institute

The amount of angel funding you should raise depends on your valuation and how much of your company you are willing to sell. For instance, let's pretend you think you need $1 million to get to your next big milestone. If the value of your company is determined by investors to be worth $1 million, you'd have to sell 50% of your company to raise $1 million. But if investors value your company at $4 million, you only need to sell 20% to raise $1 million. The general rule of thumb is that any given round should be a sale of about 20% of the company after the money is invested.

Valuation

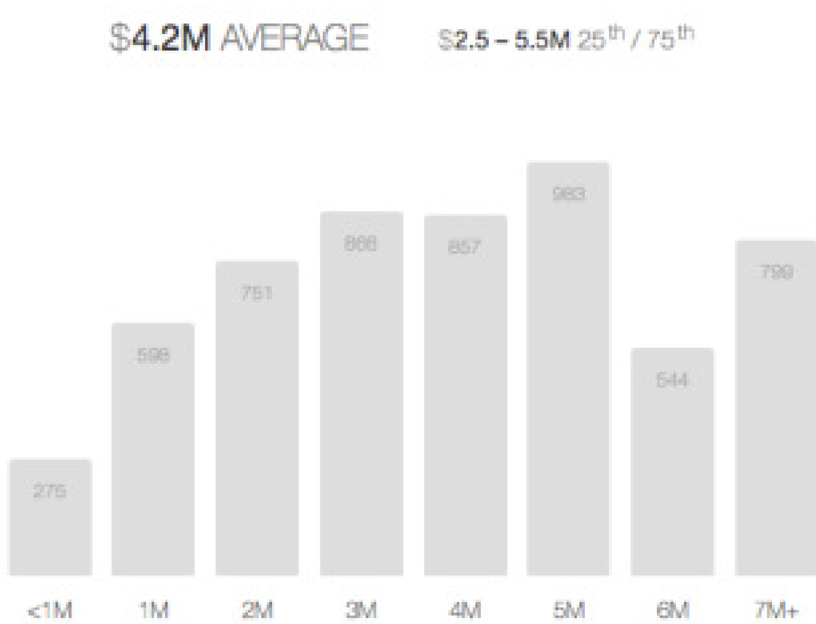
So what should you expect the value of your company to be? There are number of factors that affect valuation, including:

- How experienced are the founders / team
- The scope of your business opportunity
- How far along in generating revenue you are
- How much you need to raise

At the end of the day, when raising money from investors, valuation is a negotiation. This is especially true when the company is in early stages of high growth. That being said, there are some traditional ways to value a stable company. They include:

1. **Net Asset Valuation** where you add up all of the business' assets of saleable value and subtract any liabilities.
2. **Profit Multiples**. This usually a multiple of Earnings Before Interest, Depreciation, and Amortization (EBITDA). For example a stable company might be 3x to 5x EBITDA but a fast growth company could be 10x EBITDA.
3. **Discounted Cash Flow**. This is the process of projecting all future free cash flows and discounting to the present using a risk adjusted interest rate.

You can see the math and methodology behind these techniques in this article.



Source: AngelList

As a reference point, AngelList puts the average valuation of deals done on their platform at $4.2 million. They have an interesting valuation viewer on their website. Don't put too much stock into this calculator.

Ultimately, traditional valuation techniques or using comparison companies tend not to be very useful for a high-risk, fast growth company that would attract an angel investor. The circumstances of any company tend to be very specific to that company. The best solution is to create a market for your product or service and speak to multiple potential investors. But don't focus on valuation. It's more important that you're getting into bed with the right long-term partner.

How Should I Tell My Story?

The single biggest factor in raising angel funding, besides having a promising company, is the ability to tell a compelling story. The extent that you need to have each aspect of your story buttoned up depends on what stage your company is at. If you are trying to raise $50,000 to get a prototype built, you're not going to need as much substance compared to someone who is trying to raise $1 million to expand sales. But the following are the general areas you should hit in your story.

After telling you what you'll need to be prepared to share with investors, we'll go through the different formats for pitching your story.

An Exciting Market Opportunity

You may have invented the best mouse trap on the planet, but if there's no demand for it, then you don't have a company. You'll need to convince investors of the following:

- There's a large enough market to create an interesting company.
- How do people do things now? Don't say you have no competition. There's always a way to do something people want to do.
- Why now, and why you? What has changed that will make people want to change how they are doing things and switch from a competing product or service to what your company is offering?

Why Your Solution Is the Best

If you've ever been in sales or have run a company, you know that it's hard to get people to change their behavior. They're only going to do it if there is a fairly large and obvious benefit. You'll find most people are perfectly happy to not buy something from you. So you should be able to explain the following:

- Why is your solution 10x better than the way things are currently done?
- Why is your solution going to be unique when compared to competitors? Be honest. Is it a big difference or an insignificant difference when buyers are thinking of buying?
- What social proof can you offer potential buyers (e.g. testimonials from other users)?

Why You or Your Team

The common refrain in startup investing is that ideas are cheap. It's all about execution. There have been a lot of good ideas that never went anywhere because the people working on them weren't up to the task. So why should an investor believe you or your team are the ones to actually execute on your brilliant idea? What experience do you have? What expertise? What special talent sauce do you have that will help you overcome competitors?

Demonstration or Prototype

You need to be able to demonstrate your product or service. If you're raising funds to build a product you should at least have a prototype. Ideally you should be able to show your solution as it would be used by your target user. You should be able to demonstrate the before and after and show the benefit to the user.

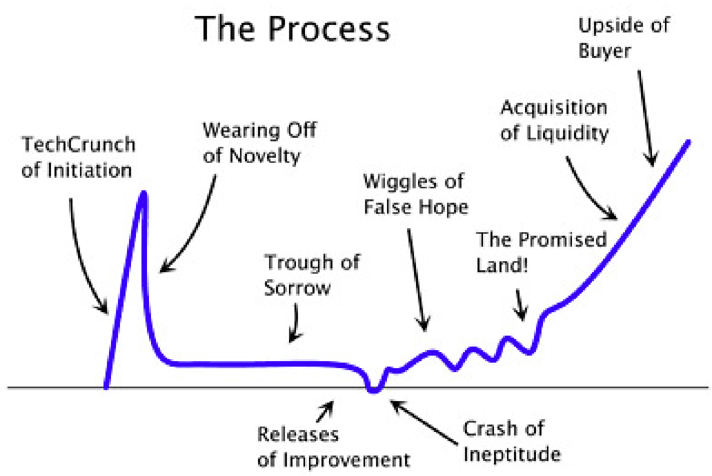
Milestones

The more traction you can show the better off you'll be. Do you have users, endorsements, customers, a repeatable sales model, a track record of solving production issues, etc. Do you have rockstar advisors? Are you generating revenue? Are you generating profits? All of these might be the milestones you use to show traction.

Passion

When telling investors your story, passion is the hard-to-measure but all important factor that can mean the difference between a successful fundraise and an unsuccessful one. Investors can feel passion from a mile away and they expect founders to have it.

As a company owner you're in for a really, really difficult journey. If you don't have passion you'll never make it through the Trough of Sorrow. In Paul Graham's Life of a Product Startup, the Trough of Sorrow is when you've put a ton of work into a company and sales are just not taking off as expected. It happens to most companies in the early stages. You'll need a lot of passion to keep the faith during this part of your journey.



Paul Graham's Life of a Product Startup. Source: AndrewChen.co

How to Present Your Story

You'll share your story in a few different ways to investors. Since angel funding is generally less formal than raising a venture capital round or private equity, most of this information will be shared verbally.

Elevator Pitch

You need to get in front of very busy people to raise angel funding. So you need to be able to quickly peak potential investors' interest either in person or email. If you are networking your way to them, which you will be, you'll likely need to send a brief summary (pitch) to the person introducing you to the angel investor. It needs to quickly identify the opportunity, why your solution is different, and why they should believe you – either through traction, important references, or your pedigree. Here a few examples of interesting elevator pitches:

- Cup Ads
- Travel Blender
- Klash

Pitch Deck

You should have a short pitch deck created on PowerPoint or Google Slides that lays out the above. You don't need to spend a ton of time on this. Angel investors tend to be super busy. You need to answer basic questions but above all else get their interest. You'll have time to follow up with them in person on details if they are interested.

Source: Alliance of Angels

If you want to read more on the pitch deck format, here's a presentation on the anatomy of a 10 minute pitch from the Alliance of Angels.

And here are some successful pitch decks:

- Buffer
- Kickfolio
- SEOmoz

Business Plan

You usually don't need a formal business plan for an angel funding round. However, you do need to be able to answer questions about the business. Some items include:

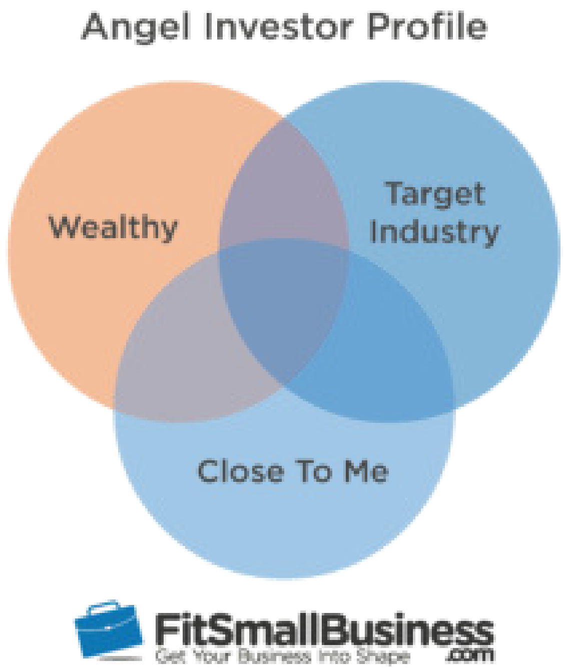
- How are you going to produce your solution at scale?
- What is your pricing strategy?
- Who is your competition, and why are you better?
- What team do you need?
- How are you going to use the funding?
- What are the general economics of your business?

Learn more in our article How to Write a Business Plan in 9 Easy Steps.

Who Should I Target & How Should I Reach Them?

Okay, so you’re armed and dangerous with your story and your pitch deck. Now how do you target the angel investors and how do you meet them?

First, you need to figure out what type of angel investor you are looking for. It will help you focus on the right people and enhance your chance of actually raising angel funding.



The three main criteria you should focus on are as follows:

1. **Wealthy Individuals**. This is a relative term but angel investments tend to be around $25,000 and up. Angel investors tend to make many investments to diversify so I suggest reaching out to people who have around $200,000 to invest in startups, and this should only be a percentage of their investment portfolio. So we’re talking wealthy people here.
2. **Target Industry**. Targeting angels in or near your target industry is not absolutely necessary, but the closer they are the better your chances. Angel investors tend to invest in areas that interest them personally. These angels could have invested in your industry before, currently run companies in your industry, be involved academically in the industry, etc.
3. **Close To Me**. Target angels should be close to you in one or more of these 3 ways:

- **Relationships**. You’re going to have to network your way to them so the closer they are from a network perspective the better. In other words, how many connections away from you is the potential investor? (family friend or distant friend of a friend)?
- **Geographically**. Investors like to see their company founders in person often, so it’ll be easier if you are in the same city. A lot of investors assume a busy entrepreneur won’t travel to see them so they don’t even look at deals that aren’t geographically close. Of course, exceptions are made for the right deal.
- **Perspective**. It’s really hard to convince angel investors of anything they disagree with. These are successful, confident people. You’re better off sticking to folks who have a similar view of the market

opportunity as you do. They may have invested in a similar company or have studied the problem you're solving.

Resources for Finding Angel Investors

To build your list there are a number angel clubs and directories that list angels or help you connect with them. Some prominent ones include:

- AngelList. AngelList matches startups with Angel Investors.
- FundersClub. 19,000 successful people invest in each other's startups.
- Boogar. Directory of angel investment groups by location and industry.
- Angel Capital Association. List of angel groups by region and accredited investment platforms.

Since geography is important, your best bet is to focus on local angels and organizations. The Angel Capital Association link above breaks down angels by region. Another example is this directory to East Coast angel groups.

Network, Network, Network

Ok, so you've created your list of target angels and prioritized them based on industry and closeness to you. Now, you need to get in front of them.

- First, start by getting feedback on your product from experts. They could be at target companies, in academia, or in adjacent industries. These people can provide important feedback, and they also might be angel investors themselves or be able to help you network your way to the right angels.
- Canvas friends, family, and your business network to try and find angel investors who might already be in your network. Spend some time on LinkedIn and AngelList.
- Talk to other founders about angels who have invested in their companies.
- Canvas professionals around the space – lawyers, accountants, writers – for leads on people who are active angels in the space.

Talk to all of these people in parallel, not serial, fashion, so you have multiple leads at once. That will expedite things.

Enter Competitions

Another good way to get in front of angels is to enter a business plan competition or startup competition. You don't even need to win. A lot of angels follow these competitions looking for interesting opportunities. Here are a few of the larger competitions and a directory of others:

- TechCrunch Disrupt
- Web Summit PITCH
- SXSW Accelerator Startup Competition
- MassChallenge
- Business plan contest directory

Incubators

Startup incubators can be good way to get angel investment as well. Many incubators will make angel investments directly and have a strong network of angels (and other investors) who they can introduce you to. Here's a list of some prominent ones and some lists of others.

- Y Combinator
- Techstars
- 500 Startups
- AngelPad
- MIT Seed Accelerator Ranking
- Large list of incubators

Equity Crowdfunding

The latest entry into the angel-like funding space is online equity crowdfunding. Similar to rewards-based crowdfunding, equity crowdfunding pairs startups with individual investors on an online platform. The larger equity crowdfunding sites include:

- AngelList
- CircleUp
- Fundable
- WeFunder
- Indiegogo

Closing The Deal

Ok so you've found your angel investors and are actively pitching them. Here are a few final notes to keep in mind to close the deal. The logistics involved can trip up novices, so try to keep organized and keep a cool head.

The Agreement

The most common kind of financial agreement used in angel funding is a convertible note. This is an agreement whereby the investor loans you a certain amount of money that provides for interest payments and then converts to equity ownership when the company reaches a certain valuation (determined by future investors or buyers). Here are some of the key aspects of convertible notes:

Secured vs. Unsecured

Is the loan secured by corporate or personal assets as a guarantee of repayment? Most angel funding is unsecured.

Interest Rate & Accrual

This spells out the interest rate that needs to be paid and whether interest is paid to the investor over time or when the loan converts to equity. Typical interest rates range from 1% to 2%, and it is usually paid at the time of equity conversion to conserve the startup's cash flow. Rates can fluctuate based on general market rate levels.

Discount

Usually the valuation at which the loan principal converts to equity is determined by a subsequent fundraising round with professional investors, usually a venture capital round. For taking early risk, angel investors are rewarded by converting their loan into equity at a discount to whatever valuation is agreed to in the professional investment round. The discount is typically 20%. For instance, if a venture capital investor invests at a pre-money valuation of $5 million, at a 20% discount, the angel investor's investment would convert at a valuation of $4 million.

Valuation Cap

Since the valuation in a subsequent funding round is unknown, angel investors typically like to have a maximum valuation at which their loan will convert to equity. For example, if a venture capital firm invests at a valuation of $50 million, a valuation cap of $10 million in the convertible note means that the angel investment would convert into equity at a $10 million valuation, not $50 million. This protects angel investors from their ownership being too small due to a very high valuation in subsequent fundraising.

A more detailed discussion of the convertible note can be found here.

No Until Yes

You're going to get a lot of folks who are interested in hearing your idea but will never invest for a variety of different reasons. Assume that everyone is going to say no until they actually say yes. Don't get too focused on the folks that are nice to you and show interest. You need to keep talking to potential investors no matter how friendly some of them are because no one is a sure thing until you have the money in your bank account.

Let Them Flake

Some potential investors will show initial interest and then disappear. Let them. The salesperson in you might be inclined to keep pounding on their door. Don't. Focus your efforts on those that are acting as well as talking interest. Those are your real leads.

Avoid Single Investor Work

One of the big benefits of raising angel funding, as opposed to venture capital, is that it's less time consuming. Reputable angel investors do not need a ton of details and can make decisions quickly. They know you have a lot of things to do other than fundraise. Be wary of folks who keep asking for more proof as a way of deferring making a decision or looking for a risk-free investment. These folks will suck up your time and probably not invest anyway.

The Bottom Line

So now you know how to raise an angel round. Make sure angel funding is for you, keeping in mind most companies don't raise angel funding. Focus on your story and have a great pitch. Network and target angels who are kindred spirits and close by. That, plus a good company and some luck, should enable you to raise angel funding. Good luck!