Your essential guide
to investing in early-stage businesses

How to start up investing in startups

SYNDICATE ROOM
Intelligent Equity Crowdfunding

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Angel investing is an excellent asset class to invest in. You get to participate in changing the future.

Josh Maher

From calculus to sunspots, from lightning rods to the telephone, innovations denote step changes in the advancement of our civilisation. Innovation is everywhere. It's constant. People have been experimenting with marketing new tools and services since before Fred Flintstone bought his first pedal car, and in the age of the internet you'd be hard pressed to go a day without hearing of some new company or app having a go at making it big – or, at least, big enough.

Experienced venture capitalists and business angels already know this, and they have unique access to the best entrepreneurs the world over. They also know that finding the best opportunities means finding a network of investors, online or offline, whom you trust and alongside whom you can invest. This is just as true for active angels as it is for passive ones with full-time jobs.

And now, thanks to crowdfunding, more people than ever before can access all this innovation – but there's a big difference between having the ability to invest and having the ability to invest well.

The best business angels tread the same path: they follow a process, keep records and reflect on their past performance to find ways to improve. They know it's ok to go slow and stick to familiar territory, but they also recognise the importance of building a diverse portfolio further afield.

This is the guide to put you on that path.

Josh Maher
President, Seattle Angel
Author of *Startup Wealth: How the Best Angel Investors Make Money in Startups*

Where do I start?

100 million new businesses are launched each year[1]

From Silicon Roundabout to Silicon Valley, the number of startups being created across the world is simply astounding. In the UK, more than 50,000 new companies launch every month (Experian); in the US, this figure surpasses 500,000 (Forbes).

The UK's equity crowdfunding market has been 'coming of age' since 2014, and this year may well be the time it fully grows up. March 2016 marked the first time the public could invest in public market opportunities on the London Stock Exchange through a crowdfunding platform.

In its 2015/16 report The Deal, leading UK data provider Beauhurst found that crowdfunding is now a leading force in seed investing, and is also on track to become one in growth investing as its average deal size grows.

According to Crowdfund Insider: 'Across the three stages of investing, equity crowdfunding is now the second most active funder type after private equity firms, far ahead of angel networks and private investment vehicles.'

To put it simply, there is no shortage of companies in which you can invest – but we'll talk about that later.

With so many new companies entering the ring, everyone is eager to be in with a chance of backing the next Facebook. But startups aren't cash cows – far from it, in fact. Before you invest, you should be aware of what you're getting yourself into.

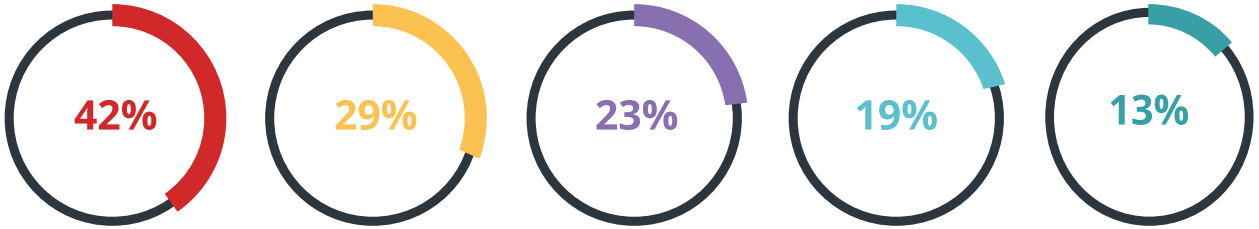
Be aware of the risks

9 out of 10 startups will fail[2]

It's a hard pill to swallow, but swallow it we must: most startups won't make it past year three. There are countless reasons for why a startup may fail, and 154 of these have been detailed in CB Insights' 156 Startup Failure Post-Mortems – which makes for an enlightening yet sobering read. Here are a few of the highlights.

Steve Hogan, Co-Founder and Partner at Tech-Rx, says that the number one thing failed startups have in common is a single founder. 'That is the single biggest indicator of why they got in trouble,' he says. A co-founder can help address many of the trip-ups listed by CB Insights, including disharmony, poor marketing and hiring the wrong team.

Why startups fail



Based on Fortune analysis of 101 Startup Post-Mortems by CB Insights, 2014

Make sure you can afford to lose

Investing in early-stage companies is about as high risk as it gets, so you can't go into it thinking you're going to win big. There's no guarantee of that. If you put all your eggs into the early-stage basket, there's a fine chance all of them are going to get broken.

There's a reason investment platforms flag up all those 'your capital is at risk' warnings: you can lose everything.

One of the ways to level the playing field a bit is portfolio diversification: spread your risk over different-stage businesses, different types of investment and different sectors. And, of course, do your due diligence (pp. 14–19).

1 2015 Global Entrepreneurship Monitor Report

2 'Why startups fail, according to their founders', Fortune, 2014

What type of investor are you?

High-net-worth individual

This is a person who has self-certified that they have an annual income exceeding £100,000 or have net assets totalling £250,000 or more in value (some exclusions apply).

Sophisticated investor

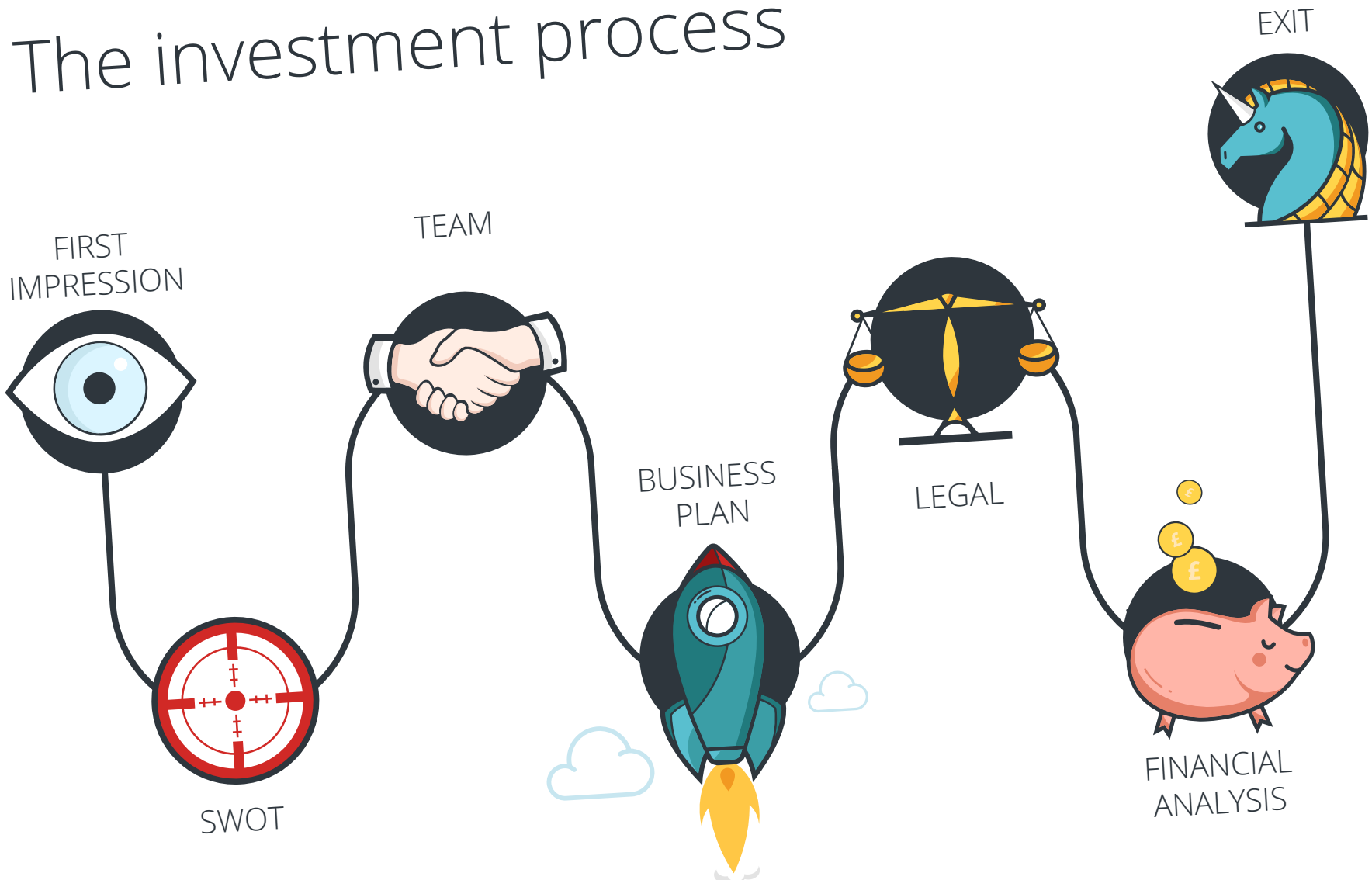
Someone who can satisfy one of several criteria to demonstrate that they are aware of the risks inherent in early-stage investing and can afford to stake a certain amount of their capital.

Everyday investor

That's most of us. In the UK, the everyday investor must promise they will not invest more than 10% of their net investable assets into this highly risky asset class. Bear in mind that not all crowdfunding platforms cater to everyday investors.

Be aware that definitions and legislation vary by country and jurisdiction. Consult your local or national regulation authority for the most up-to- date legal information.

The investment process



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The importance of having multiple founders cannot be overstated. Creating and running a startup is one of the hardest, most emotionally and physically draining jobs anyone can do.

Samer Karam

Angel investor, entrepreneur and startup adviser

How can I invest?

Angel networks

Wherever in the world you are, there'll be an online directory of local, regional and national angel groups available: the UK Business Angels Association and US Angel Capital Association are two good examples. There are many advantages to investing as part of an established group, not least of which is combined experience, and for novice investors it can be a very good way to learn.

There are, however, also some disadvantages. Angel networks and offline syndicates only have so much visibility and reach; regardless of how many you belong to, there will always be opportunities that aren't covered.

On the other hand, with online platforms anybody can introduce an investment opportunity: individuals, small groups and large networks/funds can leverage the crowd both for capital and to source new deals.

Accelerator programmes

Startup accelerators run set courses and offer investment with the aim of growing small businesses in a short space of time. They tend to take a small amount of equity in the startup in exchange for initial seed funding.

Accelerators can offer you certain services, such as conducting due diligence and helping to negotiate deals on your behalf. And you needn't be monogamous about it: as an investor, there's no need for you to limit yourself to one accelerator. Keeping an eye on several different programmes can help you maintain an up-to-date view of the greater fundraising ecosystem.

Equity crowdfunding

Equity crowdfunding is a relatively new form of alternative finance, but it's been gaining a lot of traction over the past few years. Equity crowdfunding platforms allow people (the 'crowd') to invest in unlisted companies in exchange for shares in that company, and can be a good way of diversifying your portfolio since they tend to offer diverse opportunities over an undesignated number of sectors.

Plus, as all the action takes place online, information can be updated and disseminated quickly to members, and there will often be opportunities for investors and entrepreneurs to discuss prospects in an open forum.

Many platforms run pitching events that give you the chance to meet the entrepreneurs raising capital in person and speak with them one-on-one. Take advantage of such opportunities to get up close and personal with the company's founders (and chew things over with your fellow investors) before staking your money.

But remember: equity crowdfunding platforms are not all the same, and there are several factors you should consider when shopping around.

Investor-led vs entrepreneur-led platforms

This is a fundamental difference in the way that platforms approach investors. With an entrepreneur-led platform, the entrepreneurs set the investment terms, including share price and the amount of equity given away. Naturally, the entrepreneurs will put their interests first.

Investor-led platforms have an experienced 'lead' investor negotiate the terms of the investment with the company, both for themselves and for the 'crowd'. As the lead investor is staking a significant portion of their own money in the round, it stands to reason that they will negotiate terms with the investors' interests in mind.

Direct shareholding vs nominee structure

With direct shareholding, investors hold their own shares and the company liaises directly with them. While most experienced investors prefer this arguably more 'hands-on' structure, it can put off companies and add to their administrative burden. Indeed, some companies will only deal with platforms operating a nominee structure.

Under a nominee structure, a nominated individual holds the shares of a group of investors. Companies like using a nominee structure as it makes administration of their shareholders far less cumbersome since they only need to deal with a single person – the nominee – which frees up more of their time to concentrate on making their business work.

This is the general difference between the two structures, but every platform will have its own nuances – as always, be sure to do your research when determining which one is right for you.

FCA authorisation

Only invest through platforms that are regulated by the financial regulators of the country in which they operate. In the UK, this is the Financial Conduct Authority (FCA) and in the US, the Securities and Exchange Commission (SEC). If a platform is not authorised by the regulator, you cannot be confident that your money is being handled correctly, or that it is safe during transactions, and it's best to steer clear.

If you're new to investing, one of the best things you can do is immerse yourself in whatever network you choose – attend events, read updates, do everything you can to stay in the loop. The relationships you build will be priceless in growing your aptitude and confidence as an investor.

"The best deal flow I get is from people I know. There's a group of about 15 of us who are all entrepreneurs, all on our second or third businesses, so we know what it's like to build a business and we know what a good entrepreneur looks like.

We share deal flow because we're all from different backgrounds; we've got some people from SaaS, some from commerce, some from gaming, some from mobile development, enterprise, you name it.

People come to them for different things – they'll say 'you're the expert in SaaS, I want to speak to you' – so then we share it amongst the group, we all chat about it. We all have diverse backgrounds so we can bring different opinions to the table.

It's things like that and other angel groups of individuals I trust that bring deal flow to me.

Philip Wilkinson
Angel investor

Venture capital funds

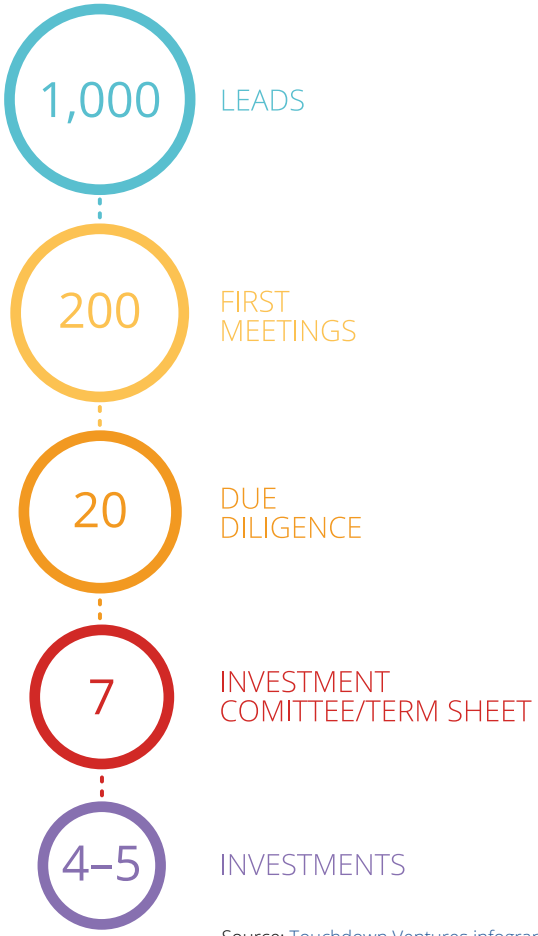
These are made up of money raised from private investors with the expectation that the fund will return investors more than they put into it. For every 1,000 leads a VC fund looks at, it'll invest in maybe five ventures.

Investors in the fund fall into two categories of partners: general partners (the actual partners of the firm who will typically invest 1% of the fund) and limited partners (typically pension funds, endowments of universities and hospitals, charitable foundations, insurance companies, very wealthy families or 'family offices' and corporations). Unlike with most equity crowdfunding platforms, funds normally operate joining and/or management fees.

Once sufficient money has been raised, the fund will make a number of investments in high-growth early-stage companies in return for an equity stake in the businesses. Alongside this investment the venture firm organising the fund will often provide guidance, mentoring, network connections and a plethora of other benefits. It is normal for the fund to set aside a portion of its funds to pitch in on follow-on rounds.

Ultimately, the goal of the fund is to exit the companies in which they have invested via either a trade sale or an initial public offering (IPO). VC funds tend to operate in seven- to ten-year cycles, aiming to exit and pay the profit out to the partners and partners before that period ends.

In the UK there are special types of venture capital funds that allow investors to receive tax reliefs from the government: SEIS funds and EIS funds.



Source: Touchdown Ventures infographic, Fairy Bower

Listen to these

The benefits of investing as a syndicate

Keith Wallace, Co-Founder and Managing Partner at DeInvesteerdersClub

The 3 A's of investing

Andy McLoughlin, Co-Founder at Huddle, Venture Partner at SoftTech VC

What are startup accelerators and how can they help you invest?

Max Kelly, Managing Director at Techstars London

The importance of founder/market fit

Avin Rabheru, Founder and CEO, Housekeep

Salty

The first ever equity crowdfunded Hollywood film.

In March 2015 Simon West's *Salty* made the record books by becoming the first ever equity crowdfunded Hollywood film, after successfully raising £1.9m from 148 investors on investor-led crowdfunding platform **SyndicateRoom**. During the May 2016 Cannes film festival international film star Antonio Banderas was confirmed to play the film's leading role.

Knowing the market

Look at the industry in which your prospective investment is operating. What's the size of the market? Has it been exhibiting growth year on year? How is the company performing in comparison to similar ventures in its sector? Is it likely to be able to grab a share of the market, and if so, what would that equate to? What's the competition like?

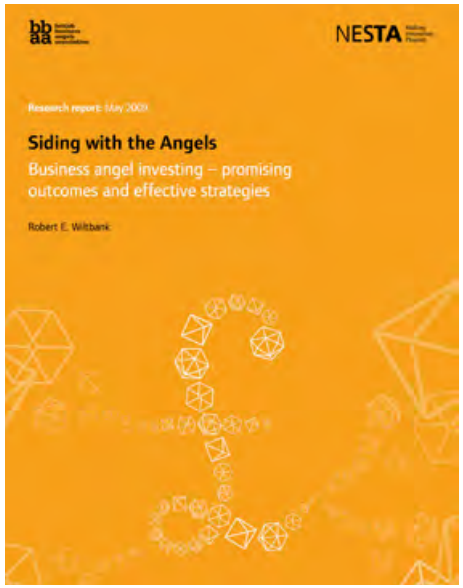
As always, staying up to date with what's hot with regard to sectors is key – you don't want to invest in an area just as it's plummeting. For instance, you might not expect to find that social media is currently coming down off its 2010 high and health tech is taking a dive, while for SaaS it looks like the sky's the limit. There's a lot of data out there, so use sites like Tomasz Tunguz to stay in the loop with what's hot.

You can't overestimate the value of experience

If you can invest in an industry where you have experience, do. You are far more qualified to evaluate an investment opportunity in a field that you are passionate about or have personal knowledge of than an industry that looks hot but in which you've never worked.

Siding with the Angels

Nesta's report shows that investors who have specific knowledge and experience within the industry of the investee company are more likely to see returns than those who don't. If you don't have the specific industry experience for the investment, invest with people who do.



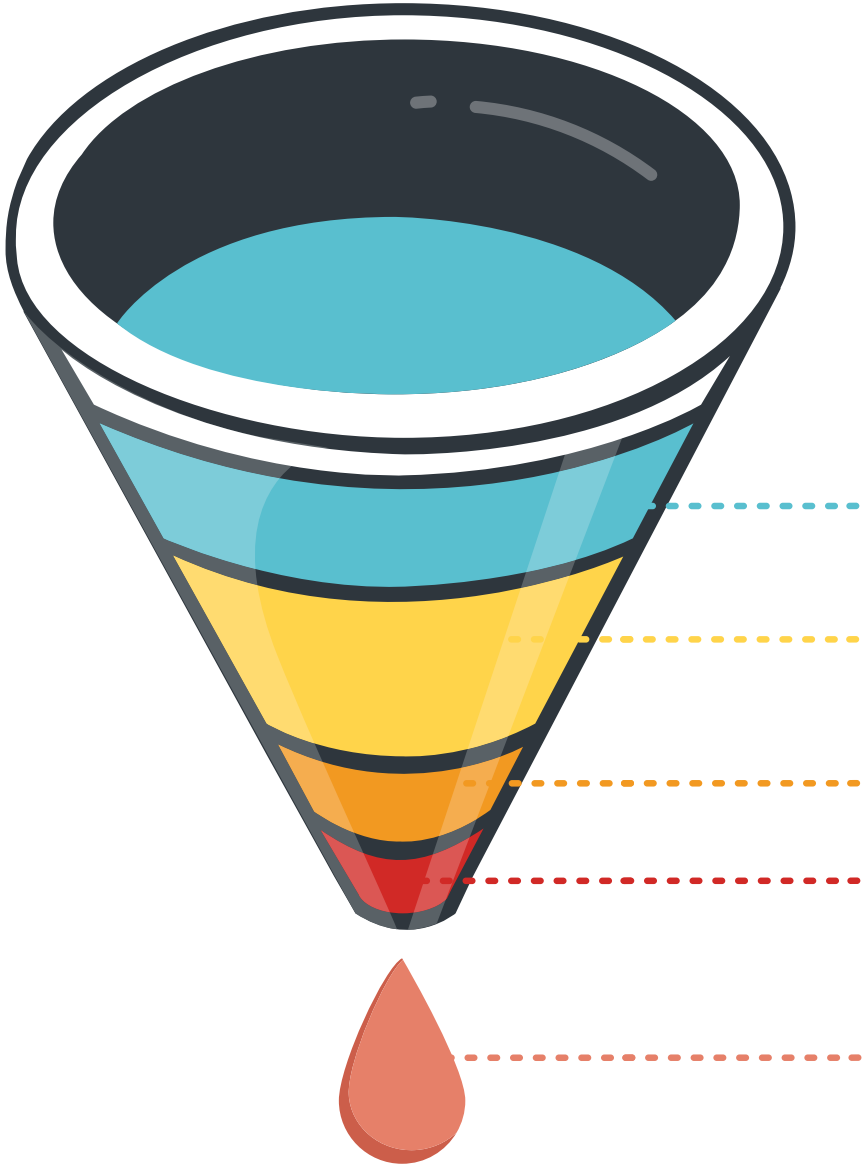
Don't let your expertise go stale

While it may be easy to do your research one time around and then consider yourself an expert, you need to continue to stay in the loop because market trends do go up and down, swapping out when 'the next big thing' comes along. Beware of these cycles.

These days staying up to date doesn't need to take up all your time – have a good few sources to check on a daily basis and stick to it. No one person can follow everything, so pick a niche and keep up with that – let curated content do the rest.

Here are a few sources to kick-start your research:

- Mark Suster
- Beauhurst
- Mattermark Daily (newsletter)
- Tomasz Tunguz
- Angel Insights – a weekly podcast with some of the world's most successful angels, part biography, part tips on what's made them so successful
- 20 Minute VC – Angel Insights host Harry Stebbings interviews leading VCs



Only 1 in 10 startups will make it into its 5th year

25% fail in their 1st year

27% fail in their 2nd year

21% fail in their 3rd year

14% fail in their 4th year

13% survive to year 5

Source: Adapted from 'Startup success by the numbers' by Mashable (2014); research by Harvard Business School.

Doing your due diligence

Due diligence is the most important aspect of investing. Without it, you won't have the slightest idea of how successful (or unsuccessful) a venture is likely to be – you might as well be throwing your money into the wind.

Due diligence requires a bit of digging, especially as its trail is often hard to find – complex regulations and fear of putting off potential investors means that the facts may be hidden beneath layers of flowery (and imprecise) language. Having a lead investor in on the round can help, since they will do some digging before pledging their own money into the round – but, regardless of what anyone else has said, always be sure to carry out your own research before investing.

Broadly speaking, there are five main things you should definitely consider:

1. The team

Ask any experienced investor and they'll tell you: the founders matter. While opinion is split over whether or not it's a make-or-break factor, there is general consensus that you shouldn't overlook the team behind the idea.

So what should you look for in a startup team? For founders, having relevant experience is important, but so is motivation and vision. What is their reason for creating the startup? Are they reliable? Trustworthy? Do you get along with them? A founder can tick all the right boxes, but if you can't stand to be in a room together then you're unlikely to have a good business relationship.

It is very unlikely that you will find all the characteristics needed to run a successful startup in a single person; that's why you're far more likely to come across co-founders than entrepreneurs pitching solo. The ideal team will be made up of people with complementary skill sets who are enthusiastic and able to turn their hands to whatever's needed.

2. The product

Naturally, it's also a good idea to look into the product or service the startup is offering. Is it innovative? Is it easily replicable? Has it been trialled? If so, was it well received? Does the company hold any patents? If you're investing in an early-stage business, it's likely that its product will not be fully developed and the degree of risk will be higher.

Conduct research on the competition and find out what's worked for them, and what hasn't. If a similar product has recently flopped, it may be best to sit this one out.

3. Traction

Traction is any kind of forward momentum, but the bigger it is, the better. A company's traction gives you an idea of how well it's been executed to date. What you want to see is a steady growth in metrics month on month, with no big drops or plateaus.

Here are some measures to look at when evaluating a startup's traction:

- Growth – How many customers do they have? At what rate is this figure growing?
- Revenue – What's their track record like? How many sources of revenue have they planned for?
- PR – How is the startup scaling its metrics?

4. The market

Look at the market to gauge whether the product/service is likely to do well. Assess the market size, competition, potential acquirers. How 'hot' is the sector?

The acquisition value of a company can be calculated using a multiple of annual revenues (or expected annual revenues) – listen to this Angel Insights interview with Peter Cowley, Fellow at the Cambridge Judge Business School, for a few tips.

If you're going to invest, you should be sure that the market is large enough for the venture to achieve healthy revenues and a healthy return. At the same time remember that, unlike a VC, you don't need to wait for an opportunity in a billion-pound market since angels come in much earlier on in the process.

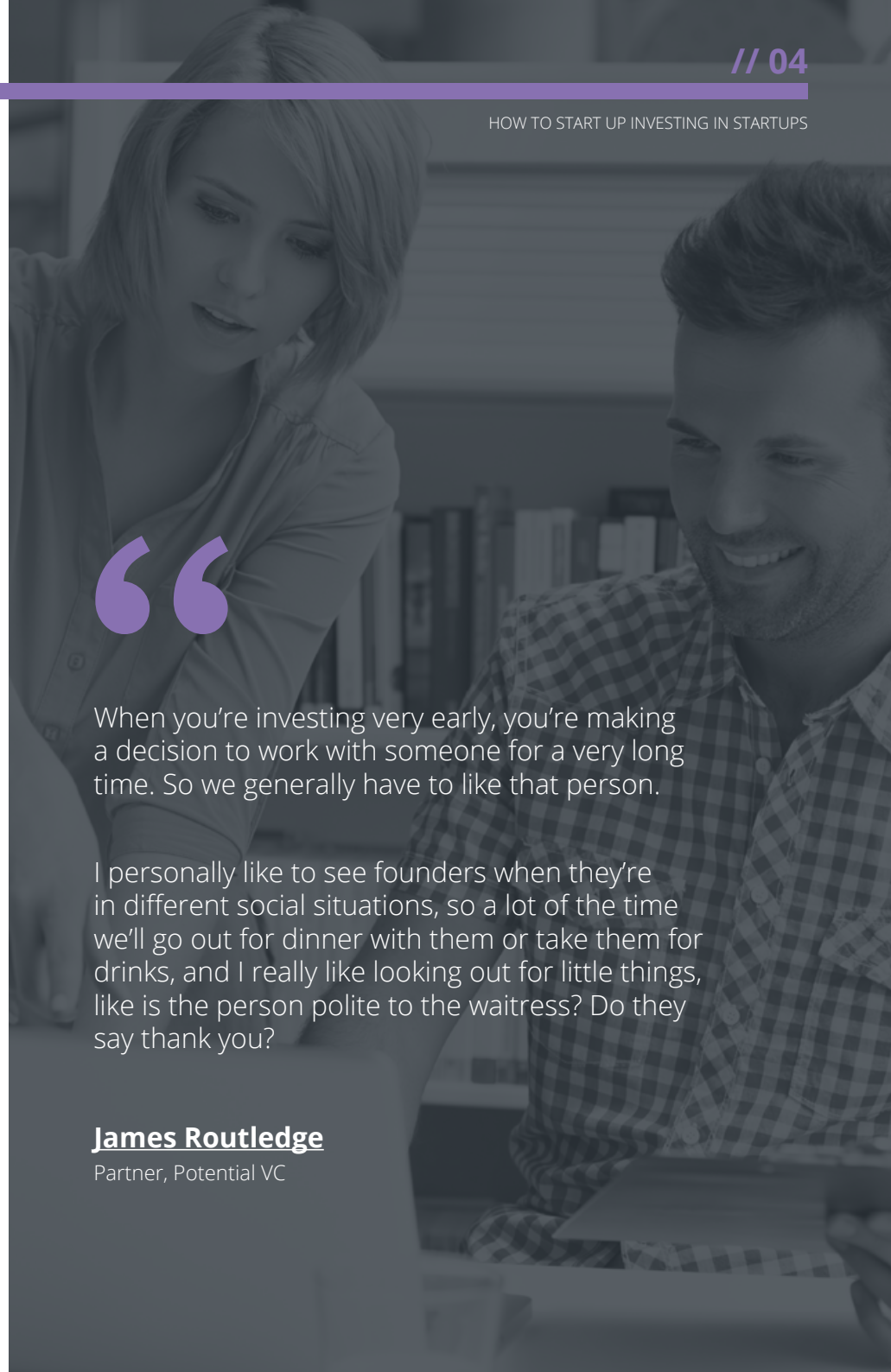
And then there's the factor that everybody forgets about...

5. The investors

When deciding whether or not to invest in a startup, it's crucial to know who you'll be investing with, and yet this is one consideration that isn't immediately obvious to many aspiring investors.

Will you be investing as part of a syndicate? What industry or financial experience do the other investors in your group have? Who will be leading the round – you, or someone you can trust?

Investing as part of a group or syndicate has many benefits, not least among these being due diligence. Two heads are better than one, and ten inquiring minds are even more likely to poke holes in a sub-standard business plan. You can learn a lot through camaraderie.



"When you're investing very early, you're making a decision to work with someone for a very long time. So we generally have to like that person.

I personally like to see founders when they're in different social situations, so a lot of the time we'll go out for dinner with them or take them for drinks, and I really like looking out for little things, like is the person polite to the waitress? Do they say thank you?

James Routledge
Partner, Potential VC

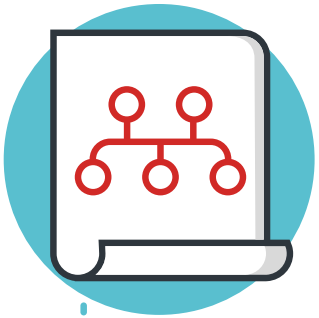
> At early stage, really it's all about identifying a really strong founder and matching them with a very, very strong and growing market.

Paul Dowling
Founder and CEO at Dreamstake

What your due diligence might look like

At a glance

- Your familiarity with the space
- Trustworthiness of source
- Problem being solved
- First impression



Market opportunity

- Strengths, weaknesses, opportunities, threats (SWOT)
- Total attainable market
- Key risks

Key components

- Team
- Product/service
- Distribution
- Revenue model

Deep dive

- Legal diligence
- Financial analysis
- Cap table
- Exit plan

Source: Adapted from Invested Development (2013)

A few more things to consider...

Is there a lead investor?

A useful way of gauging whether a deal is worth checking out is seeing who else is investing. Is the lead investor a prominent business angel with a track record of good investments? Do they have experience or industry-specific knowledge that gives them an edge when it comes to due diligence?

Since they'll be staking their own money in the opportunity (often a rather sizable chunk of it), they will have significant confidence in the likelihood of it paying off, so having their cachet on the round can be a hallmark of good opportunity.

But remember: regardless of who else is involved, be sure to conduct your own due diligence before tossing in your lot.

Do you want to be an active investor or a passive one?

Bear in mind also that all startups worth their salt value good advice. If you have the experience and knowledge to help the company you've invested in succeed, it will be welcomed with open arms. Investors that regularly offer their expertise and support to the company are a valuable resource in a broader sense, and are known as active investors.

This isn't to say that there's a problem with being a passive investor. You might have a full-time job, or may simply be unable to spend a lot of time with entrepreneurs day to day. That's perfectly ok!

Crowdfunding is a great place to start whichever camp you fall into: a few investors will likely want to weigh in on the ins and outs of the company, while the rest can come along for the ride without committing their time.

Further reading

Is there such a thing as a dream team, and if so, what does it look like?

Joanna Higgins, former Editor of Director and Launch Editor of BNETUK (now part of CBS Moneywatch)

What due diligence should be done on the team?

Christopher Smith, Chartered Marketer

How to value a startup

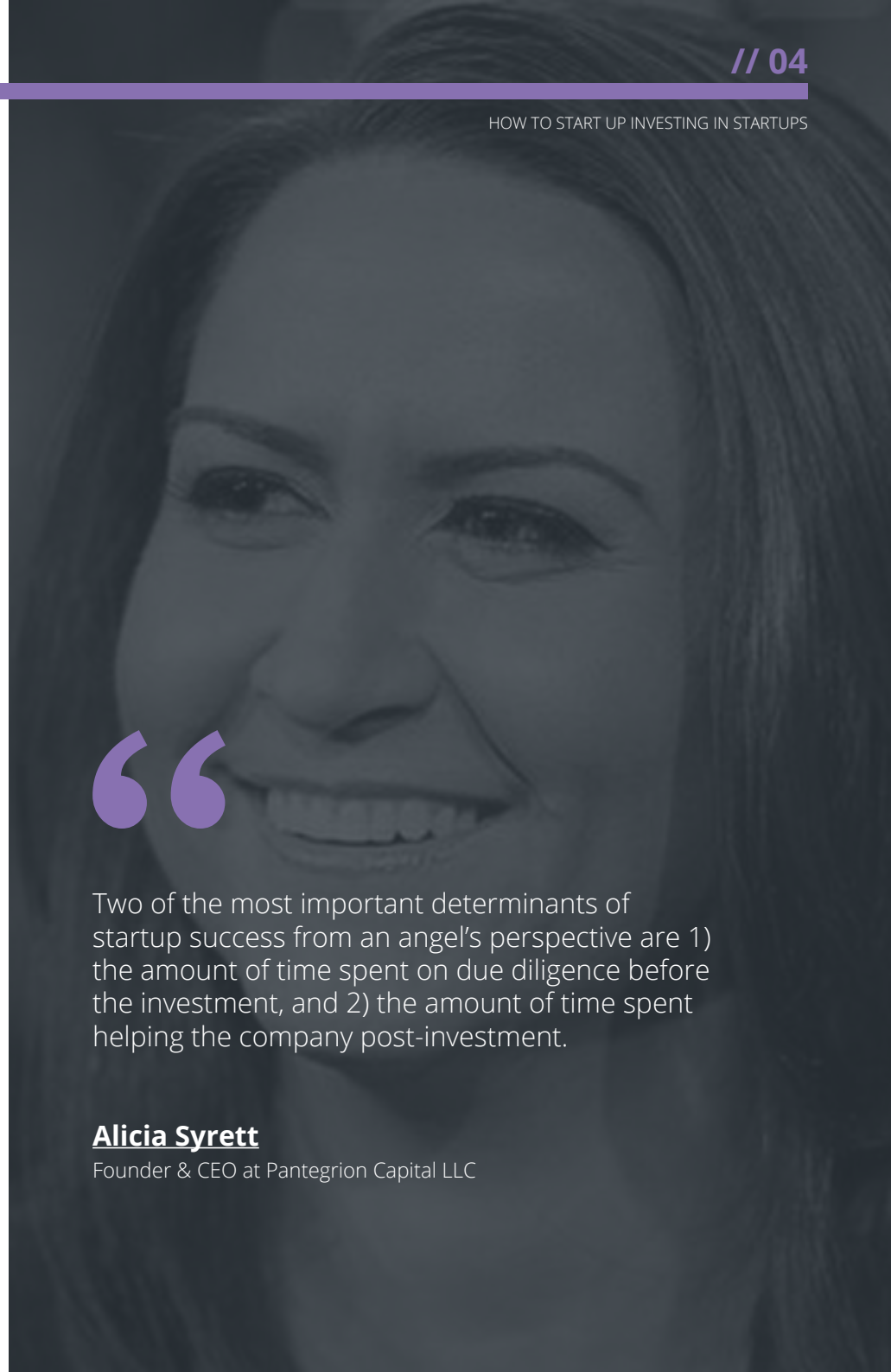
Marty Zwilling, entrepreneur, angel investor and author

Collaboration is key

Relationships are vitally important to startups: like in all business, it's often who you know that counts. What prominent partners is the startup working with? Who are its clientele? Is it being backed by knowledgeable investors and advisers? Are there any other influencers involved in helping the startup expand its reach?

This goes for the other side as well: if you know big names in the startup's sector or other investors who would be interested in putting their own funds into the round, use them! They can let you know whether the business looks viable before you invest, and after you invest they can become valuable assets that will help the startup – and your investment – reach fruition.

Crowdfunding is a social game, so spread the word.



"Two of the most important determinants of startup success from an angel's perspective are 1) the amount of time spent on due diligence before the investment, and 2) the amount of time spent helping the company post-investment.

Alicia Syrett
Founder & CEO at Pantegrion Capital LLC

A quick look at legals

The full extent of the laws that govern early-stage investing are, as is so often the case, exceptionally complicated and constantly evolving. You should always check the most current legislation for the country in which you wish to make your investment before proceeding.

A good lawyer is worth their weight in gold. While legal help isn't cheap, it's better to spend a little now to protect your interests in the long run. Make sure you get advice from a trusted professional before you sign anything.

Similarly, you should make certain that your accountant understands the relevant tax ramifications and completes the necessary filings on your behalf, specifically around SEIS and EIS.

Investor protections

The following are considered by many early-stage investors to be the most basic investor protections.

Pre-emption rights

Check whether your shares come with pre-emption rights. These allow investors to 'follow' their money by getting first dibs on future raises, thereby giving them the opportunity to maintain their percentage ownership. Without pre-emption, you could find your investment diluted to virtually nothing.

(For those of you who watched *The Social Network* and wondered how Facebook managed to dilute the shareholding of Eduardo Saverin from 30% to just 0.5%, this is how!)

Tag-along rights

Should the majority shareholder sell their stake in a business, tag-along rights give minority shareholders the right (but not the obligation) to sell their own stake on the same terms and conditions as the majority shareholder.

This gives minority shareholders some protection against a potential majority shareholder that may wish to change the business in a way that could put the minority at a disadvantage.

Drag-along rights

Drag-along rights are the contractual obligation that allows majority shareholders to force minority shareholders to join in the sale of a company on the same terms, valuation and conditions as the majority shareholders, effectively 'dragging' the minority along with them to force an exit.

This prevents minority shareholders from digging in their heels if a buyer who wants full ownership of the company proposes an offer to the majority shareholder.

Stages of funding

Seed round

The seed stage refers to the period just after a company has launched, when it's working on its proof of concept. During this time, it'll also be looking to gain initial transaction and receive feedback from early adopters to refine its offering before moving into the growth stage. Seed-round investors tend to be the friends and family of the founders, or a specialist early-stage VC.

Series A

A company's first significant round of financing. The money raised at this stage will be from more arm's-length investors rather than family and friends, which are likely to have participated in the Seed round. 'Series A' refers to the class of preferred stock given to these early investors in the business.

Series B

The second big round of finance a company raises, normally after hitting certain business development milestones. Successive rounds are referred to as C, D, E and so on.

Note: this section is written with reference to UK legislation.

> You know what works in venture capital? A group of incredibly smart, connected people who have the financial wherewithal and risk appetite to make multi-million dollar bets on unproven ideas and inexperienced founders. People who can make decisions quickly, and who spend their time trying to help entrepreneurs make the most of that cash.

Sarah Lacy
Technology/startup journalist

What to expect now you've invested

So, you've made your investment, the money has left your account and you've become a shareholder. What happens next?

You get shares

Firstly, you should receive proof that you own shares in the company. Typically this will happen a month or so after your investment goes through.

For direct shareholders this will come in the form of a paper or digital share certificate. Your holding will also be listed on the company's share register, which in the UK is held at Companies House and in the US, a state-level registry.

Alternatively, if the crowdfunding platform operates a nominee structure, the shares will be held in trust for you by the appointed nominee.

Tax certificates

If you are a UK taxpayer and the company you invested in is EIS or SEIS eligible, you should receive a certificate that will allow you to claim back the relevant tax reliefs. The company will be sent this certificate by HMRC and will then forward it to you. Be aware that it can take a considerable length of time as HMRC's system for issuing such certificates is still paper based.

Updates from the company

As a shareholder, you will naturally be interested to know how the company is doing. So, you should expect to receive periodic reports on its progress. Typically, these are documents such as trading updates and financial reports. They are usually delivered by email and follow on from board meetings.

Surprises in the investing world are a bad thing, so at the very least you should look for biannual reports, but bear in mind that reports take a significant amount of time to prepare – time the entrepreneur could spend building the business – so don't push too hard for constant updates.

You may also be invited to vote if, for example, the company needs to consult its shareholders and obtain their opinion on a particular decision.

If your investment is held under a nominee structure then your nominee should keep you informed by passing on information from the company.

The company may request more funding

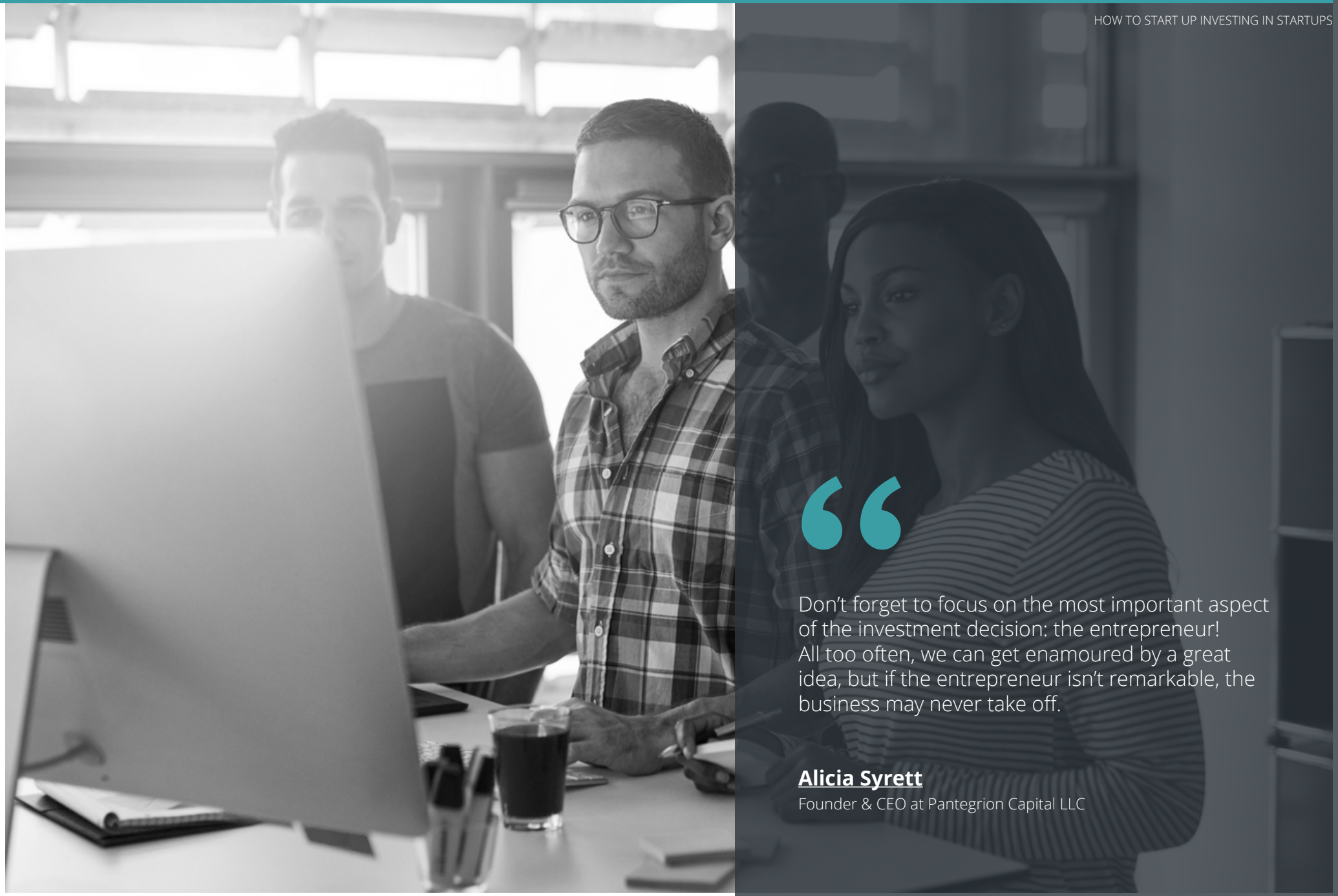
In due course, you may be contacted by the company regarding a follow-on funding round or rounds. This is by no means unusual with new businesses.

If you are investing via an equity crowdfunding platform, you may have pre-emption rights (see previous section, 'A quick look at legals'). These give you the right of first refusal whenever the company is issuing new shares and are one of the most important rights you can have as an investor in a company. In fact, in early-stage investing, many business angels and investor syndicates funding early-stage businesses insist on having pre-emption rights as standard.

Other things to think about

The company you invested in may be successful and in due course exit if, for example, an IPO or an acquisition is on the cards. Depending on the circumstances, you could be obliged or choose to join in the sale of the company on the same terms, valuation and conditions as the majority shareholders (read more about drag-along and tag-along rights in the previous section, 'A quick look at legals').

Of course, this is a very risky investment class and most startups ultimately fail, in which case you could lose all the money you invested. One way to address this is by spreading the risk through creating a diversified portfolio of investments – something all investors should consider.



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Don’t forget to focus on the most important aspect of the investment decision: the entrepreneur! All too often, we can get enamoured by a great idea, but if the entrepreneur isn’t remarkable, the business may never take off.

Alicia Syrett
Founder & CEO at Pantegrion Capital LLC

Exit

The nature of investing in early-stage companies means that there is a high risk involved. It stands to reason then that the potential returns need to be large enough to cover this risk. Each company will have its own exit strategy, but these are notoriously easy to get wrong.

Here are the key things you should consider when it comes to analysing a company's exit plan.

What type of exit is the company planning for?

While there are other ways of achieving an exit, the big three are a trade sale, IPO and recapitalisation, which can be done through a management buyout, dividends or private sale of shares by any shareholder.

Trade sale

This is the most common type of exit in the US and Europe. Trade sales entail the disposal of a company's shares or assets and even liabilities – in whole or in part – to a strategic or financial buyer.

Effectively, the company is bought out by another company or another group of investors.

Your rights as an investor

Remember drag-along and tag-along? This is where they come in.

Being diligent about investor protections early on can save you a lot of disappointment further down the line, so it's worth reading through the paperwork before you sign on the dotted line.

Initial Public Offering (IPO)

An IPO occurs when a privately held company goes through the process of listing shares on a publicly traded market, such as the London Stock Exchange (LSE) in the UK or the New York Stock Exchange (NYSE) in the US.

Management buyout

A management buyout involves a company's existing managers seeking to acquire a large part or entirety of the company from the parent company or the private owners.

How long is this likely to take?

A general rule of thumb is to double the time the company thinks it will take to exit. While you should hope that the founders can stick with their business plan and deliver on their planned timescale, there are endless outside factors that can impact on their ability to sell.

How big will the exit be?

Start by looking at the exits of companies similar to the one in which you're considering investing. If they have all exited for a much smaller figure than what the company you are looking at is hoping for, you should bear that in mind.

Very few companies will reach even a £100 million valuation, so make sure what they're saying is realistic.

Market conditions

The market for company sales and IPOs is cyclical and generally tracks that of the wider economy. If a company is expecting to sale/IPO in the next few years, have a think about where the wider economy will be at that point in time.

Potential competition and intellectual property

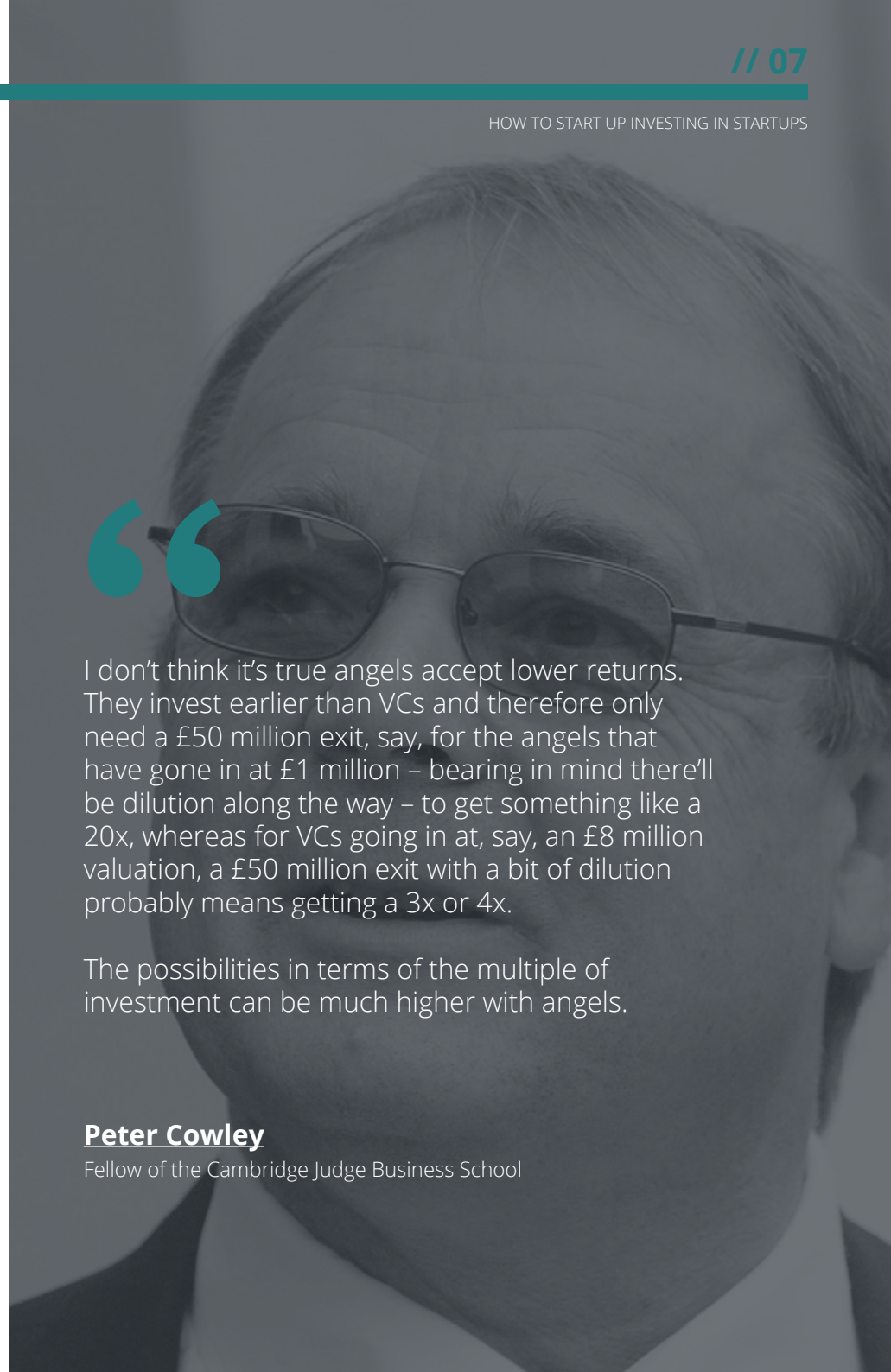
There are often a number of businesses competing within a space and it can be difficult to predict which one will get the best exit. There are a number of factors that make a company an attractive target, and if there's a lot of competition within the space you need to understand what the competition could offer potential suitors.

One way of making a company stand out from the competition is the intellectual property, or IP, that it owns. Many acquisitions have been made where the IP owned is the main motivation for the purchase.

Does the company have a back-up plan?

Things can and do go wrong, so it's good to know what a company plans to do in the event that the planned exit does not materialise in the expected way or the expected time. Private companies can issue dividends just as easily as publicly traded companies, so this may be one way of giving back to the investors if things don't go to plan.

As always, investing in early-stage ventures is risky and even the best-formed exit plans can go off the rails.



"I don't think it's true angels accept lower returns. They invest earlier than VCs and therefore only need a £50 million exit, say, for the angels that have gone in at £1 million – bearing in mind there'll be dilution along the way – to get something like a 20x, whereas for VCs going in at, say, an £8 million valuation, a £50 million exit with a bit of dilution probably means getting a 3x or 4x.

The possibilities in terms of the multiple of investment can be much higher with angels.

Peter Cowley
Fellow of the Cambridge Judge Business School

When things go wrong

Most startups fail – this is the truth you must embrace when deciding whether or not to take the plunge and start investing in early-stage businesses. Now that the 800 lb gorilla is out in the open, we can discuss how to prepare for when things go wrong and what you should do when, inevitably, one of your companies does fail.

Veering off course

A company completely going under is about as bad as it's likely to get, but chances are there'll be a few warning signs en route. If the issues are addressed as they arise and the course adjusted, then there's no reason why (with a bit of luck) the iceberg can't be avoided.

Things that can disrupt a startup's rise to its full potential include targets not being hit, key personnel changes and sales not materialising. It may be that the company simply needs additional funds to reach the milestones set out in a previous round. If this is the case, it could try to raise funds at either a lower valuation than the previous round (this is known as a down round), or at the post-money valuation of the previous round (a flat round), depending on how poorly they have performed.

Stay in the loop

The best thing you can do is establish a clear line of communication with the company, either as a direct shareholder or via a nominee, so that you're aware of the company's progress and can avoid any nasty surprises.

Should things start to take a downward turn you and your syndicate should discuss the best way to support the business, either through providing contacts or (if possible) sharing your experience of similar situations and 'lessons learned'. Remember: investors are a startup's best source for network connections, buyers, suppliers and more.

Keep the pot topped up

Most companies will require more than one funding round, so setting aside cash for future raises isn't a bad idea. In fact, Business Angel of the Year 2014 Peter Cowley recommends keeping aside two to three times your original investment for follow-on funding rounds.

Down and flat rounds

While down rounds and flat rounds are generally thought of as losses, they are a natural part of the game. Approach them as if you're reviewing the company for the first time. In an insightful interview for the podcast Angel Insights, Founding Partner of London Bridge Capital Yenyun Fu reminds us that some of the most highly acclaimed success stories have been through down rounds. In another interview, Peter Cowley, Entrepreneurship Fellow at the Cambridge Judge Business School, talks about what he takes into account before deciding whether or not to invest in a flat round.

What to do when the ship sinks

Of course, there will be times when you've done everything you can to shovel water back overboard and the old vessel's gone down all the same. It might seem like there isn't anything that can make the situation worse, but there is: panic.

If the company you've invested in ceases to operate, emotions will be running high – entrepreneurs and investors alike will be upset and disappointed. What's important is that no one storms in with the sole intention of looking out for themselves.

Stay calm, level headed, and see if any of the following applies to you.

Tax breaks

Some countries, including the UK, offer downside protections for early-stage investors in SEIS- or EIS-qualifying shares. You'll know if you've got them, and you'll be able to write off part of the loss on your next tax bill.

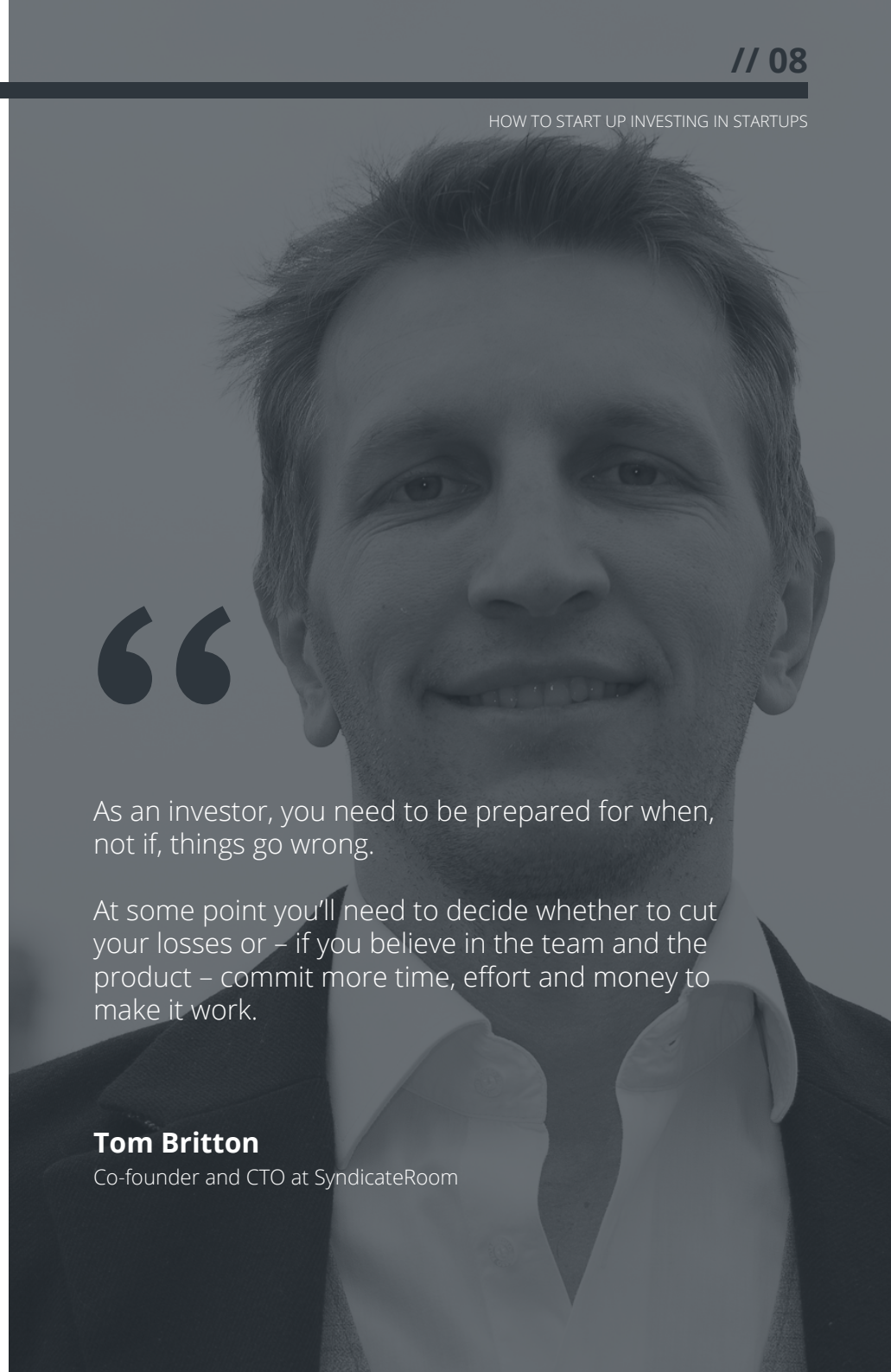
Liquidation of assets

Depending on the type of company you've invested in, a small amount of value able to be returned to investors through a sale of the assets. These assets can be physical (office, equipment, hardware), IP based (patents and such) or derived from the value of the user database. If there's something of value it will need to be sold and the money can then be distributed.

Supporting the team post closure

Being an entrepreneur is incredibly difficult and going through a failure even more so. Soshi Games Founder Cliff Dennett knows that much firsthand and explains a bit more about the experience in this candid interview.

The best thing you can do when things go wrong is support the team. Remember, while you may have lost out financially, they will have poured their own invested capital together with years of blood, sweat and tears down the drain. Your first instinct may be to get angry, but good entrepreneurs will bounce back – and you don't want to burn any bridges should their next venture hold more promise. Consider it a learning opportunity.



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As an investor, you need to be prepared for when, not if, things go wrong.

At some point you'll need to decide whether to cut your losses or – if you believe in the team and the product – commit more time, effort and money to make it work.

Tom Britton
Co-founder and CTO at SyndicateRoom

More information

Hopefully this resource has given you an insight into the world of alternative finance and the prospect of investing in early-stage businesses – or at least provided a springboard for further research. There's a lot more to cover if you want to get serious about angel investing; fortunately, there's a good place to start.

The Investors' Academy is a free online resource for investors. Updated on a regular basis with articles, podcasts, videos and mini courses created in conjunction with seasoned angel investors and venture capitalists, the Academy will keep you up to date.

Here are a few other free online resources that will help build your knowledge.

Useful resources

Websites and newsletters

- Above the Crowd
- AVC.com
- Beauhurst
- Calacanis
- CB Insights (daily newsletter)
- Chris Dixon
- FeldThoughts
- Mark Suster
- Mattermark Daily (newsletter)
- Term Sheet
- The Barefoot VC
- The Equity Kicker
- Tomasz Tunguz

Reports

- Alternative Finance Industry Report 2015
- Bridging the Equity Divide (SyndicateRoom)
- Siding with the Angels (Nesta)
- The Deal (Beauhurst)

Podcasts and shows

- 20 Minute VC
- a16z
- Angel Insights
- Recode
- The Seed & EIS Hour
- This Week In Startups

Some important terms

Crowdfunding

The funding of projects or ventures by raising money from a large number of people, usually online.

Dilution

The reduction in the ownership percentage that an investor holds in a company.

Diversification

An investment strategy to spread risk and minimise losses by investing across different sectors.

Dividends

The distribution of a portion of a company's profits to shareholders.

Drag-along rights

The contractual obligation that allows majority shareholders to force minority shareholders to join in the sale of a company sale.

Due diligence

The process of comprehensively examining an investment opportunity to ensure that everything is as it seems.

Equity

Equity refers to shares or other securities that represent an ownership interest in a company.

Exit

An Exit is an event that offers investors the opportunity to dispose or "exit" part or all of their shareholding.

Illiquid asset

An asset that can't be turned into cash quickly or without losing substantial value.

Lead investor

A Lead Investor is an individual or group who are leading a funding round.

Nominee

A nominee is a person or company who holds an asset on behalf of another.

Portfolio

A group of financial assets held by an individual or a group.

Pre-emption

A contractual provision regarding the issue of shares to existing shareholders.

Tag-along rights

Tag-along rights give minority shareholders certain legal protections.

Unicorn

A startup valued at more than £1 billion, the unicorn is a mythical beast. Few of us are likely to see one coming or get the chance to invest; if you happen across one, grab onto its horn with both hands and don't let go.

You can find a complete glossary online at:
www.syndicateroom.com/learn/glossary

Thank you to everyone that contributed to this guide, particularly Josh Maher for writing the introduction as well as everyone who's taken part in Angel Insights and the Investors' Academy.

How to start up investing in startups was created by **SyndicateRoom** as an unbiased resource for those new to investing. We believe that everyone should have fair access to investment opportunities – indeed, this is the very foundation of our company – and knowledge is the first step towards that goal.

A bit about SyndicateRoom

SyndicateRoom is the UK's only investor-led crowdfunding platform, allowing the crowd to invest alongside angel investors on the same economic terms. In March 2016 SyndicateRoom became the first and only crowdfunding platform to give members access to public markets.

We'd love to hear from you

If you want to talk about this guide or would like to collaborate, please do drop us a line at team@syndicateroom.com or visit us at www.syndicateroom.com

Share and share alike

How to start up investing in startups was created by SyndicateRoom, written by Ekaterina Bystrova and Tom Britton, and designed by Sonia Caetano.

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We’ve invested where we thought the business model was weak, but we really liked the people.

Ricardo Schäfer
European accelerator Seedcamp

SYNDICATE ROOM

Intelligent Equity Crowdfunding

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