



Valuable Advice from Workshop 4

A Global Perspective on Angel Investing: Is Angel Investing a Sensible Thing to Do? The Profits and Pitfalls

Held at the Northern Club, Auckland on Tuesday 14 October 2014

Mark Lowndes (Managing Partner, Lowndes) introduced the five speakers: John Huston (United States), Catherine Mott (United States), Tom McKaskill (Australia), Jim Connor (United States) and Jordan Green (Australia).

The discussion was opened with questions from Mark Lowndes.

What is the most exciting of your Angel Investments?

John originally invested in a medical device that benefits patients during invasive surgery. Although there has been no exit, it has been the most exciting and rewarding investment as it improves patient care.

Catherine's favourite and most rewarding investment was similarly a small catheter medical device that benefits hospital patients. Tom's background as an entrepreneur and running a Master of Entrepreneurship Programme in Australia has helped him to specialise in and develop the theory and framework around strategic exits for investors. Jim expressed his passion for actively investing in educational companies to transform the way children learn using interactive technology. Jordan's most exciting investment has been with an Australian entrepreneur who invested in a solar-powered LED lamp for third world countries as a substitute to burning kerosene.



(L-R) Jordan Green, Catherine Mott, Jim Connor, Dr Tim McKaskill, Mark Lowndes (Chair), John Huston

What would you like to see in a potential CEO? Are there any buttons you would like them to press?

Catherine said that an Angel in a first pitch is always doing the math as to what the market opportunity is and how to get a return. A typical pitch should therefore be focussed on the practicality of the business, the quality of the team and management, the business strategy and business model rather than the technology or product.

Jim said it was important to ask yourself as an investor whether you would be able to work with the CEO, and whether they

have the ability to take on your advice. A good technique is to ask them questions that will reveal their motivations and style. Jim's example was to ask how they would hire someone more intelligent and successful than themselves. Tom needs a CEO to be open to advice. A telling sign of this is someone who is ready to take notes in every meeting.

John said his number one reason not to invest in a CEO or entrepreneur is if he can't relate to that person. It is important that the CEO or entrepreneur is able to concede that they don't have everything figured out and they have capacity to take on advice. Finding out about the person's family and personal life can be indicative of their preparedness and commitment to making the business grow and be successful. The long 80 hour weeks and little time with family requires a strong support system.



How can an investor really find out about a CEO?

Jordan said that it is common for CEOs in an initial meeting to behave in a certain way so as to meet the investors' expectations. They answer questions they know will be asked of them and have prepared answers. The solution to this is move past the questions they are expecting and to extend the first meeting to last a few hours. That way you can properly assess and investigate a person, reveal their family dynamic, their commitment to the business, and what motivates them. You can also properly determine your compatibility with one another.

When listening to a pitch, are you thinking about the potential for an exit and if the person is prepared for an exit?

Tom explained that it is crucial to a CEO's pitch to convince an investor that there is a strategic exit post-investment. Being able to outline how they, the CEO, will get the business to that point and the amount of money needed to get there is fundamental. The pitch will need to demonstrate how the investor will be able to exploit the business strategy over the next few years, what their return will be, and why it is a big enough opportunity to invest in.



What should entrepreneurs look out for? What are the positive and negative signs of a relationship with an investor?

Some investors can be overbearing and controlling, while some can be incompetent and offer poor advice. Jim suggested it is important to find a balanced investor who suits your business model and management, is aligned with your business strategy and your views as an entrepreneur. A good investor will have a strong business acumen, an understanding of how to work effectively with people, know their role in a meeting, and be someone who can maintain control whilst giving the entrepreneur enough room.

Catherine added that it is important for an entrepreneur to understand the differences between individual investors and groups of investors. Some investors are unsophisticated who will write cheques easily and are happy to stand back and build their portfolio. Other investors are more sophisticated and will pursue an active involvement in a company. Generally an entrepreneur needs to decide what they want from an investor, whether it be advice, an introduction to distributors, or pure capital, as this will determine the type of Angel to pitch to.

What is your preference as to your role in a company, how much involvement do you like to have?

John said his involvement depends on the stage of a company, but explained he is normally always involved on the board to build strategic value for the company.

If you are not happy with how a company is being managed or if it is running out of money, what happens at that point?

Jordan emphasised that no business runs in a straight line and there will always be ups and downs. It is important to assess a detailed financial plan from the outset and confirm whether you can have a productive relationship with the CEO, share a consensus view on the right strategy to take and how important decisions for the company will be made.

Jordan added that it is imperative to choose co-investors wisely and decide whether you can have a productive relationship with them.



Does a Chairman have an important role to balance entrepreneurs and angel investors?

Catherine believes the Chairman of the Board of a company should be the founder. She mentioned protective provisions should be put in place so that certain decisions cannot be made about the company without Chairman or Board consent. The Chairman is usually expected to prepare the board meetings and maintain governance of a company. Catherine emphasised three key responsibilities of the Chairman are to make sure a company never runs out of cash, making sure the company gets an exit, and maintaining the ability to fire a CEO if it is needed. These responsibilities are a great way to prepare the board and stay focussed.

How often do you have a plan in mind that leads to an entrepreneur no longer being a CEO? How does that work out?

From experience, Jim said he did not see this type of situation happening often, but that sometimes CEOs reach their potential and need to be replaced. It is therefore crucial to hire people who will grow with the company and who have the confidence in the long term running of the company. Catherine added that an upfront conversation should be had with the CEO explaining that this type of situation could happen. She said it is often a difficult decision and the board should be involved where possible.

Mark invited others in the audience to raise questions for the panel:

Is there a greater propensity to invest elsewhere other than in New Zealand? Does US have more of an entrepreneurial society?

The market for venture capital began in the United States due to its increasing number of high tech industries and today there is five times more high level investing in the US than elsewhere. Tom emphasised that the US has a historic culture of making money and it does not have the Australian and New Zealand tall poppy syndrome. There may be a greater incentive to earn money, as people are considered heroes when they are successful and wealthy. The US economy provides a greater basis for investors as the markets are larger and businesses have the ability grow without the need to expand internationally.



In what industries or sectors are the best opportunities for investing at the moment?

Jordan explained he personally is staying away from investing in the retail and 'app' industries. There is not really any way to know which industry is profitable or one which guarantees an exit. As an investor you should be looking to invest in a team of people or the management of a company as much as the product. You cannot measure a good investment in purely financial terms, and looking three to five years ahead will help you in that decision.

What are some common elements of why an investment is not going to plan or is going to fail?

Catherine emphasised dysfunctional management and bad co-investors as being fundamental issues for companies which can lead to investment failures. John added that aside from management, a company that burns through the initial round of investment money and as a result cannot get through the second round of development, will often struggle and potentially fail.

Why is Angel investing a sensible thing to do? What sort of return is realistic and what sort of share should you put in?

Jordan recommended never to invest more money than you are willing to lose. Due to the high risk nature of Angel Investing you should always be prepared to lose. Your investment should make a contribution to something that interests you, that benefits your community or increases your wealth. Jordan advised not invest purely to make money, whilst Jim advised that investing say five percent of your portfolio would be a good start.

Catherine pointed out there is both a financial reward and a psychological reward from Angel investing. It is incredibly rewarding to have a company that you are part of develop and grow, but you should separate this from the financial reward as that is not guaranteed; there will always be ups and downs.

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