Successful angel investors are focused on the exit.

Purpose of this article

This article has a two-fold purpose:

1) Help angel investors identify the exit questions and issues they need to consider when assessing potential angel investments and managing their exit.
2) Help founders understand what successful angel investors may be thinking regarding exits.

This article considers success to be the cash return the angels receives upon exit. One of the key measures is IRR (Internal rate of return).

How to read the article

This article identifies four sets of issues, questions, and analysis angels should consider. This article is not intended to educate angels regarding the techniques and tools to address the issues, questions and analysis,

#1 Alignment of goals.

Do the founders and angels have the same goals? The angels want to get cash out, which almost always occurs via a sale of the startup. Do the founders expect to sell the startup? Are the founders focused on the startup being their lifetime calling or reaching the stage where the startup provides a comfortable income for the founders?

Do the founders and angels have the same commitment regarding when to sell the company? Perhaps on day 1 the founders and investors agree. Then a buyer comes along which meets the original expectations. What happens if a VC then comes along with a term sheet with a high valuation that the founders want to accept? Great news with the founders but the investors may end up being stuck in the company for a much longer period time as well as taking the risk that growth never happens or the VC terms preclude a sale.

The founders and angels are aligned on day one for a longer-term sale. Then VC provide funding with liquidation preferences and accruing dividends. The eventual sale does occur but the bulk of the cash goes to the VCs with little return for the angels.

What is the financial plan and cap-table leading to exit? What will the rounds, types of investors, valuation, and key business milestone?

What criteria have the founders and angels agreed upon regarding when to sell. What happens if follow on investors want to change the criteria? What legal protections and agreements are possible to bind the founders and angels?

#2 Will an appropriate exit be possible?

Before an angel writes a cheque, she needs to determine:

1) Who might buy the startup?
2) Why? E.g. a PE firm looking for a 15-year investment or a high-tech company needing specific IP and talent?
3) What would they value it at and why?
4) What must the startup have accomplished?

It is risky to make a cheque and not know if an exit is possible.

The angel's due diligence process will require validating exit assumptions, through research and even contacting potential future buyers.

The startup financial forecast will include a line for exit planning expenses e.g. going to attending conference and events which attract buyers; building relationships with potential buyers.

#3 What is the potential impact of dilution on founders and angels?

The financial plan and cap table will include all items which may impact capital inflow or capital outflow upon exit including SAFE, convertible debt, preferred shares, debt, government grants, anti-dilution provisions, option pool, etc.

#4 What is the value of pro-rata rights for angels?

1) Pro-rata rights can enable an angel to maintain her percentage equity ownership in follow-on rounds of a successful startup. The angel must determine if they have the financial resources to be able to take advantage of pro-rata rights.
2) The financial plan and cap table can show the financial implications of pro-rata rights.

Your next steps

1) As an angel investor, you require a financial plan and cap-table which leads to an exit. You'll need the skills and knowledge to create this if the founders lack the skills and knowledge.
2) As a founder, you require a financial plan and cap-table which leads to an exit. You may need an advisor with these skills and knowledge to help you create these.
3) The founders and angels need to discuss the above four sets of issues.