How to ...

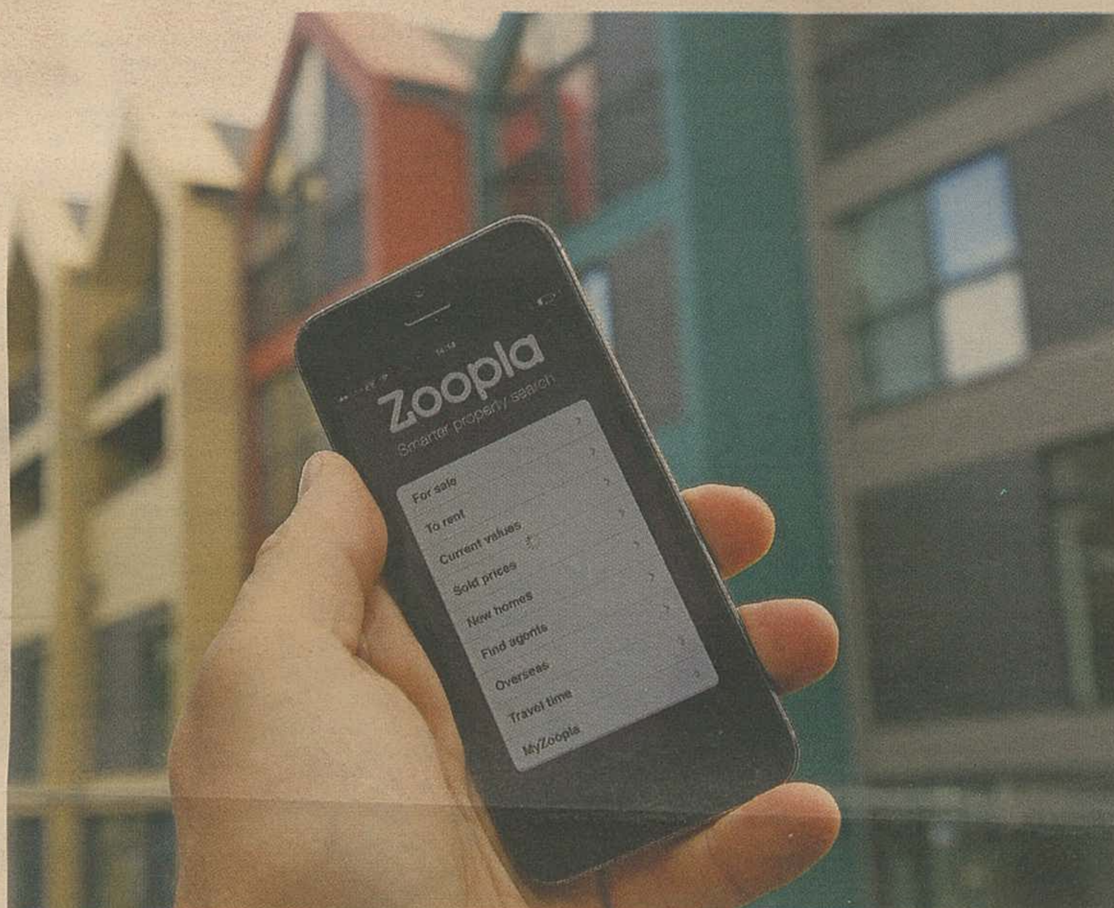
Become an angel investor

As always, the devil is in the detail

James Caan is nothing if not candid about his early mistakes as an angel investor. "My first investment was in a tech business, and I lost all my money," says the serial entrepreneur and former star of BBC's Dragons' Den.

The reason was simple. "What most people do is because they have built up a business, sold it and made money, they start to believe they can run any business," Mr Caan says. He lost money in the tech sector "because I knew nothing about the key drivers of the technology market".

The first lesson for anyone looking to become a business angel, therefore, is to invest in what you know. Hugo Greenhalgh looks at the art of angel investing.



Zoopla benefited from early investment by angels — Simon Dawson/Bloomberg

The market

Angel investing gained wide public exposure around a decade ago with the emergence of a more entrepreneurial culture and popular television programmes such as *Dragons' Den* and *The Apprentice*. Estimates vary as to its size, but in 2013-14, 2,600 companies received £1.4bn through Enterprise Investment Schemes — a popular programme for angel investors — up from £1bn the previous year.

Almost 1,900 companies also saw investments in 2013-14 worth £155m placed through its sister scheme, the Seed Enterprise Investment Scheme, up from £80m a year.

Many well-known companies have benefited from angel investors, including Zoopla, the house-hunting website, and Lovefilm, a online DVD rental service bought by Amazon in 2011 for nearly £200m.

The investor

An angel investor is "very different from someone who might invest some money into a fund at arm's length", explains Jenny Tooth, chief executive of the UK Business Angels Association. They take their own decisions "about putting their own personal money into a small business, and may take an active role in helping that business to grow; giving their time and contacts as well as strategic advice".

James Badgett, managing director of the Angel Investment Network, divides investors into three main categories. First, there are the entrepreneurs: "Someone who has had an exit at the age of 35-40, for example. They've got spare money available and they have expertise in running their own company."

This section represents a large portion of business angels, Mr Badgett says. "They have an understanding of what they believe makes a successful entrepreneur, and will try and replicate that success in the business or marketplaces they know."

Second are members of the professional classes with spare money to invest. "That will be lawyers, accountants — some of them will be able to come in and offer expertise to the company."

Angel investing is not always just about making money. For some, it can represent the start of a second career while for others it can prove a welcome distraction during retirement. "Those people who have worked in advertising or marketing can add value as well as money," says Mr Badgett.

Next comes the City crowd: those with a background in private equity or perhaps run a family office. These are likely to be more experienced investors — including those with inherited wealth for whom this is not a hobby, but a career.

Technology has thrown up a fourth category, with the advent of crowdfunding, which has drawn in a new group of predominantly first-time investors.

Getting started

The risks of angel investing mean the first thing you need to consider is just how much you can afford to lose. Once that is established, how do you want to invest — on your own or within a syndicate? The majority of angel investors belong to syndicates for a number of reasons. First, the ability to tap into greater expertise. Second, being able to access better opportunities at lower costs; and third, the more people you have behind an investment, the more widely the risk is spread.

There are many networks available, each offering advice on how to get started. But be warned: "It is fairly easy to find places to invest your money," says Mr Caan, "but finding places where you can actually make money is more challenging."

Averages for first-time investments vary, but most individuals will have £30,000-£40,000 either to invest in one stake or, more likely, divided into chunks of £10,000 broken down among different syndicates.

The benefits

Aside from the potential returns, angel investing offers attractive tax breaks. The UK government runs two schemes through which investors can access certain smaller companies. The Enterprise Investment Scheme, which was launched two decades ago, offers 30 per cent income tax relief up to a maximum of £1m a year. Various rules apply to this, but key is that the shares must be held for at least three years — and once they have been, any profits from their sale are free from capital gains tax.

"It's an amazing scheme, but it should never lead your thinking," advises Ms Tooth. "Your attitude towards any investment should be that this is a great company, it ticks all the right boxes — and great, I can also get a tax relief on it."

The Seed Enterprise Investment Scheme is similar but, as the name suggests, is aimed at funding early-stage companies.

As a result, the income tax relief on offer is higher — at 50 per cent — but for an overall smaller amount capped at £100,000 a year. Again, the shares must be held for three years to qualify.

The rise and rise of crowdfunding

Why go to the trouble of being an angel investor when you can put your cash into any of the growing number of crowdfunded ventures? Angel networks are at pains to stress the different nature of the two processes. "[Crowdfunding is] more for high street investors," says Mr Badgett.

With both crowdfunding and angel investing, the onus is on the investor to conduct due diligence. But most angel networks offer help to ascertain the value of each individual company or deal.

Gauging value is one of the key aspects for anyone looking to become an angel investor, particularly if you do not have a financial background.

Twenty hours is the average time you should invest in looking through a company's financials. "If you spend too long, then it means you're worried," says Ms Tooth.

When to sell?

First, make sure when you invest you are in sync with everyone on the timing of an exit, says Mr Holroyd. "I check with the management team, and then I will work with them specifically on the exit plan — dressing the bride, as they say."

For syndicate members, the process is usually agreed at the point of investment. In determining the shareholder agreements, angels are becoming more like venture capital funds, says Anthony Clarke, chief executive of London Business Angels. "These will typically have clauses that mean the minority shareholder is not left out in the cold," he says. If the majority of shareholders decide to sell, this means a minority cannot hold out — and conversely these will also protect the minority's interests.

Ultimately, though, Mr Clarke says evaluating the development of the business will determine when to sell. "If the company is growing rapidly and its markets are now international, it might be time for the company to remove itself from its angel investors."