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Do you have what it takes to invest in startups?

Insight: ‘Angel’ investing groups pool capital, resources and experience

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One of the best ways to become an angel investor in early-stage private companies is to join a local angel group.

More than 1,000 such organizations exist around the world, with at least one in every state in the United States, and at least one in more than 75 countries. What all these groups have in common is bringing together accredited investors who want to put capital to work and assist each other.

The benefits of joining a group include pooling deal flow and capital, domain expertise, and investing experience. Most groups run regular education sessions for new members and provide mentoring for less-experienced investors.

Angel groups over the past decade have become highly sophisticated, with professional trade associations, standardized best practices, extensive syndication, and a generally strong track record. New York Angels, for example, has invested more than $70 million in more than 100 startups over the past several years, and companies in which we’ve invested have been acquired by Google, Intel, Amazon, AOL, Living Social, CBS, Kodak, and other major firms — in some cases with returns of more than 50-100x. (Exits like these are extremely rare, but they do happen.)

In selecting a group to join, first make sure it belongs to its national federation of professional angel groups. In the United States, that would be the Angel Capital Association (ACA); in Canada, the National Angel Capital Organization (NACO). Then it’s important to understand what makes the experience of working with a group different from being an individual angel or investing in a professional venture fund.

As an individual angel investor, you are responsible for your investment decisions. This means you could, in theory, meet an entrepreneur at a cocktail party, hear a three-minute elevator pitch and write a check for a full investment round on the spot. This has happened, but it’s not necessarily the best way to make an investment decision.

Venture capital funds, at the other end of the spectrum, are commercial organizations whose business it is to find the five to 20 companies each year that they believe have a chance of being one of the only 80 companies a year that will ultimately exit in a sale of over $50 million.

Because these funds are highly visible, every entrepreneur is vying to get in front of them for funding. The major VC funds each receive between 5,000 and 10,000 funding requests a year.

Angel groups are between these two extremes. Unlike individual angels, they make themselves available to entrepreneurs (including having a website, soliciting funding applications even from entrepreneurs they don’t personally know, running events, and so on), but unlike venture funds they typically receive hundreds of applications a year instead of thousands. Accordingly, angels who are members of a group are exposed to a healthy but manageable flow of investment opportunities.

The typical U.S. angel group will receive a dozen or more funding applications from startups or referrals from members each month; the most active ones may receive more than 100. Groups also often syndicate investments, working cooperatively to fund rounds bigger than one group can handle. A typical group member invests in one or two companies each year, putting in $25,000 to $100,000 in each. Most groups expect this level of investment from members; some even require it.

In practice, most angel groups work on a monthly cycle, reviewing submissions that have come in during the previous 30 days and choosing five- to 15 for screening. The selected companies, which usually will not have had a previous relationship with anyone in the group, meet with a screening committee of two to 20 angels, who will usually spend at least half an hour hearing the company's pitch.

The screening committee will then invite three to five companies to return a few weeks later to present their pitch formally to the entire group, usually in a 15- to 30-minute session including questions and answers. If enough of the angels in attendance are interested in hearing more about the company, there will usually be follow-up meetings and due-diligence sessions, resulting (everyone hopes) in either a term sheet for an investment, or one or more angels agreeing to invest alongside other investors that the company has found.

After you’ve participated in an angel group for a year or so, you will have experienced a wide range of pitches, and will have watched first hand as other experienced angels ask tough questions, negotiate term sheets, and go through the mechanics of closing an investment round. At that point, you’ll likely be comfortable enough to start looking at — and investing in — interesting opportunities on your own.

David S. Rose is the founder & chairman emeritus of New York Angels; CEO of Gust, the angel industry’s online platform, and author of Angel Investing: The Gust Guide to Making Money & Having Fun Investing in Startups (Wiley).