



Angel Investing 201: Assessing and Managing Risk in Angel Impact Investing





The SWAN Impact Network

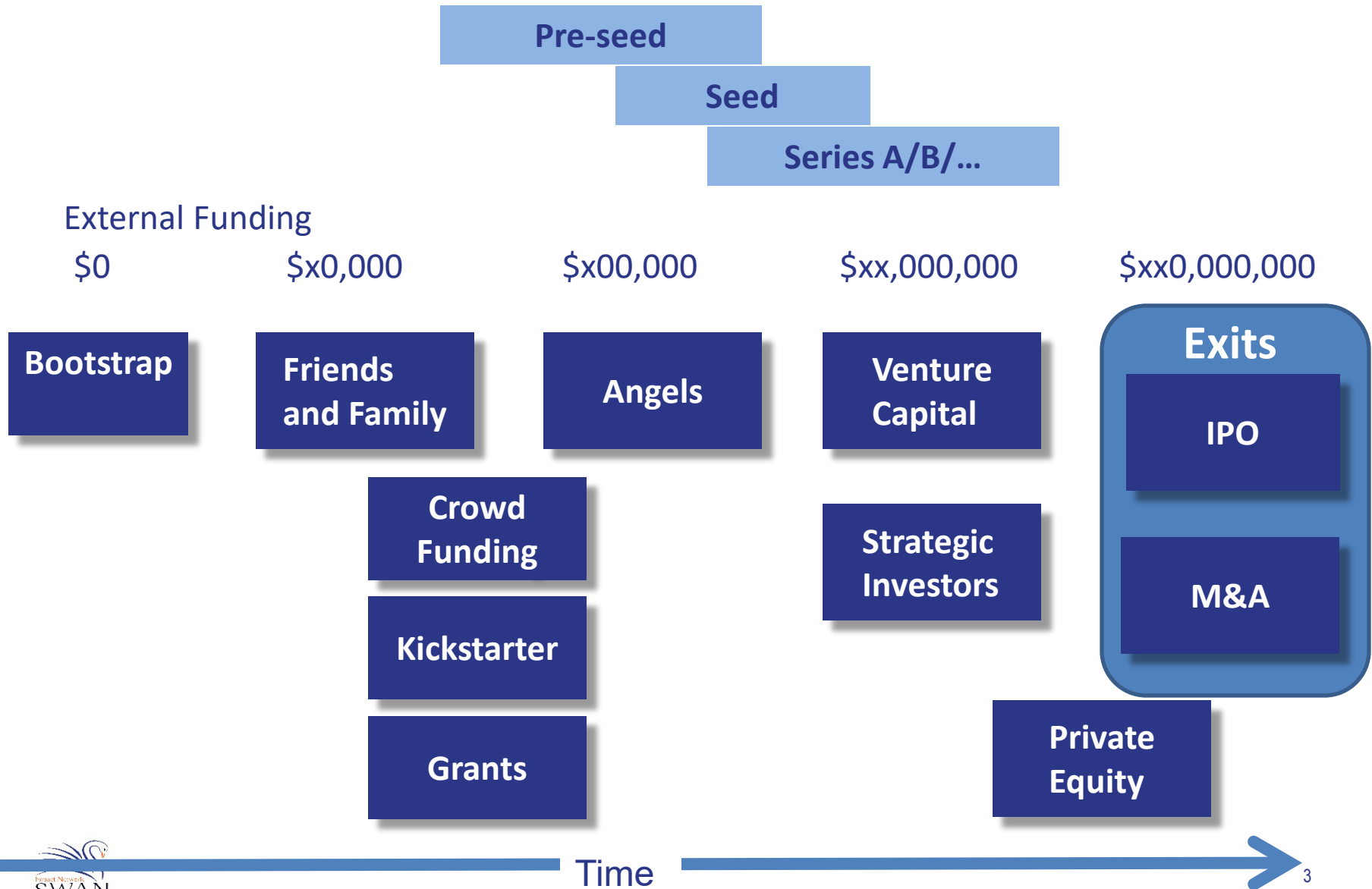
About

- Focus: for-profit, pre-seed, US, social and environmental impact companies
- 85 angel investors
- Chapters in Austin, Dallas and Houston
- Also has a Philanthropic sidecar fund

Investments

- Have invested \$14M in 44 impact companies since 2016
- Per year
 - ~350 company apply
 - ~ 6 companies get initial funding
 - ~6 portfolio companies get follow-on funding

Stages of Investing



SWAN Evaluates Two Bottom Lines

Primary Consideration

Financial return to shareholders

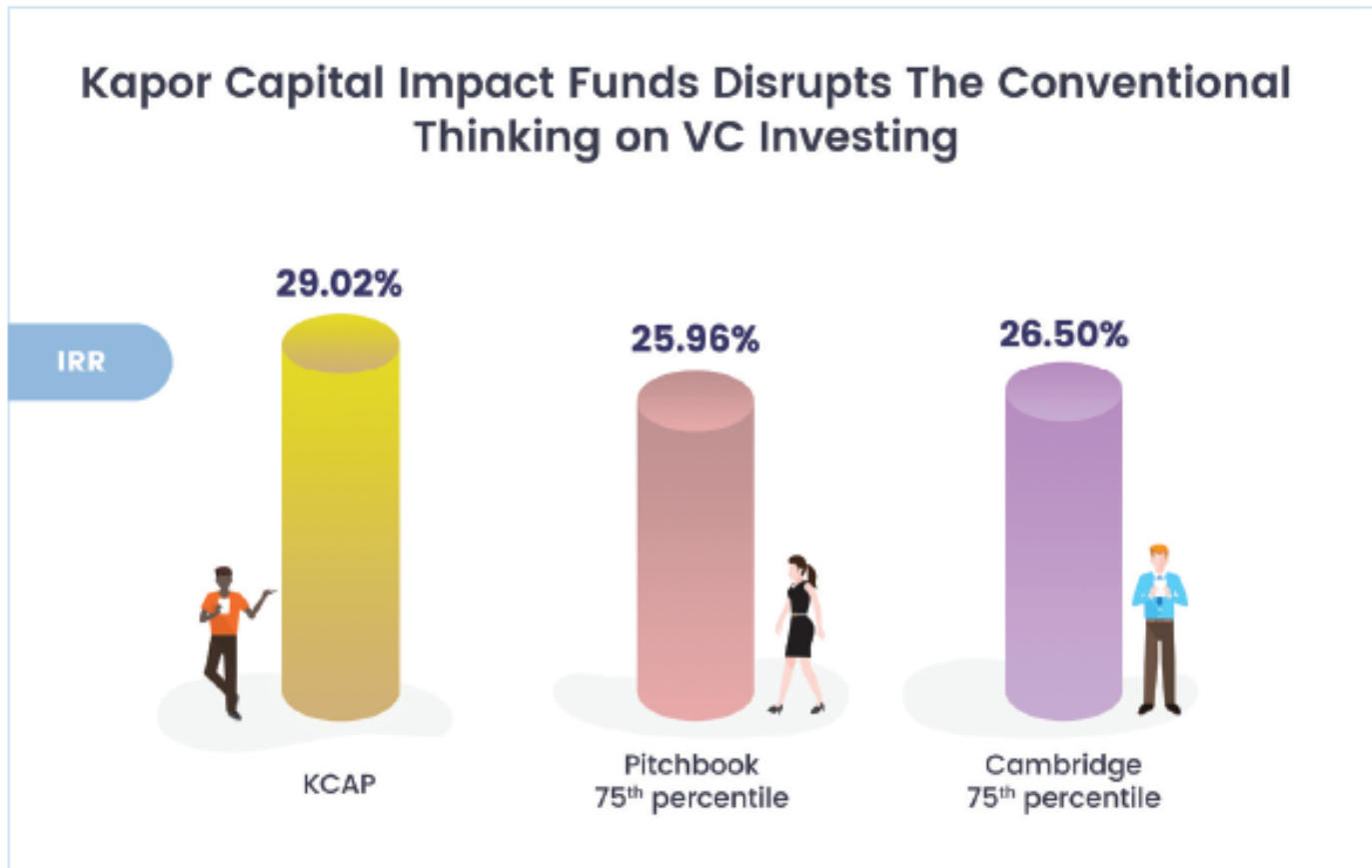
Impact created by company's primary business mission

Secondary Consideration

ESG (Environmental, Social, Governance), DEI & other socially responsible internal operations

Impact investing provides good returns

Impact Fund's IRR compared with 75th percentile benchmarks as of 9/30/18



Q: What is early-stage angel investing all about?

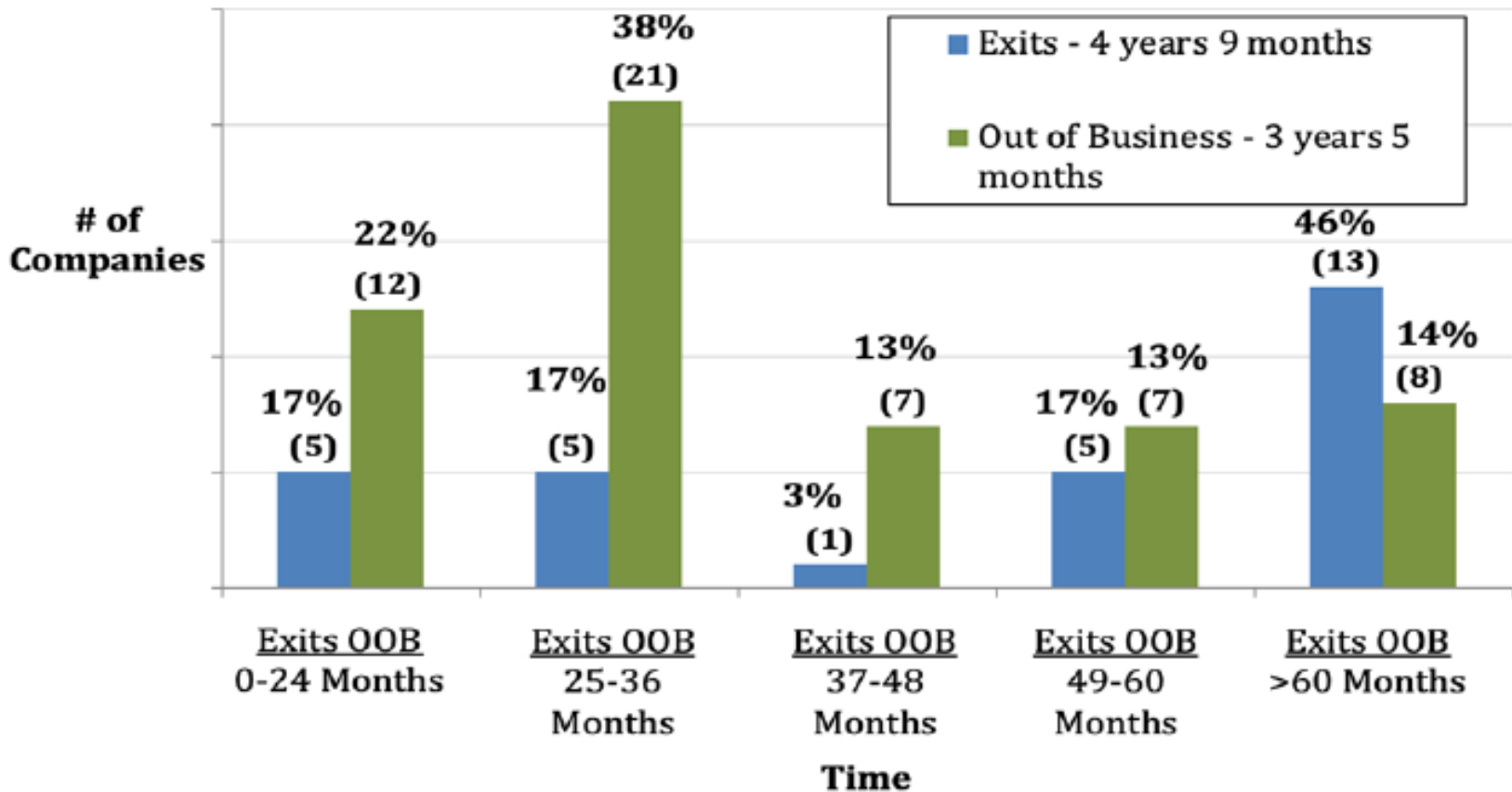
A: Assessing Risks



Lower risk: investing in Apple or Citi Bank

Higher risk: investing in pre-seed startups.

Angel Investing Outcomes



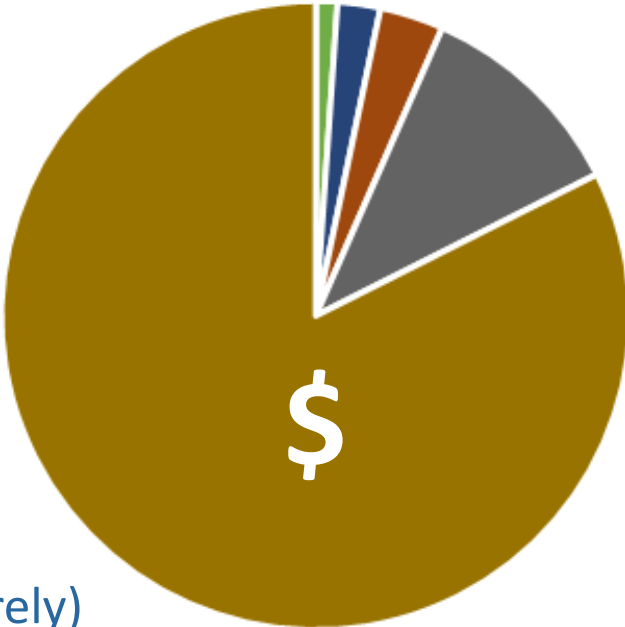
Making a Return Despite the Risks

Make a bunch of investments



50% fail.
45% survive (barely)
5% are highly successful

One company will provide a total return on your total investments



Our Pre-seed Due Diligence Considers:

★ Team

★ Product,
Technology &
Advantages

★ Market
Opportunity

★ Impact
Efficacy

Sales
Approach

Finances

Deal Terms

Corporate
Structure -
Governance

Exit
Opportunity

★ = Needs a compelling story.

All other topics must not have any red flags.

Team Validation –Job #1



Key Risks

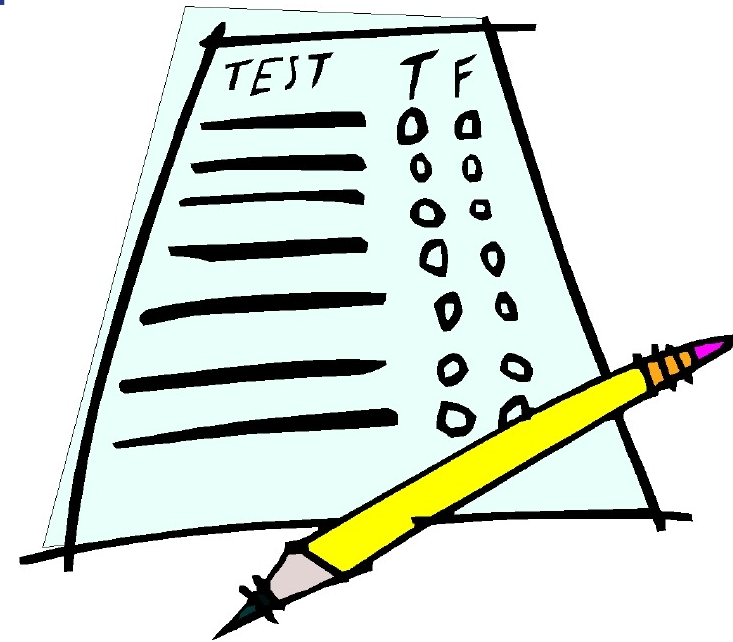
- CEO lacks emotional maturity
- CEO lacks experience in the company's marketplace
- CEO lacks startup experience
- CEO is not full time at the company

How to assess

- Interacting with the CEO and C-Levels
 - Typically, via zoom
- Reference checks
 - To direct references supplied
 - Ideally to secondary references shared by direct references
 - To former co-workers, board members, investors (LinkedIn is your friend)

Impact Risks

- The company's primary business mission is not clearly focused on delivering impact
 - Is impact part of their basic DNA?
- The CEO has no emotional connection to the impact mission
- The company's home page does not communicate their impact mission



Impact risk – Uncertain Efficacy

- What evidence is there that the company will effectively deliver significant impact?
- A must-have-impact for beneficiaries?
- Effective plan for acquiring beneficiaries?
- Long-term competitive impact advantages?
 - Higher adoption rates?
 - More significant impact?
- Direct impact?



Market Validation Risks

Risks

- Willingness and ability of customers pay for the solution
 - Must-have vs. nice-to-have
 - Person with must-have-need has budget available
 - Unpaid pilots don't establish willingness to pay
- Lack of enough of those payers to generate enough revenue (big market)?

How to assess

- Phone calls with three to five payers
 - Understand their pain point and budget
 - Understand the sales channels they routinely use
- Try the product out



Sales / Go-to-Market Risks

- Lack of a credible sales operating plan for scaling to enough revenue to allow acquisition
 - What type of marketing and sales organization and partners do they need (internal and external)?
 - Not sufficient: the CEO is today talking to the CEO's friends
- No cost-effective way to connect with potential customers
 - What is the cost of acquiring one incremental customer?
- No compelling insights on:
 - Customer retention rate
 - Customer lifetime revenue



Product/Technology Risks

- Product-market fit not yet demonstrated
- Product not ready for pilots (hard tech) or sales (soft tech)
- Development priorities not being driven by customer feedback
- Industry specific
 - SAAS: platform not scalable to large number of users
 - Hardware: supply chain not established
 - Medical/pharma: animal trials not complete



Competitive Risks

- No significant competitive advantage today
- No long-term, sustainable advantage => What keeps them successful for the seven years until acquisition?
 - Critical mass of customers?
 - Sales channel lock?
 - Supply chain lock?
 - IP/Copyright/trade secret?
- Competitive analysis focused on feature comparisons rather than customer-benefits comparison



Financial Risks



- Not raising enough in this round
 - Companies take twice as much time and money to hit planned deliverables
- Financial model not built on detailed assumptions
- Company not spending enough on R&D and Marketing/Sales in out years
- Revenue model not credible
 - Must be bottom-up revenue plan based upon serviceable obtainable market (SOM)
 - Number of customers willing to pay how much to solve a must-have solution
- Red flags
 - Very small revenue ramp => life-style business
 - Incredibly large revenue ramp => team not credible

Corporate Governance Risks

- Capitalization table risks
 - Do disinterested parties have significant ownership?
 - Does the CEO have the more ownership than other co-founders
 - Is the post-funding option pool in the range of 15%?
- Post-funding, will the post-funding board of directors contain only company representatives?
- If this is a corporate spinout, who controls the cap table, C-levels or parent company?



Investor Return Risks

- With this investment, can the company achieve a business result that significantly increases valuation at the next round?
- Is the company able to identify acquisition comparables?
- Is our post-funding percent ownership consistent with typical models?
 - E.g., will pre-seed investor have ~15% ownership
- Huge amount of funding is required for an exit



Investment Deal Terms

More
Company
Friendly



More
Investor
Friendly

Stronger
company?

Easier to
syndicate?

Higher
valuation cap
or pre-money

SAFE
note?

Convertible
note or
preferred
stock

If we lead,
we can set
terms

Higher risk of
future down
round?

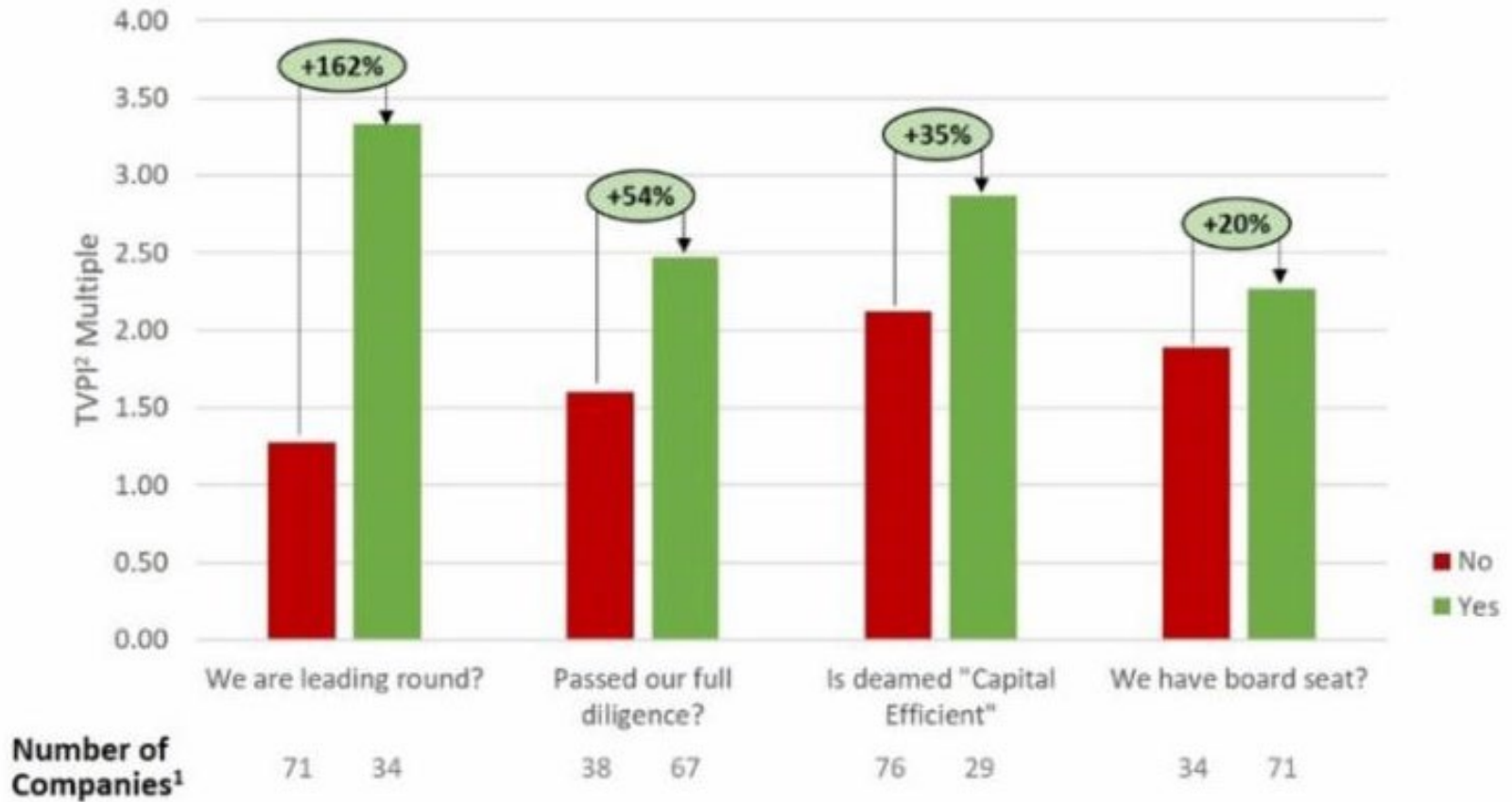
Lower
valuation cap
or pre-money

portland seedfund experience

- Portland Seed Fund is an early-stage venture fund in Portland and has made 70 investments.
- They analyzed what parameters best predicted a high investment ROI
- By far, the best predictor of high ROI was company-friendly terms
 - Companies with the best products, the best teams and large markets can demand the best deal terms

findings

Portfolio returns by key deal characteristics



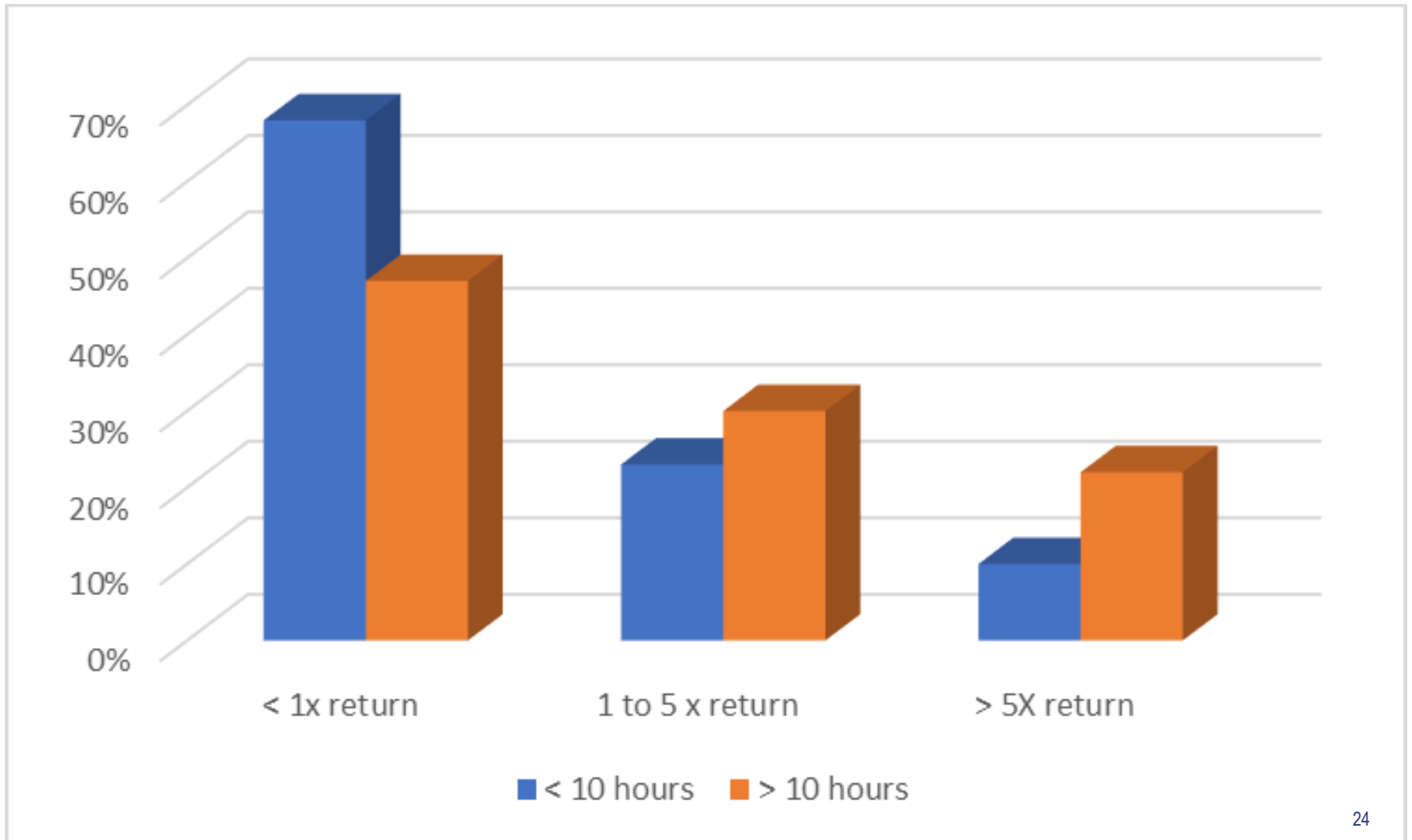
Measured based upon valuation increase.
 Leading round = negotiated the terms.
 Capital Efficient = needs less than \$5M total.



Managing Risk

1. Perform high-quality Due Diligence
2. Build a Portfolio
3. Mentor / Advise after funding

The Due Diligence Payoff



Additional Webinars



Angel Investing 101

- Introduction to Angel Investing



Angel Investing 202

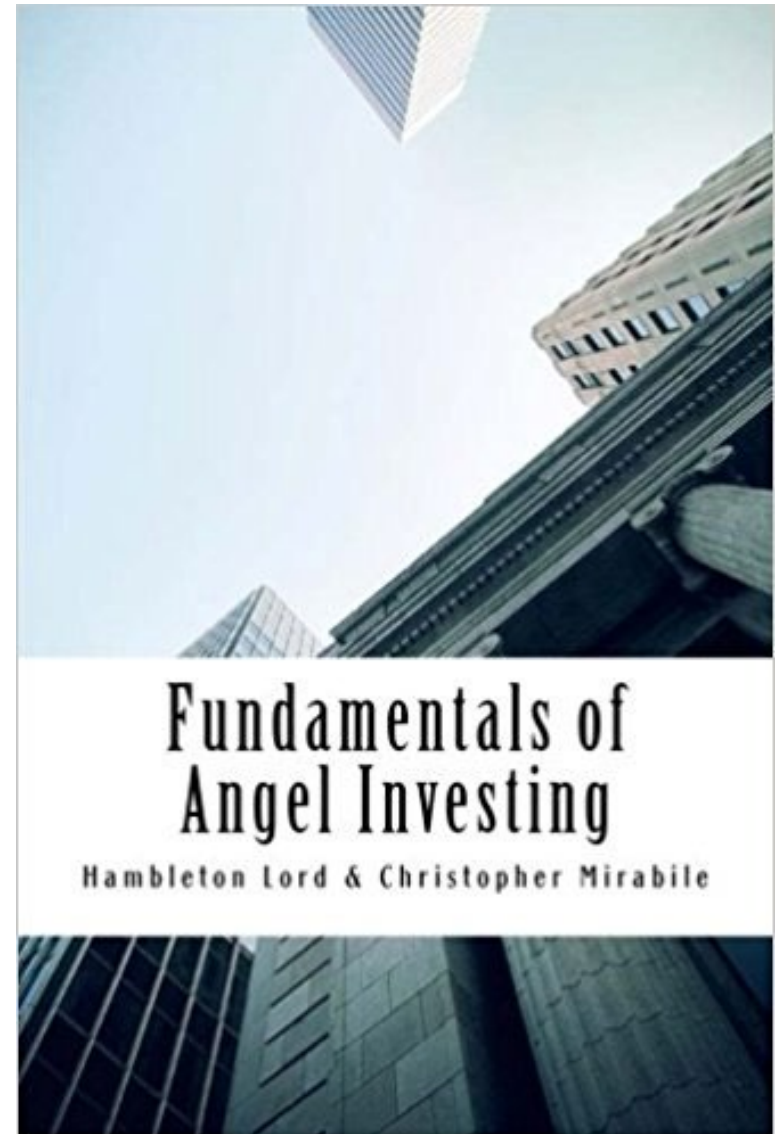
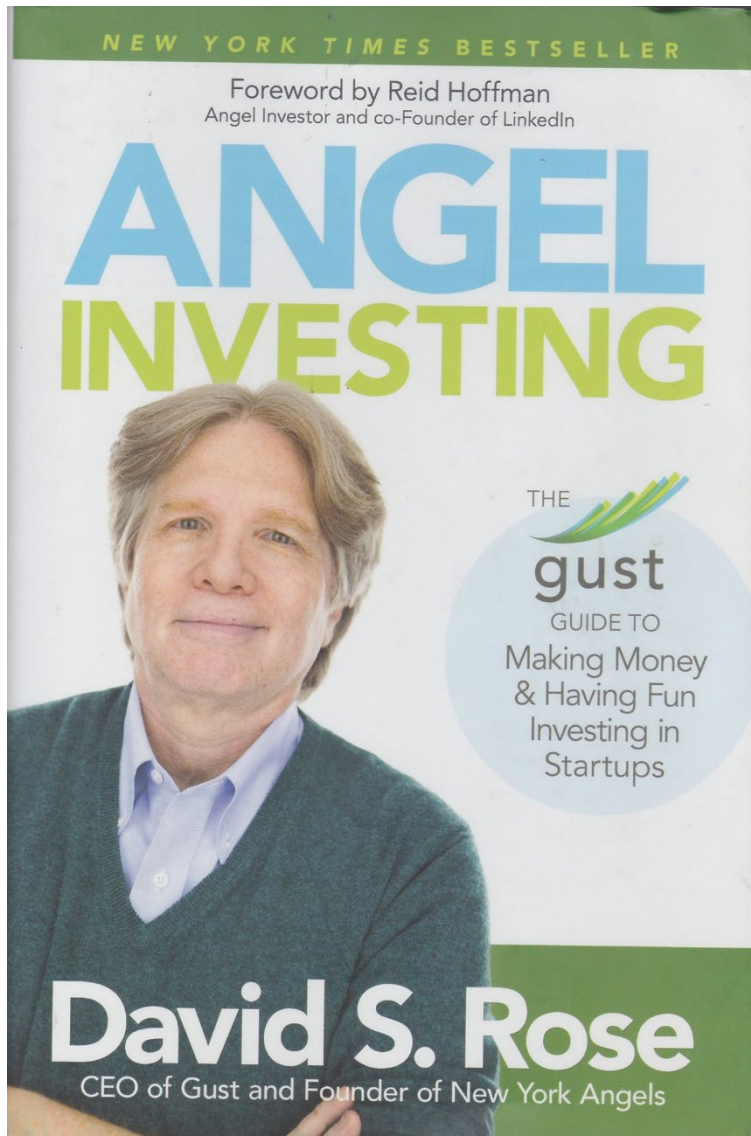
- Introduction to investment instruments and company valuations



Angel Investing 203

- Assessing and measuring Social and Environmental Impact

Good Resources



Ways to Connect with SWAN



**Become an
Angel.**

[https://swanimpact.org/
become-an-impact-
angel/](https://swanimpact.org/become-an-impact-angel/)



**Apply for
funding.**

[https://swanimpact.org/
obtain-funding-for-
impact-startup-
companies/](https://swanimpact.org/obtain-funding-for-impact-startup-companies/)



**Become an
Associate
member.**

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**Become a
Sponsor.**

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sponsors/](https://swanimpact.org/sponsors/)

Speak with our Executive Director.

<https://calendly.com/bob-bridge/15-minute-zoom-call>

Webinar Feedback



Any final questions?



What was most helpful?



What was less interesting?



What would you like to learn more about?