FINANCIAL PLANNING
PERSPECTIVES

TOUCHED BY AN ANGEL: PRIVATE EQUITY INVESTING

Are you a retired business owner or retired executive looking for a way to diversify your investment portfolio? Consider becoming an angel.

An "angel investor" is someone who invests in start-up businesses, providing not only cash but expertise to people who may have a great idea but not necessarily great business skills. (The phrase originally referred to investors in Broadway plays.) The risk is high, but the reward also can be high if you go into it with your eyes open.

What kinds of businesses need angels? Typically they are small high-tech, health services, retailing and personal services companies that are too risky for bank loans and not at an advanced stage for venture capital. They may need seed money to develop an invention or concept, finance development or bring their product or service to market.

Who's an ideal investment angel? Obviously someone with money to invest and who can afford to lose their investment. But it's not just a matter of having money. Angels generally are or were entrepreneurs themselves or who have business and management experience as a company executive. Being an angel is often ideal for someone who, say, has sold their own successful business. They may not want to return to the long hours and headaches of running a business, yet enjoy the idea of investing money and giving advice to someone who may have a potentially lucrative invention or concept. Angels may choose to take an active management role, perhaps just sit on the board of directors, or let a venture-capital firm or investment manager monitor the investment.

Having a solid business background is nearly de rigueur because as an angel you must be able to spot a product or service that works, that will have demand and that won't incur huge start-up costs. You'll need to do the due diligence, evaluate the business, negotiate a deal, monitor the investment and eventually exit the investment.

Finding potential companies has gotten easier. A number of Internet sites and regional angel networks have cropped up in recent years to play matchmaker. More traditional methods include word-of-mouth through friends and acquaintances, other angel investors (who might share in some

of your investments], bankers and lenders, technology transfer arms of universities, brokers hired by start-up firms to find investors, professional venture capitalists and other professionals in the field such as lawyers and accountants.

As you might imagine, the risks and rewards are enormous. Angel investors generally expect 20 to 40 percent returns or better—certainly higher returns than the stock market typically returns. But the risks are many.

- Information about the company or the market may be limited.
- Investments are illiquid. Your money will probably be locked up for several years before the payoff begins—if it ever begins.
- You can lose all of your investment money.
- You need to negotiate a deal—the price is not set by the market.
- Diversification can be difficult.

You can reduce the risk by diversifying among more than one angel investment, depending on the diversification of the rest of your portfolio. Usually it's advisable to stick to businesses or markets you're familiar with. If you don't know how to turn on a computer, you probably should stay away from investing in a software company. And be choosy. Review many plans for each business you ultimately choose.

Investments might be as small as $5,000 but are more likely to be $50,000 or more. Investment advisors generally recommend that angel investors put no more than five to ten percent of their total portfolio into these private equity investments. The bulk of their portfolio should remain in the core investments of stocks, bonds and cash.

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