

## Angel Investment Terms – The Role of Negotiations and Convertible Notes

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Angel and venture investors in startups and early-stage companies often enjoy the option to determine to what extent they intend to contribute professionally to their new portfolio holding. Investment advisors that allocate client capital to private investments often lend their business skills, resources and rolodex to the venture, as well, helping the company solve tough problems, prioritize objectives, build a great team and even seek out strategic partners and potential customers.

That makes private venture investment a unique asset class for investment advisors because they often have the option to be more than simply passive investors. Rather, they can choose to add value and influence the outcome of their investment in the same manner that advisor's efforts ultimately contribute to the return of their client's investment portfolio or retirement. The discretion to engage with the entrepreneur and contribute to the enterprise is a facet of private venture investing that attracts family offices and wealth managers.

Equally compelling to advisors is the ability to influence the terms of engagement for their client's capital in a manner that increases the opportunity for a favorable investment outcome. Unlike conventional public investment vehicles and most alternative products such as hedge funds, the investment terms for private venture investments are often very negotiable depending on the size of the contemplated investment, stage of the company and financing history.

### **Evaluate - Negotiate - Allocate**

Between due diligence and the investment decision is the opportunity to have a material impact on a private investment outcome. It surprises me when angel allocators, particularly lead investors in a seed round, simply accept the offering terms of a private venture without fully leveraging their currency to negotiate the best deal for their capital. Startup capital for new ventures is scarce relative to the go-go days of the 1990's. That tilts the advantage in favor of capital and provides angel investors with an opportunity to materially improve their position.

Angel round investors are a special breed. They take on startups at the riskier seed stage (in pursuit of higher-multiple exits) at a point where venture capital firms will typically not engage. VCs and institutional investors are more apt to see some evidence of progress with a startup...whether with regards to financing, product development a proven business model or market. Yet that does not prevent VCs from coming to the table with their own terms for a Series A financing. Yet angels too often let the entrepreneur's counsel set the terms for the seed and bridge financing rounds.

So which provisions in an angel round's term sheet are negotiable? All of them. I am humored by entrepreneurs who describe their terms as being "market". There is no market without the angel's capital and that means valuation, liquidation preference, anti-dilution protection, dividends, various protective provisions, Board composition and even the vesting of the founders stock should be subject to negotiation.

Each of these terms may have a critical influence on the outcome of an early-stage investment, but valuation is arguably the most difficult for angel investors to negotiate as there is little meaningful company history to value...rather, merely a vision around an idea, a market and a management team, and perhaps a business plan.

The “market” (of angel investors and entrepreneurs) has responded to this quandary by relying upon Convertible Notes to fund seed stage companies. Rather than dickering endlessly about the present value of a future uncertainty, for the most part, angels and entrepreneurs agree to lend their capital to the new venture in the form of a note (often secured with some form of collateral and offering a dividend) and agree to convert their debt to equity at the price set in the subsequent round of financing. The theory is at that point, more will be known about the business, market, competition and opportunity and that it will be easier to agree on a valuation.

Consequently, Convertible Notes have become the primary template for seeding young companies and providing bridge financing from the concept stage to a larger, perhaps institutional financing round.

Advisors should engage the growing universe of online content that speaks to best practices, suggested deal terms and negotiation tips for investors in private early-stage ventures. Among them, [venturepopulist.com](http://venturepopulist.com) is a free online resource that specifically provides investment advisors, wealth managers and family offices education and counsel on general matters pertaining to private venture investments. Additionally, advisors should engage a securities attorney with ample experience in private venture financings to advise on each term sheet negotiation.

Advisors that allocate to private investments on behalf of their clients have a unique opportunity to positively influence the investment outcome....and it is their obligation to exploit that opportunity.

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