How to Distinguish Business Angels and Venture Capitalists to Better Convince Them?

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1. Executive Summary

Finding investors for a company is never an easy thing to achieve. Investors in the market are numerous and different and it is hard for a young entrepreneur to know what their expectations are and how to convince them efficiently to invest their money. This technical note aims to clarify the distinction between two of the most common sources of financing many start-ups are confronted with: business angels and venture capitalists.

Business angels, who are wealthy private individuals that invest money in the early stages of companies, have skills and resources to offer to young entrepreneurs. They are generally thought of as a way to bridge the equity gap between the '3F' (Family, Friends, Fools) and venture capitalists. They provide the entrepreneurs with more than financial resources as they also advise them and make their network of contacts available. Venture capitalists invest on behalf of a venture capital company and often come after business angels in the stages of financing. They also bring financial resources, often accompanied by growth opportunities, such as an open door to the international market, for instance. Aside from a difference in their status (private individual/company) these two sources of financing also differ by the amount of money they invest, as well as the relationship they have with the entrepreneur. Business angels should be favoured in earlier stages, when the start-up needs smaller amounts of money and more advice. Venture capitalists should be solicited after one or two rounds of financing have taken place.

Among the most important expectations from investors are: the quality of the team, the return on investment, the opportunity and innovation the project represents and its financial details. Entrepreneurs have to understand that, in order to convince investors, they need to attract them, be able to pitch properly, evaluate the risks of the project and get to know the profile of investor they are dealing with. The business plan itself is a crucial element as it is the starting point for an investor to even consider a project. Both types of investors are more interested in exits than remuneration through dividends and the investment time horizon tends to be longer with business angels.

The example of *Hytchers*, a start-up specialized in package delivery, represents a concrete example of a start-up, which called on both business angels and a venture capitalist in its different stages of growth. The characteristics and expectations of the sources of financing are aligned with the theory on the matter.

2. Context

This technical note aims to present entrepreneurs with key elements on which investors to choose to finance their start-up and how to convince them. Many sources of financing are available but this technical note focuses on equity, as it is characterized by its higher 'risk'. Among the options of equity financing, the following can be encountered:

- The '3F' (Friends, Family, Fools) are often among the first people to invest in a project, mainly due to their relationship with the entrepreneur;
- Crowdfunding, which consists in asking for contributions from many individuals, often through the Internet;
- Business angels;
- Venture capitalists.

The last two types of investors were not described because they represent the main focus of this technical note. Although the other actors have an important role to play as well in the financing stages of a company, a recurrent problem lies in the confusion between two types of investors: business angels and venture capitalists. For this reason, the objective of this technical note is first to properly define both terms. Though similar in some ways, it will be easy to see that business angels and venture capitalists differ in many regards.

For this reason, a second objective of this paper is to provide a concrete distinction between the two sources of financing. It is not always easy for a young and inexperienced entrepreneur to know how to differentiate the two types of investors. In this sense, this paper will provide the entrepreneurs with 'keys' to know which source of financing to favour based on their own situation and profile. It is indeed crucial for an entrepreneur to know what to look for in a potential investor and to be able to clearly pinpoint the characteristics that are needed for the advancement of their entrepreneurial journey.

Furthermore, another objective this note aims to achieve is to include tips on how to convince and seduce business angels and venture capitalists. Key elements to put forward when pitching a project will also be highlighted. This will ensure that the entrepreneur leaves the best possible impression to his investor. The importance of having a business plan, as well as what to expect in term of exit strategies will also be discussed.

Moreover, a concrete example of an entrepreneurial venture will how key theoretical elements concerning business angels and venture capitalists can be translated to reality. This is crucial because it can provide the entrepreneurs with real-life elements that might be closer to their own venture than mere theory.

Finally, the (re)sources that may be helpful to entrepreneurs, as well as contact persons are listed in the 'Learn more' section.

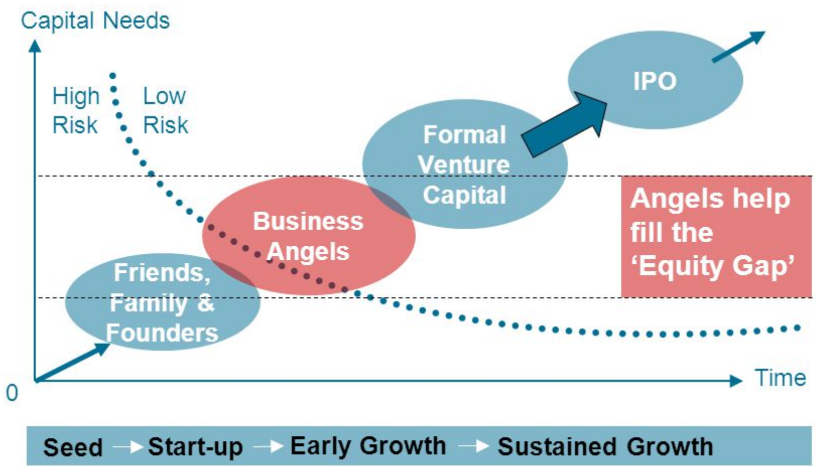
3. Development of key lessons related to the topic

This section addresses key elements that are linked with the theme at hand. For this reason, it is logical to start off by clearly defining what business angels and venture capitalists do. This will help to better comprehend in which ways the two types of investors are similar, but also different, and for what reason(s) the entrepreneur should solicit one or the other (or both) to concretize their dreams.

3.1. Definitions

3.1.1. Business angels

Most definitions regarding business angels tend to be rather similar in meaning. A business angel can be described as a wealthy individual who invests part of his own money and his time in young and innovative companies that show a high-growth potential. They often have an entrepreneurial past and tend to invest in their own sector and geographical region. They bring more than 'just' money to the table, also investing their time and providing advice and/or a network of contacts. They are often thought of as a means to bridge the gap between the 3Fs and venture capital. For this reason, they intervene quite early in the financing stages, as can be seen in the image below.



3.1.2. Venture capitalists

Venture capitalists are investment managers and therefore have to be cautious of the kind of venture they invest in, since the money is not their own. The money they invest can come from a multitude of private companies such as insurance companies, pension funds, etc. As can again be seen in the image above, the companies they invest in are usually at a further development stage than that of business angels. There are different profiles of venture capitalists: some of them are specialized geographically or by sector, whereas others have no such limitations and invest on a more global scale.

3.2. Main differences & similarities between business angels and venture capitalists

Before highlighting what investor to favour at what time, a clear comparison between the two sources of financing is needed.

3.2.1. Differences

A first important difference is the amount of money that each investor brings to the table. Most business angels invest between 25 and 50 thousand EUR (or more depending on the sector and/or country), whereas venture capitalists' investments are often between 1 and 10 million EUR. However, both business angels and venture capitalists are satisfied with minority stakes in the company (often around 25-30%).

A major difference between the two types of investors is that they are not to be considered as similar 'entities'. Business angels, on the one hand, are private individuals, who invest their own money into ventures they believe in. Venture capitalists, on the other hand, are companies looking for smart investments for other people's money. For this reason, the decision-making process is much faster with business angels as they have to make the decision regarding their money, whereas venture capitalists need more time to analyse the situation in order to come to a decision.

Furthermore, the 'human' criterion is one of utmost importance for business angels. Though venture capitalists grant importance to this element as well, the relationship business angels and entrepreneurs maintain has a much stronger bond. Hence, even if the project is appealing, business angels will often only invest if there is a 'spark' between them and the entrepreneur. The need for such a relationship is justified by the fact that business angels participate more actively in the start-up's life.

Finally, a last significant difference between the two types of investors is that business angels and venture capitalists are not driven by the same motivations. Indeed, venture capitalists tend to be solely driven by the financial results a start-up may have and therefore, its outcomes in the future. Business angels, however, though interested in gain, also consider the role the start-up will play in society as an important factor as well. For this particular reason, they like to invest in projects that have societal and/or environmental motives.

3.2.2. Similarities

A first similarity worth mentioning is linked to the high-risk investment that both types of investors take part in. Indeed, business angels and venture capitalists face a similar risk/profitability ratio. As opposed to a banker, for instance, they are involved with the start-ups they invest in and they share their successes and failures.

Moreover, depending on the project, business angels and venture capitalists can have the same targets. Indeed, it is not rare for business angels and venture capitalists to share a round of financing. However, that round is rarely the first one initiated by a start-up.

3.3. What type of investor for what entrepreneur?

How can one entrepreneur know whose financing to ask for? Depending on the type of project and the profile of the investor there may or may not be a positive match. As will be seen in the next section, investors usually have rather similar expectations from the entrepreneur and his project.

Here are a few pieces of advice to keep in mind when hesitating between a business angel and a venture capitalist:

- If your company is in its early stages, there may be no need in attempting to charm a venture capitalist just yet. They expect a project that already has a sensible structure. However, if you have already been financed by one or more business angels, thinking about tying the knot with a venture capitalist may be the best bet for you. Indeed, there is no reason not to be involved with the two profiles. They each bring particular skills and resources to the table, and therefore are not mutually exclusive. They should be seen as complementary rather than in competition.

- Since business angels bring more than just money, they might be much more helpful if you need to grow your network of contacts or need professional advice on your project. Business angels often invest in sectors they know well and their advice is therefore valuable. Moreover, a business angel's entry into the capital of a start-up can be the best kind of invitation for other kinds of financing, such as venture capitalists.

❖ Financing is needed when the venture is in need of 'speed'. The question therefore is not 'When should I raise money?' but rather 'How should I raise depending on where my project is right now?'. For this reason, once a business model has been created and there is a need to try it out and find the 'recipe', angel investors should be preferred. However, when there is a need to really 'scale' this business model and go to the next step, the ideal investor would be a venture capitalist.

4. Questioning

This section investigates further questions and answers that might be of use to entrepreneurs.

4.1. What are the expectations of business angels and venture capitalists?

- **Quality of the team**: the entrepreneurial team is a crucial factor for both types of investors. The members of the team need to be motivated, balanced and skilled. Moreover, relationship is of utmost importance in the case of business angels. Since they are going to be more than just a financial source and be a part of the journey, they want to make sure that there is a real spark with the entrepreneur/entrepreneurial team.
- **Return on investment (ROI)**: due to the high risk that both types of investors have to face, they require a high rate of return. Venture capitalists tend to be return-driven; in need to deliver returns to the investors whose money they invest. Business angels, however, are pleased by the role they get to play in the start-up and though financial returns remain a dominant motivation, non-financial motivations also exist.
- **Opportunity**: the market in which the start-up operates needs to be large and the company has to have room to grow. Business angels and venture capitalists prefer to invest in high-growth companies, in which there is room for improvement, rather than stable ones in a tight market.
- **Innovation**: most business angels and venture capitalists look for innovative products or services. Therefore, entrepreneurs should highlight it if their project has such a characteristic, or if it is part of a growing and innovative sector (green energy, virtual reality, etc.).
- **Financial projections**: a venture capitalist's financial expectations are much higher than those of his business angel counterpart. This is mainly because, usually, entrepreneurs contact venture capitalists later on and their project is more structured at that stage of investment. When it comes to new businesses, venture capitalists tend to be rather cynical regarding the projections, since no reassuring numbers can be encountered in the past of the start-up.

All types of investors have different expectations and it is sometimes easier to ask the question 'What motivates you?'. This can prevent wasting a lot of time trying to discover what the investor expects from you and your venture and can set the right path from the start.

4.2. What could be 'keys' to efficiently convince the two sources of financing?

Most of the recommendations given below refer to both types of investors:

- **Attract attention**: it is important to put your project in the spotlight. You will have a head start if your potential investors have heard about you before you get in contact with them. This is particularly the case for business angels, who have a tendency to hide in plain sight.
- **Discuss the risk**: though you need to sell your project as well as possible, you will be taken seriously if you are objective about it. Showing the investors that you have considered the risks can show them that you are mature about your project. Highlighting positive points regarding your project is important, but showing that you have considered its negative points, as well as how to counter them, is crucial.
- **Tell a story – *The Art of the Pitch***: convincing an investor is a real seduction game. For this reason, you need to have a 'battle plan'. This plan is the 'pitch' of the entrepreneur. It is an important element to master. In order to properly pitch, you need to be able to synthetize the key elements of your project: the problem it helps solving, the solution it proposes, its innovative aspect, the behaviour of the market, a description of yourself/your team, etc. It should be concise, yet include all the necessary elements to be etched in the investor's mind. This pitch should also be tailored to the type of investor you are trying to convince. For instance, if it is a business angel, the composition and the motivation of the entrepreneurial team are key, whereas venture capitalists might be interested in getting more details about the financial projections and possible returns.
- **Business angels do not 'only' bring money**: business angels are not mere wallets. Indeed, aside from money, they can offer you advice, a network of contacts, experience in the sector, etc. In order to convince business angels to invest, they need to see that you look for this kind of involvement in the life of your start-up, as it is pretty rare for such an investor to take a back seat and not get involved. Before

soliciting the help of a business angel, make sure he or she is coherent with your project.

- ❖ **Business angels are the bridge to venture capitalists**: the best way for you to have access to a venture capitalist's investment is to prove that you are already in affairs with a business angel or other types of investors. This will indeed give credibility to your project and minimize the risk in the eyes of venture capital companies.

4.3. How important is the business plan to convince such investors?

The business plan can be described as the minimum document that is required by an investor, whether business angel or venture capitalist. It is, indeed, the first contact that the entrepreneur is going to get with the potential investor and it will work as a 'Curriculum Vitae' of the project. Therefore, its importance is clear.

However, having a convincing business plan convincing enough is not sufficient in order to impress or even seduce potential investors. As stated above, other 'skills' and information are needed in order to better the entrepreneur's odds. The business plan is the first milestone to investment.

4.4. What to expect in terms of 'exit'?

Both business angels and venture capitalists are more interested in a valuable exit rather than getting a return through dividends. Most of the time, the investment horizon of business angels tends to be longer than that of venture capitalists. A reason for this is the fact that business angels, as opposed to most venture capital companies, are not limited in time. Venture capital funds are indeed often limited to ten years, which narrows considerably their investment time horizon. Moreover, since business angels appear rather early in the life of the start-up, it takes more time for the exit to become a valuable option.

Among the most common exit routes for investors are: the trade sale, the sale to another investor or going public in an initial public offering. The entrepreneur is not the only decision-maker regarding the exit of one or more investor(s). Indeed, exit decisions often depend on the clauses that were agreed upon at entry in the Shareholders' Agreement. More information on the Shareholders' Agreement and its different clauses can be found in the resources provided in the *Learn more* section of this note.

5. Example: *Hytchers*

5.1. Why *Hytchers*?

In order to provide a clearer image of the notions discussed above, it appears logical to include a real-life example. The example that was chosen to focus on here concerns the start-up *Hytchers*. Officially started in 2016, *Hytchers* is a start-up specialised in package delivery by private individuals. This innovative company's goal is to revolutionize package delivery, allowing the packages to 'hitch-hike' to their destination. This particular example was chosen for multiple reasons. First of all, *Hytchers* is a perfect example of entrepreneurial spirit. Indeed, their story started in the *Venture Lab*, a start-up incubator located in Liège, Belgium. Their goal is, however, to grow as much as possible and develop internationally. Another reason that led to this example is the fact that Jonas Douin, co-founder and CFO of *Hytchers*, was interviewed regarding this technical note's theme. The insights he shared have allowed for a better comprehension of the subject at hand. Finally, this start-up is a perfect example to differentiate business angels and venture capitalists because, in its different rounds of financing, it called on both sources of financing.

In the case of *Hytchers*, when it came to their first round of investment, they solicited the help of a business angel. This first round helped them raise enough money to finance a test with Total. It is this test that has helped them convincing investors in the second round. During this second round, they received investments from both business angels and a venture capitalist. The company is therefore a good illustration of the elements mentioned both regarding business angels and venture capitalists.

5.2. Contacts with business angels

The contacts the start-up had with business angels were different than those with venture capitalists. According to Jonas Douin, aside from investing in the company earlier than venture capitalists, business angels had different things to offer, as well as different expectations.

The two founders of *Hytchers* had a close relationship with the business angels that invested in them. The relation they have is therefore more than a financial one, as they can rely on them if they have questions or doubts. As aforementioned, business angels tend to have this type of relationship with the projects they support. Most of them do not simply want to invest money. Rather, they additionally invest their time in the start-up so the entrepreneurs can benefit from their experience, network of contacts, etc.

When asked about the expectations of such an investor, Jonas Douin listed elements such as the quality of the project but also the importance of a close-knit motivated team. Clearly, in the case of *Hytchers*, the definition and characteristics of business angels appear to have materialized.

An interesting fact to add in the case of *Hytchers* is that the business angel Hubert Brogniez, their initial *Venture Lab* coach, was so thrilled by their project and their team that he decided to invest as a business angel in the second round of financing, therefore providing them with other resources.

5.3. Contacts with the venture capitalist

Hytcher's relationship with the venture capitalist that invested in their company was different than that with the business angels. Indeed, the fact a venture capitalist invested in the second round of financing proved in line with the tendency for this kind of investors to come later in the growth of a company than business angels. He brought with him more money, but also more relations. Through a venture capitalist, an entrepreneur has the opportunity to really make his project 'explode', which means that this investor is one that can help him meet new partners to grow bigger and faster. It is for this reason that venture capitalists tend to intervene in a company's capital when it is in a 'scale-up' phase and needs to grow to further develop.

According to Jonas Douin, a venture capitalist expects different things from an entrepreneur. He is going to be much more interested in the business plan and the financial projections than the business angel. This is due to the fact that, when a company reaches the moment it needs a venture capitalist, its structure is normally more coherent as it has had one or two rounds of financing already. Though the team and the entrepreneurs' profile remain important, the project in itself is what matter the most. As mentioned earlier in the case of *Hytchers*, they were able to convince venture capitalists to invest mostly because of their partnership with Total and the test they were able to realize through it.

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6.1. Resources

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6.2. Contact persons

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