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How Can You Attract Angel Investors to Your Business?

What is this research about?

Most new business ventures fail to attract financing in Canada. Business angels (BAs) are private investors who provide funding to new businesses, especially in their early stages. Prior research suggests that angel investors use a compensatory decision model. This is where investors consider many factors with varied importance to look at the potential of a new project. This research, however, explains how BAs actually use a shortcut method known as elimination-by-aspects (EBA) to save time and reduce the size of available investment opportunities. If one or more requirement is not met, the venture is immediately rejected in the first stage of assessment. Beyond the first stage, BAs use different methods to make investment decisions.

What did the researchers do?

The researchers examined the process that BAs use to decide whether they should invest in a business opportunity. To do this, they observed behaviour during interactions between five BAs and 150 pitching entrepreneurs. The source of these interactions was unedited recordings of the Canadian version TV series "Dragons' Den." The researchers focused on the selection stage, which is the first stage in the decision making process and also when most opportunities are rejected. They also created a grading system, as well as a model to predict the outcome of each interaction.

What you need to know:

Today, business angels use a shortcut method to cut down the new business ventures eligible for funding. Entrepreneurs should consider how these decisions are made when they seek financing.

What did the researchers find?

The researchers narrowed down the eight main factors that are considered in the selection stage, before at least one BA makes an investment offer. The list of factors and related key questions include:

1. Adoption: Will customers in the target market easily adopt this product?

2. Product Status: Is the product ready for market, or is major work still required before it ships?

3. Protectability: How easy will it be for other people to copy the product or service?

4. Customer Engagement: Who is the first customer? Does the product meet customer need?

5. Route to Market: Is there a realistic marketing plan and route to market?

6. Market Potential: Is there a large market for this product?

7. Relevant Experience: Does senior management have direct and relevant experience?

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8. Financial Model: Will they make money? Are they asking for a reasonable investment?

The researchers found that an opportunity failed to pass the selection stage if there was a "fatal flaw", which is the inability to meet any of the eight requirements. For example, if a product can be easily copied, then a fatal flaw is present and the opportunity is rejected. Other instances of fatal flaws included no evidence of turning a profit, or if the market potential was likely less than $5 million. Only 16 out of the 150 opportunities in the study received an investment offer, all of which had zero fatal flaws. This confirmed that BAs use an EBA method to reduce the number of ventures they have to choose from. Beyond the selection stage however, BAs use different methods of evaluation that are closer to the compensatory model.

The researchers also offered entrepreneurs participating in the next season of "Dragons' Den" a series of sessions teaching them about the eight important factors. Over 90% felt that these sessions were helpful. As a result, the number of opportunities passing the selection stage almost doubled. New businesses also received three times the total dollar amount of funding in the new season.

How can you use this research?

This research may be used by entrepreneurs seeking investment from BAs. By learning about the eight factors, entrepreneurs can structure their presentation to address these factors and increase the chances of obtaining funding from BAs. The findings from this study can also be used by institutions that provide business education. They can incorporate this new knowledge into their teachings. Better business planning and creation of successful ventures will lead to more economic benefits.

About the Researchers

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