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VENTURE CAPITAL VERSUS ANGEL FUNDING: KNOW THE DIFFERENCES!

The many differences between venture capital and angel funding are not generally understood. A company pursuing funding that doesn't fully understand those differences is likely to waste significant effort and damage its chances of getting funding. Important differences include the following:

1. Investment Structure. The vast majority of venture capital investments are structured as purchases of preferred stock. In contrast, while significant amounts of angel investment may be in preferred stock, there is a wider range of possible investment structures, such as convertible notes, notes with attached warrants, common stock, and SAFE's (simple agreements for future equity).

2. Professional versus Non-Professional Investment. Venture capital funds pool money from third-party investors and then find suitable investment vehicles for the capital they have under management. In contrast, angel investors are affluent individuals investing their own money with no obligation to third-party investors and with flexibility to use their funds in any way they choose. This leads to a higher degree of variability and uncertainty for companies pursuing angel investment. For example, we have seen proposed angel investments withdrawn for personal reasons such as losses in other parts of the investor's portfolio or due to personal issues such as divorce.

3. Valuation. VC's frequently have numerous active investments and are generally knowledgeable about current market conditions. Moreover, VC funds are run by investment professionals with the experience and knowledge to place a value on a company. As a result, we typically counsel clients that are presenting to VC's to have an opinion on their company's value, but to let the initial statement of proposed value come from the VC. If the company starts by presenting a proposed valuation to the VC, it risks causing the company representatives to be viewed as unrealistic if they are too high or to leave money on the table if they are too low. In contrast, angel investors have less industry experience and knowledge, and accordingly have less ability to place a value on the company. For this reason, when presenting to angels it is advisable to have prepared a well-considered valuation figure and to present that proposed figure early in the negotiation process.

4. Due Diligence and Disclosure. A VC firm will have a standard and thorough list of due diligence items that they will need the company to provide before an investment will be made. Angels, in contrast, likely do not have a standard due diligence checklist, and may require little information. In addition, angel investors often request due diligence items over an extended period of time as those items occur to the investor, which can lead to a more protracted and less efficient process. Either way, securities law compliance and good investor relations are facilitated by adequate written disclosure to investors of the company's business, financial posture and risks.

5. Post-Investment Involvement. When a VC firm makes an investment, it will generally have clearly defined information requirements, the right to approve specified transactions, and typically a seat on the board of directors. The VC's will typically monitor the company's progress without becoming excessively involved, especially if the company is progressing well. Angels, in contrast, have a greater range of

expectations. At one extreme, the angel investor may have a high degree of trust in the company's management and limited time to be involved, and as a result will have a low level of involvement in the company's operations. At the other extreme, the angel investor may have extensive industry knowledge and significant available time, and as a result may seek to become involved (perhaps overly so) in the company's day-to-day operations. In any event, both VC and angels should be consulted regarding strategic decisions such as company sale or IPO or admission of new investors.

6. Process Management. VC firms have a clearly defined set process for due diligence, term sheets, and finalization of definitive documents. Angels, by contrast, typically do not have defined processes and will rely more heavily on the company to guide the process. As a result, a company pursuing angel investment will need to take the lead in several respects, including drafting a detailed term sheet describing key aspects of the proposed investment and the definitive agreements, whereas when pursuing VC investment, the VC firm typically takes responsibility for the drafting of these items.

If you are considering pursuing equity investment in your company, our attorneys can assist you in determining whether angel or VC investment is more appropriate for your company and can assist in preparing for and pursuing such investment. Whichever type of investment the company is pursuing, businesses can save time and money and reduce risk by working with legal counsel and other professionals at the outset to gain a better understanding of the process and to do the preparation that is an essential element of a successful raise.

If you would like additional information, please contact any of the following FisherBroyles partners:

Atlanta
Carl Johnston
(404) 330-8179
carl.johnston@fisherbroyles.com

Los Angeles
Steven Papkin
(310) 415-6254
steven.papkin@fisherbroyles.com

Chicago
Marty Robins
(847) 277-2580
martin.robins@fisherbroyles.com

Boston
Peter Cahill
(617) 475-0094
peter.cahill@fisherbroyles.com

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