Angels In The Fund Zone *(IW Growing Companies, January 1999 issue, page 22)*

Prospects for fast-growth sales in a smaller manufacturing firm may come along only once every couple of years. But just at the time when a major business deal presents itself, many companies come to the stark realization that a significant infusion of external capital must be secured immediately in order to turn the window of opportunity into a profitable reality.

The ensuing questions are: "From what source will the funding originated?" and "How quickly can capital be secured?"

For a typical enterprise, the existing bank line of credit is completely insufficient to support strong (and prolonged) growth. And it is most likely already being utilized for normal payables and receivables cash-flow management. The company's base of fixed assets (plant, machinery, vehicles, and equipment) may not have adequate value to act as collateral on a loan, and like the line of credit may already be pledged to existing debt. And as in many cases that I have found with clients, more debt is simply not a feasible option, given the impact that new principal and interest payments would have on the P&L statement.

Several creative alternatives for funding can provide the necessary capital in a relatively short time, without having to strap cash flow to heavy debt service or miss an opportunity due to application forms, loan committees, and other bank bureaucracy.

Most local business communities have several individual investors (and small groups of the same) who are regularly looking to review capital-funding proposals to support area firms. Many of these "angel" investors also are successful business owners or are involved in professional portfolio management or real estate holdings. Remember, these capital providers are not philanthropists. They are serious about return on investment, and they do not fund marginal deals just because it makes them feel good about backing local private-enterprise development. These angels can, however, be the perfect capital partners for three distinct reasons: They want high returns, they want portfolio diversification, and they are familiar with business risk assumption.

First, angel investors are seeking the kind of extraordinarily high returns that often are available only in smaller companies. When a manufacturing firm with $7.5 million in sales and assets of $3 million (with $1 million in equity) can expand to secure three major new accounts and grow sales to $12 million inside of two years, shareholder value likely will more than double. Annual compoundings of 50% and 60% are exactly the kinds of potential returns to which angels are attracted.

Second, angels want to further diversify their traditional portfolio of publicly traded stocks and bonds with stakes in smaller, privately held companies. In fact, they generally have a sizable cache already invested in blue chips, midcaps, bonds, and mutual funds. It also is common to find these individual investors with equity stakes in several other private companies in the same geographic market area. This affords an additional degree of diversification, in that some small-firm investments will perform poorly and others may have only marginal returns, while a few may produce two-or three-fold returns in a relatively short time.

The typical angel is very comfortable with a manageable degree of business risk. Unlike commercial bankers that seek to nearly eliminate firm-specific risk of repayment, angels understand that higher expected returns are a function of greater risk exposure. But they will not place their investment serendipitously in jeopardy. On the contrary, they like the close contact of working with local entrepreneurs to formulate a strategy to take advantage of a growth opportunity. Angels often are attracted to firms that are similar in scope and scale to their personal business background. They also can respond quickly to a strong and promising deal, and even provide specific management expertise or partnership referrals that add value to the target company. Overall, a referral to a local angel could be the best capital partner for your firm.