

How Angel Investors Identify Startups with Potential for Success

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AUTHOR BIO

George Jamieson is a student at Glynn Academy High School in Brunswick Georgia. A native of nearby St. Simons Island, Jamieson attended his local Catholic middle school, and is active at his home church of St. Williams. His interests include: politics, business, finance, architecture, and music. Outside of school, Jamieson plays the violin in the local youth Philharmonic Orchestra as well as the Chamber Ensemble. He is also active in Model UN, Boy Scouts of America, and the United Community Bank Jr. Board of Directors. In his spare time, Jamieson enjoys reading, following politics, taking piano lessons, and playing golf with friends or family.

ABSTRACT

This paper serves as a reference to prospective angel investors looking to find a way to get started in investing in their first start-ups. Identifying start-ups with greater potential for growth than others is the focus and identifying factors that allow companies to grow and survive are articulated in this paper. Since a large percentage of companies fail within the first several years, being able to select companies with greater chances than others to succeed is crucial to potential investors.

Keywords: Angel Investing, Startups, Business, Business Competitiveness.

INTRODUCTION

Within the first five years of starting, 45% of companies will fail (Deane, 2022, as cited from the Bureau of Labor Statistics, 2022). Given these high rates of non-success, identifying companies with higher potential than others for growth is crucial to success in investing during the due diligence phase. This is especially true when such companies are in seed-stage development and before they become well-known to the market and competing investors. In the following essay, identifying start-ups that are less likely to fail is the focus, as well as how to learn the early signs and infrastructure for success. Market compatibility, a well-constructed business and financial plan, and a functional and expertly assembled team are all factors that are to be considered when future angel investors are looking to support start-ups.

Correct Product-Market Fit

The ability of a product or service that a company is selling to match what is in demand in the market is absolutely essential to company growth. When considering investing in a company, one needs to be sure the product is compatible with the market. Selling anything that the market has no need for, is already oversaturated with, or is indifferent to is not a winning business strategy.

Need, or demand for a product is of utmost importance when deciding whether or not the company that produces this product will stay afloat. For it to succeed, the product must fill a gap that is not effectively covered by any other product. The market must have need for it in certain applications to the point where buying it makes their life easier, or more luxurious depending on what the product is. According to the International Trade Administration, per capita income of the market will determine its

ability to pay for the product being sold; however, this can be overcome in certain circumstances of exceptionally high demand such as in specific status or luxury goods that elevate the perceived rank of individuals (Export Pricing Strategy, n.d.). This means that unless the product elevates the customer's status, it should be priced according to his or her economic situation, which should be calculated during the evaluation of that individual market's average income.

Oversaturation of a product in a market mostly guarantees that a new rendition of a similar product that is put into the market will fail. The companies that any given business is competing with have already established deep roots and allowed their product to develop a reputation and certain recognition. Competing with established companies is very difficult, as the product in question must stand out to the point where it is set apart and given separate attention by advertisers and other later investors who will get the company moving. As stated earlier, the product must fill a gap in the market, and not serve the same function as too many others of its kind. Unless the product is really truly excellent for its price, and the company heads are very competent and well-versed in competing with other companies, steering clear of investing in companies that are vying to compete with other more established ones from the beginning is advised to prospective investors.

Identifying the correct market at which to advertise is equally important, as different products will have differing levels of appeal on different demographics. For example, one should not advertise lawnmowers in cities, as the people who live there will have no need for them, but the people in suburbs will, as will those living in exurbs outside the city. Furthermore, engagement rings should not be marketed towards retirees, as they are past the stage of marriage in their lives. Selecting a

market, or a niche within a larger market is necessary for the company to effectively advertise and further cultivate its product. One way to identify the market to which the product will appeal is to see to whom similar competitors are advertising. Alternatively, researchers have said that testing the product on focus groups is a good way to discover what kinds of people are interested in the product, and even going as far as to tweak it to their needs (Stewart, 2014).

A Well-constructed Business and Financial Plan

Financial responsibility coupled with a solid outline of the business plan will lead to a higher chance of success for companies. Together, they are essential factors for investors to consider when looking to support start-ups. When companies are starting out, having both a long term financial plan and set but malleable business goals and pivots are vital components of early companies to analyze when looking to invest as an angel investor.

The creation of a budgeted, cash management plan opens the window for the company to establish future goals with relation to new products or improvements to existing ones. The process of business budgeting is the preparing and overseeing of a financial document that estimates income and expenses for a period, and “at its core, budgeting’s primary function is to ensure an organization has enough resources to meet its goals” (Cote, 2022). Once money has been allocated to a certain area of the business, the future profit margins can be estimated with varying accuracy, and new extensions of the business plan can be cultivated. A good investor must look for this kind of planning in advance if he or she is looking to potentially devote resources to the growth of this company.

Having long term business goals in place allows the company to survive in the ever-changing economy where no product lasts forever. Planning into the future ensures that the company has something to pivot on when its leading products start to reach the end of their life-cycle. This also allows the business to know where to allocate resources for future projects that will need substantial funding. However, companies should leave room for unexpected market occurrences in which they will need to adapt and veer off-plan. According to Harvard Business Review, becoming “future ready” means “scaling up capabilities relevant to future competition.” Additionally, “a company must make regular shifts in its know-how in order to stay ahead of competitors over the long run” (Yu et al., 2022). This means that successful companies, while having future plans, also are able to adapt to changing business environments.

A Functional and Expertly Assembled Team

For angel investors undergoing due diligence, analyzing the capabilities of those within the company is a process that should not be neglected. Competent leadership coupled with quality intra-company cooperation and domain expertise are key elements that future investors must consider before undergoing the process of angel investing.

Knowledge in the area in which the company is operating must be abundant amongst the key members of the team. Domain expertise, as this is called, is critical for the survival of a start-up. The members of a business team must have a “thorough understanding of a particular field of study” (Wallin & Baltaxe, 2020, p. 45). Thorough comprehension of the field within which the company is operating is something that must be held by functioning members of a business. This is acquired through experience in operating in the area that company seeks to cement itself.

Intra-company communication and cooperation are equally essential to an effective business team, as it allows good relations to foster among them, but also with stakeholders, employees, and advertisers. According to Wallin and Baltaxe (2020), when looking to invest in a company, seeing if any of the members of the team have worked together before, or have prior business or personal relationships with one another is a factor that should be considered, as people who work well together within a company hugely increases the chances of success (p. 52).

Conclusion

Angel investing is a timely process requiring copious due diligence and research. In spite of this, most will fail. Prospective angel investors are usually unaware of the sheer amount of work that goes into deciding which companies to invest in. When selecting a company to financially support, investors have quite a lot of due diligence to delve into. Furthermore, product-market compatibility, a well constructed business and financial plan, and a functional and expertly assembled team are chief considerations when looking to invest in potential companies.

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