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## Angels we have heard on high

### Getting investor networks to look closer to home

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Angels were looking out for Andrew Field. Not the kind with wings. The kind with cold, hard cash available to jump-start his promising e-commerce printing business in the laid-back resort town of Livingston, Mont.

With the help of TechRanch, a financial consultancy in Bozeman, Field raised \$300,000 from "angel" investors and another \$350,000 in institutional money a few years ago to fund the business. The angel investors were part of Bridger Private Capital Network, a fund organized by TechRanch. "It was real important to get early money from angel investors," he recounted.

The result of the infusion of cash led his company, PrintingForLess.com, to grow from \$4 million in revenue in 2002 to \$20 million last year. It boasts the second-largest payroll in Park County, with 117 employees. More important to Montana's economy is that by raising the money locally, he avoided having to move the company to the San Francisco Bay Area, where venture capitalists lauded Field's concept but promised private equity only if he moved the operation to northern California.

Such angel networks have become an important option as these investors trade cash for a portion of the company in which they invest. Angels become the economic lifeblood of entrepreneurs working to expand a growing business or hoping to get one off the ground, often providing hundreds of thousands of dollars on sometimes risky ventures.

### Networking angels

Technically, angel investors are supposed to meet Securities and Exchange Commission financial requirements for being "accredited" investors, including annual personal income of at least \$200,000 or a net worth of more than \$1 million. But the SEC has never made a great effort to ensure that angels have the financial resources to participate in deals. Angel networks in the Midwest said they do not formally check out the finances of every one of their participants, using the honor system instead and assuming those who play at the table have the wherewithal to withstand losses.

Angel investors typically fill in the financing gap called “seed capital,” which allows a young business to continue research or move toward product rollouts. The required amount may not be enough to interest venture capital firms, who prefer bigger deals, companies whose products are closer to market rollout and evidence that firms have raised private capital in the past, particularly after venture capitalists' own overindulgence in dot-com bombs of a few years ago.

For years, entrepreneurs in Ninth District towns and cities have headed for the coasts or for large regional cities in search of cash for their business concepts, or they have bootstrapped a business idea with their own money or that of friends and family. Few entrepreneurs or economic development experts considered tapping local wealth or had a ready-made vehicle for doing that.

But this has begun to change as states, universities and nonprofit organizations aggressively court wealthy members of their own communities into networks of angel investors. These groups of anywhere from a handful to as many as 50 or so men—and yes, they tend to all be men—have sprung up in Wisconsin and Minnesota and have just started to take flight in the Dakotas and Montana.

Angel investors have played an instrumental role for decades in funding start-up companies in the United States. Few statistical data exist on how many angel investors lived in the rural Midwest, but the sense among most observers is that small-town money went into conservative investments such as bonds, stocks and mutual funds. And to be an active angel investor in the past usually required a personal network of acquaintances who knew about deals and invited friends to join in. Hearing about those deals usually meant living in large cities or on the coasts.

“A lot of investors we saw were in real estate and stocks and mutual funds, but not many in the Midwest are comfortable or versed in the area of financing small business through private equity,” said Christopher Bye, director of the St. Croix Valley Angel Network. “What our network does is introduce people to angel investing as an option.”

Part of the impetus for organizing local angel networks came after the Minnesota Investment Network, widely known as MIN-Corp., started the first one in the Ninth District in 1998 in Alexandria. MIN-Corp.'s rural focus and its plan to create 10 angel networks in Minnesota—it's more than halfway there now—caught the attention of economic development officials and investors in other states, especially Wisconsin.

The efforts of Steve Mercil, who founded MIN-Corp., proved to be on the front end of a national movement to tap the wealthy to give back to their communities through angel networks. One of the first groups outside of Madison and Milwaukee to start an angel group in Wisconsin was in La Crosse, and others soon followed its lead. A flurry of media attention helped the angel network cause, as did an investor community looking for new opportunities outside of the stock market.

In 2002, the Kauffman Foundation of Kansas City, Mo., organized the Angel Capital Association to create a method for the groups to network, collaborate and share best practices. The organization boasts more than 150 members, the majority in large and medium-sized cities, a small number in rural areas. Other trends that may have given an assist to angel investing are a growing culture of entrepreneurship, especially among younger Americans, and rising incomes at the top of the economic ladder providing a larger pool of high-net-worth individuals than ever before.

## **Angels have an impact**

Though it doesn't receive the media attention of institutional venture capital, angel investing is a major source of early-stage financing for entrepreneurs. Nationally, the Center for Venture Research at the University of New Hampshire estimates angels invested \$22 billion last year, about the same amount as venture capital firms. The Upper Midwest is among the leaders in helping rural communities develop angel networks and in connecting those networks with one

another to share deals, said Marianne Hudson, director of entrepreneurship for the Kauffman Foundation.

Only a handful of states have aggressively worked to link angel groups together to create opportunities for investors to participate in deals outside their immediate geographical region but still within the confines of their states or the region as a whole. "I think they're both on the leading edge in this area," she said of Wisconsin and Minnesota.

"We hope to produce an entrepreneurial economy and make angel investing a household word and make people comfortable with angel investing around the state," said Lorrie Keating Heinemann, secretary of the Wisconsin Department of Financial Institutions. Wisconsin passed a law last year offering controversial tax abatements to investors, she pointed out, and Gov. Jim Doyle has made job creation through investment a top priority of his administration.

The angelic appeal for communities is easy to understand—one economic home run can add substantially to a community's economic lifeblood. And investors get to be a part of the team that makes it happen, an attraction of no small measure to many businesspeople. "You hear wealthy investors who do this say, 'I want to give back, I want to help job-creating opportunities in my own backyard instead of in the New York markets,'" said Scott Martin, president of the Minneapolis-based Minnesota Community Capital Fund and Northland Institute, two organizations helping rural business. "This is a way for wealthy individuals to make a big difference in the rural towns where they live. It only takes one or two business opportunities to make a huge difference in a small town."

In Livingston, that certainly happened. PrintingForLess.com will soon move into a 46,000-square-foot building on the west end of town. The company's burgeoning payroll and generous wages (by rural Montana standards) actually raised the per capita wage for Park County, said Field. "Existing investors strengthened the balance so the bank would loan us money for the new facility," he said.

In fact, economic development officials see rural angels funding companies that will not just create jobs, but jobs that produce higher incomes. "I think what's really critical to understand is this is not just about jobs, it's about creating wealth in any way we can," noted Marcia Hendrickson, executive director of the Enterprise Institute, a program of the South Dakota State University Foundation in Brookings with a small angel program. "The businesses we'll support may not have that many jobs, but they'll be knowledge economy jobs, not a hundred \$7-an-hour jobs. That's a big piece of it."

The failing economy of the rural Midwest also has spurred richer residents of small towns to consider giving back through investment, said Peter McDermott, chair of the North Star Fund LLC, an angel group in Grand Rapids, Minn. He pointed to the loss of 300 jobs in a local paper mill and the elimination of air service by Northwest Airlines as "two big blows to us." An aging population and declining wages only add to a bleak economic outlook, said McDermott, a situation well understood by members of his angel fund who hope their investments will re-energize the region.

Still, such *noblesse oblige* only goes so far, as investors still want to see a pretty good idea on the table before anteing up their cash. "Basically, when all these funds are established, they are expected to make money and create additional wealth for the investor," said Brian Johnson, CEO and investment manager of MIN-Corp.

## **Angel networks at work**

In discussions with angel network representatives in the Ninth District, a somewhat predictable portrait emerges of typical rural angel investors. They tend to be men between ages 50 and 70 who have earned a comfortable living operating their own businesses or practicing law or medicine. Unlike in the Twin Cities, few rural angel investors come from the ranks of corporate

America, even in towns with a corporate presence, said Mark Phillips, president of Iron Range Ventures, which operates an angel network in Duluth and northeast Minnesota.

In Bozeman, TechRanch's John O'Donnell sees an interesting blend of investors. One segment represents wealthy individuals who moved to Montana from the West Coast and elsewhere for lifestyle reasons and wanted to get involved in the community through investments. The other segment is composed of third- and fourth-generation ranchers who earned their hefty bank accounts by selling land to the newcomers.

The arrangement of having seasoned businessmen funding projects works to the advantage of start-ups, said Kevin Jones of the University of Wisconsin's Small Business Development Center and until recently manager of the Chippewa Valley Angel Investors Network LLC. "The companies under review have asked for input from our angels since [company owners] do not have a lot of management expertise, and we have a lot of people in their 60s and 70s who may not be in the same field but who have good experience and wisdom they can tap into," said Jones, adding that angels often join the boards of companies in which they have invested.

Angels generally mimic their venture capital counterparts in favoring companies with fast growth trajectories in hot industries. A number of angels have funded biomedical, medical device and information technology companies in the rural Upper Midwest that have either offices or outposts in their geographic areas. As it turns out, not all entrepreneurs with big ideas live in cities.

"You see technology-related companies, software business outsourcing, manufacturing—there's a wide variety in our portfolio," said Phillips. "Usually it's an innovative company, some kind of proprietary technology and market window for it, or a service of some sort with a steep growth curve."

Still, that's not always the case. The Center of North America Capital Fund in Grand Forks, N.D., has made investments in \$50,000 increments to four companies making organic grain, specialty foods, covers for the beds of pickup trucks and plastic coverings for electronics, each of them in different cities, said Delmore Zimmerman, founder and president of CEO Praxis, a consulting firm. Instead of looking for rapid growth, Zimmerman said the group "is making strategic investments to make something happen in these communities."

## **Developing the network**

St. Paul-based MIN-Corp. is the largest creator and promoter of what it dubs RAINs—regional angel investment networks. The organization offers angel networks a basic template they can use for working with members and provides access to deals, accounting and other services. In return, it takes a cut of a RAIN's profit when portfolio companies sell, get acquired or buy out investors.

RAINs require an upfront investment from each member, usually \$25,000 to \$30,000, and each investor gets a vote on what companies will receive funding. Six networks are under way, and a seventh is in the planning stages. MIN-Corp. vets various companies looking for private equity, and those it likes will be offered the chance to pitch their concepts to RAINs around the state. Frequently, MIN-Corp. invests in these companies through its own equity fund.

Members of the RAIN portfolio have done 22 deals worth more than \$4 million in rural Minnesota since 1998, said Johnson, though that total could be higher since many investors added money outside their local network.

Wisconsin, newer to the angel concept, recently created the Wisconsin Angel Network (WAN) to help existing networks and create new ones, said Heinemann. Less structured than MIN-Corp., each angel network operates according to its own bylaws and charter. "It's a network of networks," she reported. "We're set up to help create a deal flow for angel networks so angel

investors in the St. Croix Valley and Appleton will be able to take a look at the same deals.”

WAN reported \$1.9 million worth of deals last year, a total that could double if the state could figure out a way to account for all angel investing activity, said Tom Still, executive director of the Wisconsin Technology Council, which operates the WAN. The networks invested mainly in advanced manufacturing, life sciences, information technology and nanotechnology “in that order,” he said. Interest in being part of the network continually grows, with Ashland and Hudson likely to have their own chapters soon, he said.

Angel network directors are reluctant to talk about portfolio performances, and particularly their investment losses. Since most of them have just begun operations within the past few years, they say, the companies in their portfolios continue to operate. Angel fund managers like to point out to investors that they can write down investment losses on their taxes if a company goes belly up, a practice leading to much less heartburn among their members.

No one has had the proverbial grand slam, but a handful show great promise, among them two technology companies. AbbeyMoor Medical of tiny Parkers Prairie, Minn. (population 300) and Paradigm Diagnostics of St. Paul and River Falls, Wis., offer two examples of companies that received funding from several angel investment groups and investors in their respective states. As it turns out, AbbeyMoor's chief executive officer, John Reid, also serves as the chairman of Lakes Venture II RAIN Fund, an angel investing group based in Alexandria, Minn., associated with MIN-Corp.

The 22-employee company produces an intra-urethral device—now in clinical trials in the United States—for men who suffer bladder voiding issues. Reid managed to raise \$10 million for the company and around 5 percent, or \$500,000, from Alexandria investors. Around \$300,000 came from the RAIN fund, he said, and the rest from local investors or investment groups, including \$6.5 million from Minnesota Timberwolves owner Glen Taylor and \$1 million from MIN-Corp.

Networks in Worthington and Grand Rapids plan to make investments in AbbeyMoor soon. The ability to raise the money from people in the region meant Reid did not have to depend on venture capital firms nor move the company to the state's financial center, the Twin Cities. And he's helping other firms stay in the region by chairing the second Lakes Venture Fund and using his own money as a RAIN participant. “I want to grow business in this region,” he said. “And I truly believe these regional investment networks will help the state.”

Paradigm Diagnostics raised \$600,000 from, among others, angel investment networks in La Crosse, Eau Claire and River Falls over the last few years, said company founder Alan Olstein. The company has developed a pathogen detection system for companies involved in production and distribution of food supplies. “It certainly was important; without the early stage investors, Paradigm Diagnostics would not be where it is today,” he reported. “These networks are clearly effective in helping companies in our situation. They all have members who are well connected.”

In contrast, he said trying to secure a loan through the Small Business Administration proved to be “a waste of time” since those judging Paradigm's product had no understanding “of the subject at hand.” His investors in both Minnesota and Wisconsin have done their due diligence and comprehended the large potential market for a product offering quick turnaround tests for potentially harmful pathogens, he pointed out.

To appeal to Wisconsin investors, Olstein maintains an office in River Falls but locates his research team on the University of Minnesota's St. Paul campus, where he has access to class experts and research facilities. He chose River Falls because a Spooner-based investment group wanted the company to have a presence in western Wisconsin and because the city has a state university campus. The short drive from St. Paul helps make River Falls attractive, too.

"My take is that it's appropriate to have offices in these localities, since UW-River Falls and the University of Minnesota provide an educational output that can staff these facilities and since River Falls is not that far from St. Paul," said Olstein.

Ironically, though many groups were formed to help local entrepreneurs, they often do not find the kinds of deals they desire in their own regions. The Chippewa Valley investors put money into Paradigm in part due to its River Falls office, said Jones. It also put money into Small Tree Communications, a Minneapolis-based company offering networking products for Apple computers, which has some staff in Chippewa Valley. Another investment, eXos Services, lists Denver as its headquarters.

Jones concedes it is an imperfect balance and suggests the Chippewa network may have tougher requirements in the future for creating local employment. It represents a constant quandary faced by rural angels: What if no decent deals exist in your own backyard?

Jan Gallagher, manager of the Origin Angel Investment Group in La Crosse, said her organization has completed seven investments totaling \$850,000, not one of them in the immediate La Crosse region, though it did invest in Paradigm, which can be roughly grouped in the same western Wisconsin region, but is an hour's car ride away. "Being located here or having an office here has not been part of the negotiations at all," said Gallagher. More members have expressed interest in seeing local projects, she added, and local entrepreneurs have begun to submit business plans with more polish and promise than past efforts the group has seen.

Restricting investment to just a local area can be difficult. The North Star Fund in Grand Rapids has done deals with local companies but has been forced to widen its geographical area to include St. Cloud and other parts of north-central Minnesota. "We're looking at companies in Minnesota that could be good investments, but they're located somewhere else," said McDermott. "It's not ideal, but we're not going to keep guys (angels) interested if they're not investing."

For now they are interested, and their numbers are growing throughout the Ninth District. Angel investing should continue to grow as an economic development tool and a way to develop business while keeping capital local. Said McDermott: "It's not a silver bullet, but it is one arrow we had been lacking. You need everything you can get."