भारतीय प्रबंध संस्थान बेंगलूर

INDIAN INSTITUTE OF MANAGEMENT BANGALORE

WORKING PAPER NO: 453

Angel Networks in an Emerging Economy – The Case of Indian Angel Network[1]

G. Sabarinathan
Associate Professor
Indian Institute of Management Bangalore
Bannerghatta Road, Bangalore – 5600 76
Ph: 080-26993147
sabri@iimb.ernet.in

Year of Publication-March 2014

[1] Preliminary. Do not cite without permission.

Angel Networks in an Emerging Economy – The Case of Indian Angel Network[1]

By

G.Sabarinathan[2]

ABSTRACT

On the one hand, angel networks help address imperfections associated with angel investing such as high search and information costs by realizing economies of scope and scale. They also provide other advantages such as diversification of portfolio. On the other hand they help preserve the advantages of angel investing which are not available to investors in venture capital funds. This paper studies the working of one angel network in an emerging economy, Indian Angel Network (IAN). It critically analyses the functioning of IAN against the findings of relevant literature. The study finds that the IAN organization and processes are consistent with the characteristics of networks reported in literature. At the same time its organizational and governance throw up a few issues that would be of interest for further study.

Tag Words: Angel investing, Angel Networks, Organisation

[1]Preliminary. Do not cite without permission.

[2]This paper came out of a larger research effort that was funded by IIMB's seed research grant scheme. The author thanks IIMB's R&P division for the financial support.

Angel Networks in an Emerging Economy – The Case of Indian Angel Network

By

G.Sabarinathan

With the emergence of angel networks in India, there has been a sharp increase in the number of angel investments recorded in the public domain. However, there is little academic literature examining the activities or performance of angel investors. Rajan (2012) examines the profile of angel investors, sectors in which they have invested and the spatial distribution of investments.

Literature on angel investing elsewhere in the world has made a distinction between angels working on their own as individuals, compared to angels working as a syndicate, although there are analyses of some specific networks or clubs such as in Roach (2010) and May (2010). In this paper we examine the working of one leading angel network, the Indian Angel Network (IAN) as an example of the functioning of angel networks in India. Given the numerous challenges individual angels face in discovering, evaluating, negotiating and managing investment opportunities, examination of how an angel network does it would add to a better understanding of angel investment activity, an important source of early stage equity. In particular, country studies inform us that the structure and functioning of angel investing vary across the world. That makes it relevant to examine the state of investment activity of angel networks in India. We take advantage of the rich amount of documentation available on the IAN website relating to its investment focus, membership and investment processes as one of the key inputs to construct a picture of their activity and critically analyse the same in the light of the findings from the literature. This paper adds to the almost non-existent literature on angel networks in an important emerging economy like India.

The paper is divided into five sections. The first section reviews the literature on angel investing with particular reference to the role and functioning of angel networks. The second section reviews the investment activities of angel investors and angel networks in India. The third section describes the functioning of Indian Angel Network as one example of an angel network. The fourth section critically evaluates the organization and functioning of IAN. The fifth section concludes.

Angels and Angel Networks

Angels are recognized as the first source of external financing once funding from founders, family and friends, often known as three Fs, has been exhausted (Sahlman et al (1999) and Timmons and Spinelli (2008). Shane (2009) defines an angel as "a person who provides capital, in the form of debt or equity, from his own funds to a private business owned and operated by someone else who is neither a friend nor a family member". While Sohl (1999) notes that angel investing is becoming global, Harrison and Mason (1992) and Prowse (1998) point out that differences in entrepreneurial traditions, fiscal regimes, regulatory environments, strengths of the domestic formal venture capital and IPO markets and wealth distributions could result in differences in motivations and investment behavior of angels across different countries. Further, angels vary in terms of their financial sophistication, entrepreneurial background, source of wealth and motivations for investing.

Imperfections such as information flow on the demand and supply side, transaction costs and the frictions to flow of capital can lead to a possible case of market failure in early stage equity financing. ((Mason and Harrison (1992), Mason and Harrison (2000) and Mason and Harrison (2002)). Such imperfections can lead to an unscientific and passive approach to sourcing of deals in which serendipity plays a large part in determining the quality and quantity of dealflows. (Mason and Harrison (1997). Angel networks emerged as a policy response in Europe and as a market response in the USA to address the problems in the supply of angel capital. (Mason and Harrison (1997), (Payne and Macarty (2010)). Sohl (2002) defines an angel portal as the predominant mechanism for bringing together entrepreneurs seeking capital and business angels searching for investment opportunities in the USA while the European Business Angel Networks, an association of angel networks in Europe defines an angel network as "private or semi-public bodies whose aim is to match entrepreneurs looking for equity with business angels". (EBAN (2004). Mason and Harrison (2002) suggest that angels may become members of business angel networks to augment their networks or because they have smaller sums to invest or because they are based in remote locations. Van Osnabrugge and Robinson (2000) note that angel syndicates are useful because (i) they help pool investments and thus help investors participate in larger deals (ii) diversify across multiple investments (iii) draw upon the benefits of the network in terms of shared contacts and due diligence; and (iv) allocate a part of their investible funds for follow-on investments. Mason and Harrison (1997) classify angel network initiatives based on whether they are public sector initiatives supported by the state in terms of funding a part or the whole of their operating costs or whether they are for profit, private sector initiatives. They also make a distinction between regional and national networks. They find that the private networks invest largely in later stage investments and the smaller, early stage, high risk investments are still funded by public networks.

However doubts have been raised about the efficacy of these network services. Prowse (1998) notes that anonymous matching services may not meet the requirements of angels who emphasise previous knowledge of the entrepreneur. Mason and Harrison (2002) argue that conventional business angel networks should provide independent technology due diligence services to the investors, educate entrepreneurs on the advantages of equity financing, ensure that businesses are ready to receive angel funding when they approach the latter for raising capital and raise the levels of investment capability among those angels that do not have the competence or experience to do so. In order to provide these services, angel networks need to be well-resourced organisations. They see a potential for a public policy intervention in terms of meeting the cost of providing these services as a means of facilitating the development of informal equity markets.

The review of literature on angel networks thus suggests certain essential features and objectives of an angel network which we summarise below as a reference point for critically analysing the angel network phenomenon in India.

1. An angel network is an association of investors who come together for the common purpose of reducing the search and information cost involved in the investors and entrepreneurs finding each other. The nature of the organizational platform on which they come together may vary.
2. Networks typically emerge wherever there is a "supercharged technology industry and people with the resources to bank roll." (May (2010).
3. Another important purpose would be to participate in transactions of a wide range of ticket size by pooling the capital resources of the members. Such pooling would also help mitigate the risk for individual investors by allowing their capital to be spread across a larger number of investments.
4. The membership may vary a great deal in terms of the sophistication of investment management competence of individual members. So some investors will get to ride on the investment capabilities of other members.
5. At the minimum the network facilitates introductions between investors and entrepreneurs. Ideally, the network should enable / assist in due diligence, contracting and post investment oversight. It should also be capable of making the enterprises investment ready by helping the entrepreneurs with the development of the business plan and elements of business strategy.
6. Face to face contacts between investor and entrepreneur are required to reduce information asymmetries and create trust. Geographic proximity enables the entrepreneur to benefit from the investor's network. (Collewaert et al (2010)).
7. The network has a well laid down process for sourcing of investment opportunities and screening and evaluation of the same. It also has defined criteria for membership, usually linked to the financial networth of the member. The functioning of the network itself is based on a set of governance processes. (Knyphausen-Aufseb and Westphal (2008)). Such laid down processes and a diversified membership base are found to result in a more diversified flow of investment opportunities than that generated by individual angels, as well as deliver better investment results.
8. The combination of standardised processes and large number of deals should help minimize transaction cost, which could otherwise make the economics of the business less attractive.
9. Members of the network have the capability to add post investment value to each of the investee enterprises. The structure of the network enables them to do so.
10. In order to achieve the above goals, the network organization has to be appropriately resourced with the right professionals.
11. The network has to have a sustainable financial model that will support the functioning of such an organization. There are doubts about whether financial support from the Government will be a sustainable approach (Knyphausen-Aufseb and Westphal (2008)) and whether state supported angel networks will ever achieve financial reliance and whether the argument of market failure will constitute a tenable justification for such open ended state support to angel networks. ((Collewaert et al (2010).
12. To be financially sustainable a network may need to generate revenues in the form of fees or in the form of transfers from the government. Whatever the model, ideally it should be aligned to the goals of the various stakeholders of the network.

2 Angel Investing in India and the Role of Angel Networks

Angel Investing in India

In its current form angel investing in India has emerged partly in response to the low appetite for small early stage investments among institutional venture capital investors as pointed out in Rajan (2010) [3]. Data on angel investing in India, as elsewhere in the world, is limited. Venture Intelligence (VI) a database provider that tracks venture capital, private equity and angel transactions reported 320 transactions as of December 2013. These investments have been made by 84 angel investors including the four angel networks, namely IAN, Mumbai Angels, The Chennai Angel Network and Hyderabad Angels. While investments are spread across a large number of sub-sectors, there seems to be a high degree of concentration in certain sub-sectors such as online services (32%), enterprise software (11%), mobile / value added services related (8%), and e-commerce, education and healthcare (5% each). Band-wagoning is evident from the high concentration of investments in certain sectors such as online services or e-commerce in a recent three year window. Angel investments appear to be concentrated in a few cities, namely, Bangalore (27%), Mumbai (23%), National Capital Region or NCR (17%), Chennai (9%), Pune (8%) and Hyderabad (5%). While VI reports transactions as far back as 1999, the number of recorded transactions increased sharply from 2006 with an annual average of 37 investments. This increase coincides with the commencement of investment activity by the two principal networks, namely, Indian Angel Network and Mumbai Angels. Angels seem to have exited only from four of their investments, indicating that angel investors have not been hugely successful in harvesting their investments, a problem that they have in common with their VC counterparts.[4] Fifty nine of the 320 angel funded companies raised funding from venture capital investors. It took them a mean time of 600 days from the time they raised an angel round to raise a VC round. The average time taken to raise VC funding dropped significantly for enterprises that received angel funding during or after 2008, suggesting either that with the passage of time angels figured out what sort of enterprises / sectors might appeal to VC investors and / or that angels simply networked with VCs more effectively over time that they succeeded better in persuading VCs to fund their portfolio companies. Investment by venture investors could be seen as a sign of early, even if tentative, success for two reasons. VCs are often considered to represent "smart" money which is on average capable of identifying companies with potential for extraordinary growth. Second, their investment is seen as an independent validation of the quality of the investment made by the angel investor.

We define an angel network as a formally structured association of natural and / or artificial persons, organized under rules governing membership and conduct of the business of making angel investments. [5]

---

[3]This part of the paper draws on Sabarinathan (2014).

[4]This appears to be an underestimation since some of the networks claim more exits than reported by VI. However since we are unable to verify those exits, we have stayed with the estimate in the database. We realize that this part of the data certainly needs more working on.

[5]We classify angels who do not invest through a network as "solo angels". Solo angels need not be necessarily individuals. They could be corporate or other investment vehicles. Similarly, solo angels could come together as part of an ad hoc syndicate for sharing a particular investment opportunity. While it is possible that the members of the syndicate

A table comparing the organization and functioning of the four angel networks that figure prominently in the VI database, namely, IAN, Mumbai Angels, The Chennai Angels and Hyderabad Angels is presented in Table 1.[6] The table indicates a high degree of similarity across the four networks in terms of their approach to investing and the investment targets. However, Hyderabad Angels and The Chennai Angels seem to be focused within their respective regions. They also differ in terms of the size of their membership and the number of investments funded so far.

Yearwise data on the number of investments made by angels indicate that the entry of angel networks seems to have led to a sharp increase in reported transactions. However it is quite possible that these increases are because networks tend to report their investments more systematically as opposed to solo angels who tend to be a lot more discrete in disclosing their investment activities. Of these only IAN is the national network. Mumbai Angels opened their Bangalore office as recently as in 2012. Yet both IAN as well as Mumbai Angels have been making investments across multiple cities. IAN's investments are distributed across a larger number of sectors even though it has fewer investments. But IAN has a high concentration of investments in Online Services at 37% of all investments. Mumbai Angels on the contrary has invested in fewer sub-sectors. It also has a lower concentration in any one sector than IAN. For example, it has only 22% of its investments in Online Services, the highest single exposure it has in any one sub-sector.

3. Indian Angel Network

In this section we present our understanding of the working of IAN in terms of its mission, deal sourcing and deal management processes and organization.[7]

Business Mission

Started as the Band of Angels in 2006, the Indian Angel Network (IAN), "aspires to be the largest player in this (early stage entrepreneurial) ecosystem and the preferred choice and first port of call for any serious entrepreneur…IAN looks at investing in ventures from across India, including some overseas ones that have India centricity."[8] The Network is interested in investing in a broad range of sectors for a "three to five year period".[9] It is willing to invest USD 400,000 to USD 600,000, going up to a maximum of USD 1 mn. It would be willing to look at investments greater than USD 1 mn as part of a syndicate. IAN is interested in investing in start-ups that have "high barriers to entry, a complementary

---

may have an informal understanding to share investment opportunities we distinguish them from a network which is a formally structured association with rules of business / engagement.

[6]From the list of investors present in the database, Harvard Angels, comprising alumni of Harvard, appears to be the only other investor who may be organized as a network apart from the four networks that we analyse. We do not include them in this comparison because of the limited investments they have made and the limited information available on them.

[7]The IAN website is a great resource centre and provides far more information on its functioning as well as supporting material to entrepreneurs, than the websites of the three other leading angel networks.

[8]All data / material used in this write up, except that of membership details, were downloaded from www.indianangelnetwork.com on January 4, 2014. Membership details were downloaded from the IAN website through the months of December and January.

[9] The website lists sectors that are of investment interest to IAN's members. See http://www.indianangelnetwork.com/band-looking-for.aspx. However the Framework document, discussed later in this note, provides a slightly different set of sectors of interest. We think that these differences are not significant enough to suggest a shift in the investment strategy of the network.

management team, scalable business and differentiated value proposition." [10] The website goes on to qualify that "Entrepreneurs who can provide evidence of the validation of their concept and particularly those who have begun to engage with the market have a stronger proposition."

Geographical Reach

IAN has operations in Delhi, Mumbai, Bangalore, Pune, Kolkata and Hyderabad and has plans to expand to other cities. Each of the offices networks with entrepreneurs and sources investment opportunities in the states or areas geographically proximate to the office. The office organizes meetings of members in that region for deciding on investment opportunities and coordinates the rest of the activities that form part of the investment process outlined later in this paper.

Operations and Management

A Management Committee comprising the four founding members oversees the functioning of IAN.[11] The functioning of the network is managed by a central secretariat headquartered at New Delhi and headed by a President. The role of the secretariat includes the following functions: Creating and developing investment opportunities, evaluating the opportunities at the first stage, including initial interviews, coaching entrepreneurs for presentations to the network, handling member recruitment, communications and relationships, coordinating due diligence and investments on behalf of the investing group, interaction with network members and handling publicity and public relations. The cost of the secretariat is shared by the members of IAN.

Membership and Fees

As of January 2014, IAN had 244 members who had enrolled in the network to pursue their investment interest. (Hereafter in this paper we will refer to network members simply as members or investors, interchangeably.) Membership to IAN is only through nomination by another member or invitation. IAN provides for two types of membership, namely, individual and institutional. The latter category of members is expected to represent their organisations. The two categories of members pay different first year and recurring fees.[12] In addition to the first year and recurring fees members also pay a fee of

---

[10]IAN also runs a virtual incubator which helps entrepreneurs "convert" an "innovative concept / technology…into a product / service and build a business around it." The website goes on to say "(I)f the product / service is already developed, the business plan is finalized, you have one or two clients in place, and you are looking at scaling up your business then send your b-plan for Angel investing." (Source: http://www.indianangelnetwork.com/incubator/faqs.html).
[11]They are Mr. Saurabh Srivastava, Mr. Raman Roy, Mr. Pradeep Gupta and Mr. Mohit Goyal.
[12]The fee structure of IAN membership is as follows:

	First Year Fee	Recurring Annual Fee
Individuals		
India based (INR)	85,000	60,000
Overseas based (US$)	1930	1350
Institutional		
India based (INR)	420,000	300,000
Overseas based (US$)	9,540	6,700

1% of the transaction to the Indian Angel Network Private Limited as will be noted later. Both categories of members are governed by the same set of rules which are laid out in the governance framework.

IAN expects that members will invest at least Rs 25 lakhs per annum. The functioning of the members under the IAN umbrella is governed by a "framework document"[13] that they are required to sign "in acceptance of the broad principles that will govern the functioning of the Indian Angel Network…. The document aims to evolve and spell out a framework under which likeminded members can "network" together and work synergistically to achieve common objectives in the above areas, while not having to operate under the more traditional but rigid models such as VCs, etc." The statement of purpose of the document is interesting in that it explains some of our observations about the structure and functioning of the IAN.

Deal Sourcing and Evaluation

IAN receives investment proposals both directly via its website as well as through its members. The path from receiving a proposal to its decision to fund may be depicted by the following flow of activities:

Proposal through website   Proposal sponsored by member

Evaluation by Secretariat

(Member with Domain expertise may be involved)

Elevator Pitch - Rejected? : Feedback

- Accepted: Investor Presentation   Investor Presentation

Lead member appointed / due diligence team formed

Investor Presentation with Due Diligence findings

Term Sheet presented to entrepreneur

Advisor and Nominee on Board appointed

SHA negotiated

Funds transferred

These steps are outlined below.

[13]The framework document is an important document and much of the description and analysis of the working of the network is based on the principles laid out in the document. The document was downloaded on January 3, 2014 from http://www.indianangelnetwork.com/operating.aspx

Deals that are not sponsored by a member make a brief presentation of about five to seven slides, known as an Elevator Pitch (EP), in person or on phone, to a "vetting team" of the IAN, sometimes after several rounds of iteration with the secretariat often involving a member with relevant domain expertise. The entrepreneur is invited to present to the members if the vetting team finds the proposal appropriate. The Network does not propose a time limit for the completion of the EP and the vetting process, presumably given the highly variable level of investment-readiness of the proposals that the Network may receive. Sponsored deals are presented directly to the monthly meeting of the Network and thus do not have to go through the vetting process that non-sponsored deals go through. A member who sponsors a deal is not obligated to invest in the deal; but the Network expects that the the sponsor would have found the deal to be appropriate for the larger group to examine.

The Network meets every four to eight weeks, depending on the flow of proposals. The Network meets for two purposes: Identifying deals for due diligence and for listening to the entrepreneur's final investment pitch. The first meeting is typically held on a Saturday forenoon. Entrepreneurs, especially those that seek to raise in excess of Rs 75 lakhs, are required to make a presentation in person at these meetings. With the expansion of IAN's office to various cities, these meetings are held in rotation every week in each of the offices. Sponsored deals as well as EPs shortlisted from the vetting process above are invited to make a thirty minute presentation at these meetings, followed by fifteen minutes of question and answer and feedback to the entrepreneur. At the meeting the "assigned members" find a "sponsor" for the deal. Due diligence, valuation, structuring and eventual closure with the entrepreneur will be led offline entirely by a lead / co lead who will be identified at the monthly meeting, with coordination support from the secretariat which will stay involved throughout the process. Deals are declined within thirty days of presentation at the forum, while term sheets are presented within 45 days from the presentation. While the due diligence is in progress members will decide who amongst them can represent them on the board of the investee. However IAN may change the nominee on the investee board at any time. These Board members are expected to brief other member-investors of the developments / progress of the investee. During the period of due diligence the lead and the sub-group also negotiates the term sheet with the entrepreneur.

Deal Closure and Documentation

Once the due diligence is complete, the Secretariat announces the second of the meetings. [14] At the meeting the due diligence team presents its investment thesis, followed by the entrepreneur's presentation. The subscription process that follows is subject to an elaborate set of rules. Subscriptions to the investment are open for eight days after the end of the call during which period members have the option to change their investment commitments. After the eight day period investors are not allowed to change their commitments. Up to 35 investors are allowed to subscribe to opportunities in excess of Rs 75 lakhs, on a first come first served basis. In case the subscription exceeds the amount of investment

[14] This meeting is normally in the form of a conference call into which members interested in investing in the opportunity dial in two working days after the Secretariat has circulated the terms of the investment and the case for the investment thesis prepared by the due diligence team.

sought by the entrepreneur, the equity allotted to each member will be on a pari passu basis except in the case of the leads. Pari passu is calculated as the total amount of funding sought to be raised, divided by the number of investors. In case the subscription is less than the investment sought, the subscriptions from the first 35 investors are accepted as bid by them. The minimum investment a member can subscribe to is the lower of Rs 5 lakhs or the pari passu amount in case the deal is oversubscribed. Members are required to indicate the maximum amount that they are prepared to invest since that helps determine the amount of funding available to under-subscribed deals. Leads have the option to invest up to the higher of 20% of the investments collectively or the pari passu amount. In addition leads will be entitled to an additional 3% of the equity to be allotted as partly paid shares to be carved out of the equity to be allotted to be IAN. IAN Secretariat members have the option to invest in any of the deals on the same terms as the members without any minimum requirement. In addition, IANPL will invest up to 1% of the total IAN investment in each deal. Structured as partly paid up shares this appears to be a mechanism to provide cheap shares to IANPL. Further, each investor in a transaction will pay 1% of their investment into IANPL.

Members invest directly into the company. IAN investors are expected to enter and exit the investment at the same time. Further, IAN members are expected to work on a consensual basis with the investee on major decisions. These relationships are governed through an Investor Relations Agreement (IRA). The other important document that every investor is expected to sign before making the first investment under IAN is the Power of Attorney (POA). The POA, which is a part of the IRA, authorizes IANPL to sign the SHA and other documents on behalf of each of the investors.[15] The Network uses standard term sheets and shareholder agreements. Deviations from the standard require prior legal opinion to be obtained through the Secretariat.

4 Analysis of IAN's organization and functioning

In this section we analyse the processes of IAN to understand the extent to which it is consistent with the view of angel networks that emerges from literature. We examine it along the following dimensions: (i) Impact on transaction cost (ii) Impact on diversification and portfolio risk (iii) Economic sustainability of angel networks as a response to issues faced by angel investment markets; and (iv) Structure and Governance of Angel Network Organisations.

Impact on Transaction Cost

The IAN architecture has many positive features which address many of the factors that are at the root of the widely documented imperfections of the angel market, which push up transaction cost for solo angels. The national presence helps generate a large dealflow over which the high, fixed information and

[15]The Network distinguishes between deals that involve raising more than Rs 75 lakhs and deals that involve raising Rs 75 lakhs or less. For example entrepreneurs who wish to raise less than Rs 75 lakhs are not required to present at the monthly forum. Similarly the subscription period for investments below Rs 75 lakhs is 48 hours after the investor call. The number of investor is also less, between 10 and 15 as decided by the leads. Leads can invest up to 50% of the subscription amount in smaller deals.

search costs can be shared. The network of expert investors across a range of sectors coming together on a platform the network provides economies of scope and scale in evaluating deal flows across a wide range of sectors. Absent such a platform, for smaller groups of investors high quality due diligence could be costly or even be rendered infeasible resulting in a smaller number of investment opportunities and / or a smaller set of sectors. The geographical presence across the country and outside allows members to invest in companies that are geographically proximate. It also enables more effective and efficient due diligence and post financing engagement as it helps the network identify lead / co-leads who have a presence in that region. At the same time a tightly managed process in which the well-staffed Central Secretariat in Delhi is closely involved ensures a uniformity in the investment management process. IAN members have access to a large dealflow because they can participate in investment meetings across the country.

Impact on Diversification and Portfolio Risk

Angel networks are expected to enable investors to participate in larger and possibly more attractive deals by spreading their investible capital and diversifying their portfolio at the same time. One alternative to do so would be to invest in an early stage venture fund. That approach has several shortcomings. High management fee, negligible to no involvement in the fund's portfolio companies. Inability to "cherry pick" investments of choice as opposed to being exposed to all the investments in the portfolio, inability to adjust exposure to the asset class by temporarily pausing participation in the fund's investments and agency problems such as grandstanding, are among the more significant problems. IAN's members are able to adjust their investment exposure as well as their level and style of engagement with a given company, except in cases of oversubscription where the investment amount may be constrained. IAN's investment processes addresses the many limitations of investing in a venture fund, the other alternative that we evaluate above. Whether as a solo angel or as a member of a network such as IAN, angel investors do not face the agency problems of an investor in a VC fund. The provision in the Investor Relations Agreement, such as the one that requires all investors to will exit simultaneously, appears to address conflicts among members inter se. The network also minimizes transaction costs. Getting the Secretariat to sign the agreement on behalf of all the members quite likely enhances the efficiency of the documentation process given that there could be as many thirty five to forty signatories to an investment transaction that exceeds Rs 75 lakhs. IAN also minimizes documentation costs by working with standard SHA and term sheet structures.[16] Unlike the business angel networks of Europe which are known to focus on the pre-investment processes, (Knyphausen-Aufseb and Westphal (2008) and less on post investment value addition, IAN's architecture and process consciously provide for post investment engagement. Such engagement can be helpful in mitigating investment risk and maximizing rate of return on the portfolio. IAN's various initiatives such as the tutorial materials on its website and the knowledge repository that deals with many aspects of putting together a business plan and starting a business plan, the number of workshops it holds across the country on related topics

[16]Deal specific changes to the standard agreement are possible on an exceptional basis with the approval of the Secretariat.

such as and the member's pre-investment guidance on shaping the strategy of the enterprise could potentially improve the quality of the dealflow and thereby de-risk the portfolio, apart from generating a favourable franchise with the entrepreneur.[17]

Sustainability of Angel Networks

The sustainability of the network enterprise will depend upon its financial viability as well its ability to sustain the organization. IAN's complex structure of fees and payments allows it to meet its operational costs, incentivize the staff who have a critical role to play in the delivery of the service and remain viable as a market based response to the problems of the informal equity market.[18] For example, the aggregate proceeds of the 1% fee that is payable by members on consummated deals are distributed as bonus to the staff at the secretariat, thereby creating an incentivizing them to play a proactive part in generating quality deal flows and then supporting the consummation of the same. European angel networks are reported to have tried a variety of revenue generation mechanisms such as membership fees from investors and entrepreneurs. Most networks that provided any service beyond a computer based matching of investor and entrepreneur seem to be unable to recover the cost and evolve a sustainable financial model (Knyphausen-Aufseb and Westphal (2008)). IAN's practice of charging a fee from the investor is desirable for another reason: The institution's incentives are aligned with that of its clients, namely, the investor. On the contrary, if the Network had charged the entrepreneur it would have faced a conflict of interest that would have been similar to the conflict pointed out in the case of rating agencies or statutory auditors.

Structure and Governance of Angel Network Organisations

For its many virtues, the IAN model is not without its problems. First and foremost, the data seem to suggest that while membership has grown increase in the number of active angels has not been commensurate as suggested by the announcements of consummated deals.[19] Active angels are those who take an active role in the evaluation of investment opportunities. They pull in a high quality dealflow into the network. The process of being an active angel is purely voluntary. The data on IAN's membership indicate that a large majority of the members are full time corporate executives, with possibly no bandwidth to lead or even participate in due diligence, which is known to be effort intensive. Secondly, the high degree of centralization of the deal management process ensures predictability of the network's behaviour in the eyes of the participants in the larger entrepreneurial ecosystem. But the price of such centralization for Network members is loss of flexibility on critical matters as exemplified by the requirement that all members will exit from an investment simultaneously. A third point of interest is the governance structure of IAN. The IAN website has little material on the governance of the Network

[17]Based on a presentation made on February 19, 2014 to students of Indian Institute of Management Bangalore by Mr. Siva Devireddy, founder of Go Coop, an IAN funded start-up.
[18]Based on the financials of the network enterprise downloaded from the website of the Ministry of Company Affairs, Government of India.
[19]It could be argued that this trend could be due to the low rate of consummation of deals and that a number of angels who step up to undertake due diligence on a number of transactions do not manage to consummate those transactions. Informal feedback from a few members indicates that this is not the case and that deals that go into due diligence have a high rate of consummation.

as a whole or the relationship between those who manage the Network organization and its Members or the role of the Members in the governance of the Network. For example, it is not clear if members have a say on key new initiatives, operational processes or fixing of membership criteria or fees.

A fourth and related issue which merits a separate discussion is that of the relationship between the founders who are also on the "Statutory Board" of IANPL and the members of the Network. It may be appropriate to use the analogy of a securities exchange to examine the ownership and governance structure of the network. The statute governing stock exchanges defines a stock exchange as "a body corporate incorporated under the Companies Act, 1956 (1 of 1956) whether under a scheme of corporatisation and demutualisation or otherwise, for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities."[20] Functionally, the key participants in a stock exchange are investors, issuers, brokers, the agency that owns and operates the market and related infrastructure such as the trading and settlement systems and the staff and management that operate the exchange. Issuers raise capital from investors who buy the securities sold by the issuer. Under the statute, the marketplace is a mechanism to bring buyers and sellers of securities to trade together through a set of rules and regulations. Going by the above definition the IAN has the features of a securities exchange where the members are the investors, the enterprises that raise funds are the issuers and the S 25 company is the entity that operates the marketplace while between IANPL and its owner-directors, appear to play the dual role of a "broker" who facilitates the trade as well as owns and manages the market infrastructure as well as lay down the rules of trading. This would approximate to the structure and organization of a demutualized securities exchange.

It is not clear from the publicly available material as to how the rules of the marketplace at IAN are determined or administered. However, it is clear that IANPL receives compensation from the investors on consummated deals in the form of partly paid up shares to the extent of 1% of the total equity allotted in every deal. The economic basis for this compensation is not clear. It is possible to view the partly paid up shares acquired by IANPL as an option in which the strike price is the full price of the shares that will be paid once the decision makers at IANPL have visibility on the exit path and the exit valuation of the partly paid up shares acquired, thus making it virtually a costless option. By receiving a consideration from the members in the form of a nearly costless option, the shareholders of IANPL create for themselves an asymmetric claim on the economic value arising out of creating and managing the marketplace. Finally, the marketplace in the case of IAN differs from the securities exchange analogy in one other important manner. The value of the marketplace in the case of IAN arises from the investors and entrepreneurs who trade on it. High quality investors attract high quality entrepreneurs. High quality enterprises in turn attract more high quality capital in a virtuous circle. In the case of a securities exchange the principal driver of value is liquidity and orderly functioning of the trading and settlement systems. That raises the question of whether the agents who transact on the IAN should have a greater say in the management and the destiny of the enterprise that the network is.

[20]Adapted from S 2(j) of the Securities Contract Regulation Act, 1956, the primary statute that governs trade in securities in India.

The Network throws up another interesting question from a policy perspective. If the Network is acknowledged to be a marketplace, should it then be considered an important enough institution to warrant at least a light touch regulatory oversight? Arguably investors would move their investment activity to another network in case they are unhappy with the functioning of the IAN. But then, as pointed out in Black (2001) the securities market can easily slide into a low level equilibrium in the absence of regulatory oversight, affecting the growth and development of the exchange as well as the welfare of investors and issuers alike. This makes it necessary to think more deeply about whether marketplaces like angel networks need to be regulated and how.

5 Conclusion

In sum our analysis indicates that IAN seems to be a financially self-sustaining market based solution to the problem of providing equity funding to early stage companies that many countries in western Europe have been struggling with. Going by the number of investments made, the growth in memberships and the number of companies funded by IAN that have successfully raised VC funding, it would appear that IAN has been fairly effective as an angel funding intermediation mechanism. Our review of its processes, structure and organization suggests that much of IAN's success may be attributed to these elements of the Network. Although the final proof of performance and sustainability would be the retirn that the network produces for its investors, the current indications are that IAN is among the prominent networks that is initiating a significant change in the way angel investing is conducted in India. Much of IAN's working is in line with the current literature says about the role and functioning of angel networks elsewhere in the world. Thus, although we started with the prior that results about angel investing cannot be generalized across the world, our study of IAN seems to suggest that what works for angel networks in the west may apply after all to India too.

Our study of IAN raises may questions too about the organization and governance of the network. These and a more fine-grained analysis of the performance of the portfolio are promising areas for further work. The findings from such work may help to inform not just IAN and further improve its financial and organizational sustainability but also provide pointers to the many other angel networks that could be expected to come up in India and other emerging economies in the years to come.

Comparison of Indian Angel Network, Mumbai Angels, The Chennai Angels and Hyderabad Angels[21]

Attribute	Indian Angel Network	Mumbai Angels	The Chennai Angels	Hyderabad Angels
Commencement Year	2006	2006	2007	2010
Membership – Process	Nomination by Member	Invitation & Sponsorship by a Member	Invitation & Sponsorship by a Member	
Membership – Profile	Entrepreneurs and corporate executives from India and overseas	Executives, entrepreneurs and high networth individuals	Anyone who can invest in seed and start-up companies	Not spelt out explicitly on website. Entrepreneurs and corporate executives as seen from profiles on website
Membership Types	Institutional and Individual	Institutional and Individual	Institutional and Individual	Institutional and Individual
Preferred Investment Stage	"Startup or early stage with a potential to scale"	"Seed and early stage companies"	"Early stage investment with some nexus to South India"	"Seed and early stage"
Deal Entry into System	Sponsorship as well as direct	Direct submission	Direct submission	Direct submission
Deal Evaluation Process	Due diligence and terms negotiation by lead angel	Due diligence and terms negotiation by lead angel	Due diligence and terms negotiation by lead angel	Due diligence and terms negotiation by lead angel
Deal Size	USD 400K to 600K with a maximum of USD 1 mn	Rs 50 lakhs - Rs 200 lakhs	Rs 50 lakhs - Rs 300 lakhs	25 lakh to 200 lakhs
Time to Close Deal	30 days to decline and 45 days to accept a deal after presenting to the angels' monthly meeting	States explicitly its reluctance to mention a time frame	4 to 6 months "from start to finish" - website does not explain what start and finish mean	60 days after shortlisting by secretariat for presentation to angels
Support on Website	Comprehensive enough for engaging with the network, also has a basic knowledge repository	Comprehensive for the purpose of engaging with the network	Comprehensive for the purpose of engaging with the network	Comprehensive for the purpose of engaging with the network
Sectors of Interest	All sectors - "preference for" IT/ITES, Telecom, Mobile VAS, Gaming and Animation, Internet / Web, Media & Entertainment, Education Technology, Healthcare, Manufacturing, Alternative Energy, Clean Technology, Cloud Computing, Retail	"Industry Agnostic"	Not mentioned	Not mentioned
Deals funded by VCs	10	11	0	1
Exits	1	3	0	0
Mean Days	636	574	0	396
SD of Days taken	379	326	0	-

[21] Based on data available on the websites of the respective network, accessed by the author on January 3, 2014.

Bibliography

Black, Bernard S (2001), The Legal and Institutional Preconditions for Strong Securities Markets, UCLA Law Review, Vol 48, pp 781-855.

Collewaert, Veroniek, Sophie Manigart and Ruby Aernoudt (2008), Assessment of Government Funding of Business Angel Networks in Flanders, Regional Studies,44: 1, 119-130

Harrison, Richard, T., and Colin M Mason (1992), International Perspectives on the Supply of Informal Venture Capital, Journal of Business Venturing, Vol 7, pp 459-475

Harrison, Richard T., and Colin M Mason, "Venture Capital Market Complementarities: The links between business angels and venture capital funds in the United Kingdom, Venture Capital, Vol 2(3), pp 223-242

Knyphausen-Aufseb, Dodo Zu and Rouven Westphal (2008), Do business angel networks deliver value to business angels?" Venture Capital: An International Journal of Entrepreneurial Finance, Vol 10(2), pp 149-169.

Mason, Collin M and Richard Harrison (1997), Business Angel Networks and the Development of the Informal Network in the UK.: Is there Still A Role for the Public Sector?, Small Business Economics 9, pp 111-123

Mason, Colin M (2009), Public Policy Support for the Informal Venture Capital Market in Europe, International Small Business Journal, Vol 27(5), pp 536-556.

Mason, Colin M and Richard T Harrison, (2000), The Size of the Informal Venture Capital in the United Kingdom, Small Business Economics, Vol 15, pp 137-148

Mason, Colin M and Richard T Harrison (2002), Barriers to investment in the informal venture capital sector", Entrepreneurship and Regional Development, 14:3, 271-287

Murray, G.C. (1999), "Early-stage venture capital funds, scale economies and public support", Venture Capital, Vol 1 (4), pp 351-384

Prowse, Stephen (1998), Angel Investors and the market for angel investments, Journal of Banking and Finance, Vol 22, pp 785-792

Roach, Geoff (2010), Is angel investing worth the effort? A study of Keiretsu Forum", Venture Capital 12(2), pp 153-166

Sahlman, William, Howard Stevenson, Michael Roberts and Amar Bhide, The Entrepreneurial Venture, Harvard Business Review Press, 1999

Sahlman, William and Howard Stevenson (1985), Capital Market Myopia, Journal of Business Venturing 1(1), pp 7-30

Shane, Scott A., (2009), Fool's Gold? The Truth Behind Angel Investing in America, Oxford University Press, New York, NY. p-14

Sohl, Jeffrey (2002), The Private Equity Market Gyrations: What has been learned?, Venture Capital, 4(4), pp 267-274

Sohl Jeffrey, E., and Bruce Sommer (2006), Angel investing: changing strategies during volatile times, Journal of Entrepreneurial Finance and Business Ventures, Vol. 11, No. 2, pp. 27-47.

Sohl, Jeffrey, E., (1999): The early stage equity market in the USA, Venture Capital, 1(2), pp 101-120

Timmons, Jeffrey and Stephen Spinelli (2008) New Venture Creation: Entrepreneurship for the 21st Century, 8th ed, Mc Graw-Hill / Irwin

Van Osnabrugge, Mark and Robert J Robinson (2000), Angel Investing: Matching Startup Funds with Startup Companies--The Guide for Entrepreneurs and Individual Investors, Jossey Bass Business and Management Series, John Wiley and Sons