The Band of Angels and Venture Capitalism -
An Interview with Dr. Ian Sobieski, Ph.D., Managing Director of the Band of Angels.

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By Samuel Kwok

Dr. Ian Patrick Sobieski is the Managing Director of the Band of Angels, Silicon Valley's premier and oldest organization still dedicated exclusively to funding and advising seed stage start-ups. Dr. Sobieski has helped lead the organization since 1997. He is also the founder and manager of the Band of Angels Fund, L.P. a $50M venture fund, raised in 1999 exclusively from major institutions. In May of 2006, Dr. Sobieski was invited to present testimony to the United States House of Representatives' Committee on Small Business on the Access to Capital for Entrepreneurs Act 2006.

Q: Briefly describe your background and how you came to lead the Band of Angels.

~ My intention was to become a University Professor, so I came out to California to get a Ph.D. at Stanford in Aeronautical Engineering. While I was doing that, the whole entrepreneurial culture in Silicon Valley was evident. I worked at start-ups in the evenings to make money and caught the bug. So while I finished the Ph.D., I never pursued the academic track. I got directly into a start-up, one thing led to another, and I ended up helping a very early-stage start-up that did very well in the Internet space (www.evite.com). After that venture was completed, I joined the Band of Angels (www.bandangels.com) in 1997. It was an organization that was still very early in its life; the organization didn't have any office, didn't have a meaningful budget or a permanent staff. But, it did have a collection of about 60 or so of Silicon Valley's most successful entrepreneurs who were interested in investing their time and money into new start-up companies and had great deal flow.

Q: What makes the Band of Angels so successful? How do you ensure quality members and deal flow?

~ The deals come primarily from the members themselves and from the community at large. The Band has a strong brand as a result of its years of activity, and it's that brand that gives us the ability to attract the best deals. Our best deals and our exclusive proprietary deal flow come from our members. Every one of them is a recognized source of capital in the community, so they are pitched all the time on their own, regardless of their affiliation with the Band. Once in a while, they find a deal that is truly exceptional, and it is those deals that are brought to us that create our unique deal flow.

Q: What are the factors that contributed to building up the Band of Angels' brand?

~ We were the first. And we have survived. There's no one older with the same kind of group. We've been around and got a lot of deals. So, first-mover advantage and having a sustainable business model is why we have the brand.

Q: How do angels contribute to the funding and start-up process?

~ First venture funds are structurally unable to feed seed-stage start-ups. Every venture fund will do a few start-up deals at the sub-500K investment level, but the partnership structure is just not well suited to making investment decisions and mentoring a large number of seed-stage companies. Angels are exactly the opposite. Angels are very well suited for doing a lot of small deals. Any one angel might steal one deal, but you have so many people involved in the angel group that you're able to get an aggregate coverage that's much bigger than a similarly sized venture partnership that might be made up of just a few partners.

But, angel groups are not particularly well suited for doing large investments that require large amounts of capital to be aggregated together. So everyone has a place in the food chain. And the angels' unique competitive advantages are most evident at the seed-stage of the food chain. That's where angels add value by providing capital, and then they provide the same kind of value at that stage in the food chain that VC's provide later on. They provide, in addition to their capital, mentorship for the entrepreneur in building his business from the seed-stage to the later stage.

Q: Can you describe the working relationship between the Band of Angels and the VC's?

~ Our relationship is one of synergy where we seed deals and hand over the successful ones, subsequently financed by the venture capital community. It's rare that we get competitive on a particular deal, although it does happen. In that case, we compete with other venture firms for a deal in the same way that venture firms compete with one another. I think it's worth thinking about angels and angel groups as really just being another player in the food chain with particular investment traits and appetites. So, just to pick a specific group, NEA (New Enterprise Associates) tends to be later-stage investors because of the size of their multi-billion dollar fund. They are still called venture capitalists even though they really just don't do seed deals. It just isn't their flavor of deal. Similarly, angels and angel groups are also venture capitalists; they just have a particular appetite for seed-stage deals.

Q: What are some of the difficulties you have faced as a venture investor?

~ Well, the last six years has been a nuclear winter and its aftermath. So the biggest difficulties in the venture business have been the collapse of the public equity market for technology companies and the resulting lack of liquidity for venture investments. The consequence is that a lot of money is lost and a lot of venture firms are in trouble and are probably not going to be around in the next few years. Angels are, in that sense, very stable in that they are individual investors, and so the Band has grown in this period of venture capital shrinkage. The world is not coming to an end, but the story is not yet over about the impact of the dot-com collapse on the financial food chain.

Q: What is the most challenging aspect of managing an angel group? What are some of the frustrations associated with managing such a group?

~ I'm the Vice Chairman of the Angel Capital Association (www.angelcapitalassociation.org), the trade group of angel groups around the country. And, the biggest challenge that angel groups have is paying the bill. It's finding a business model that makes sense for a manager or group of managers to deal with handling the administrivia that any organization will require. This is the biggest challenge. Unlike the venture business, which has a very high management fee and is actually pretty excessive in compensation to managers, the angel business simply doesn't have an economic model that's lucrative; that has been proven to provide the carrot that would incentivize someone to stick with it over the long term. Then again, the low fees associated with angel groups are a benefit; I like to say that angel groups are "capital efficient venture capital".

Q: Do you see a convergence of the angel groups into one particular business model?

~ I think there will be a convergence to one particular model, but it's too early to say what that model is yet. I expect it will be a hybrid venture capital model with a side fund that pays the bills.

Q: What are the common traits across the range of Band of Angels' members?

~ The biggest distinction between the groups is the membership criteria. In the Bay Area alone, there's one group that lets pretty much anybody in who's willing to pay their dues. The result is that they find that the deals that that particular group is willing to do are very different than those of the Band whose members are exclusively individuals who have either started or run a high technology company. Of course, there are exceptions to that rule, but 90% of our members fit that criterion. We also deliberately exclude any service providers and any venture capitalists from the group, and that is also different from other groups.

Q: You raised a $50 million venture fund. Could you comment on how the fund is strategically aligned with the Band?

~ It is strategically aligned with the group in that it derives its deal flow from the Band of Angels. So the venture fund invests exclusively in those seed deals that are sourced and fit for Band of Angels members. The result is that investors in the Band of Angels Fund, who tend to be institutions and individuals outside of the Bay Area, get access to some of the best Silicon Valley deals that get mentored by some of the best Silicon Valley mentors; consequently, they have an improved opportunity to generate a healthy return on their investment versus other seed opportunities.

Q: How would you advise angels on working with start-ups and becoming a more sophisticated angel investor?

~ My advice is that angels should be very careful. They should only invest the money they are really ready to lose. The vast majority of angels will lose their money in their angel investments. Angel funds make a lot of sense because they aggregate the risk and the rewards, and they have a higher chance of finding the needle in the haystack because at the seed stage, success is all finding needles in the haystack. So, if you're only going to do a couple of deals, the most likely outcome is that you're going to lose all your money. There's always a chance you could score big, but it's a lot riskier than any other kind of investing you're going to do. So first, be careful – invest only money you're willing to lose. And then take steps to mitigate that risk. If you're going to do angel investing, invest in more deals – smaller amounts in many deals – and join an angel group. There are a lot of aspects we could talk about on how to minimize the risk: Don't do bridges. Make sure you get low valuations on the deals you do. Do thorough diligence on the companies. Reserve capital for follow-on financings so you don't get washed out. Invest locally; don't invest in deals outside the area. Spend on the team not the product. These are all rules I would advise anyone to follow.

Q: For those professionals interested in becoming venture capitalists or investors, would you suggest they link up with angels or angel groups to gain the experience and the skill sets to learn some of these rules you just mentioned?

~ Well, maybe, although I have to say that most angels tend not to be very experienced investors. They became angels through some other activity. Maybe they started a software company that was just sold for $100 million or were successful real estate developers. The fact that they were very successful executives and operators doesn't mean they are very good investors, so one of the great advantages of joining an angel group is in fact to gain investment experience.

Q: What advice would you give a founder on starting an angel group?

~ Figure out what it is you are trying to accomplish as the founder of the angel group. Are you trying to make money? Are you trying to gather deal flow together? Are you trying to help entrepreneurs? Are you trying to get a platform to enhance your personal network? Are you doing it because you enjoy entrepreneurs and just want to be in the mix? Be very clear about what your goal is, as your goal is going to drive the kind of group you start, the policies you implement, the fees you charge, and everything else. Most people get in trouble starting angel groups when they start one with a set of intentions that is not adequately expressed in the operating procedures of the firm they start.