The Guide to Successful Startup Investing

Become an angel in the next startup Cinderella story

OurCrowd

About OurCrowd:

OurCrowd is the leading online venture capital platform for accredited investors who wish to invest in Israeli and global startup companies. Managed by a team of well-known investment professionals and led by serial entrepreneur Jon Medved, OurCrowd selects opportunities, invests its own capital and brings these startups to its accredited membership. Members can then choose the deals that they want to invest in, allowing them to build robust, diverse portfolios of startup companies. OurCrowd investors must meet stringent accreditation criteria and invest a minimum of $10,000 per deal. OurCrowd provides post investment support to its portfolio companies, assigning industry experts as mentors and taking board seats. OurCrowd has raised over $100 million in equity crowdfunding for its 56 portfolio companies which include leading companies, such as: BillGuard, Consumer Physics (SCiO), BioCatch, Abe's Market and ReWalk (RWLK), OurCrowd's first portfolio company to complete a successful IPO on the NASDAQ.

We would like to thank Jonathan Ellison for all of his hard work in researching and writing this eBook.

Disclaimer

Nothing contained in andaccompanying this communication shall be construed as an offer to sell, a solicitation of an offer to buy, or a recommendation to purchase any security by OurCrowd, its portfolio companies or any third party. Information regarding OurCrowd's limited partnerships and/or portfolio companies and the investment opportunities on OurCrowd's website is intended and available for accredited investors only (criteria at www.ourcrowd.com). OurCrowd urges potential investors to consult with licensed legal professionals and investment advisors for any legal, tax, insurance, or investment advice.

© OurCrowd 2015

All rights reserved. To view our investment opportunities, register at OurCrowd.com.

The Guide to Successful Startup Investing is licensed under a Creative Commons Attribution 4.0 International License. **Find the original at** http://content.ourcrowd.com/startup-investing-guide.

TABLE OF CONTENTS

Introduction 5

1. Startups 6
   - Lifecycle of a Startup 8
   - What Makes a 'Hot' Startup Industry 9
   - Early-Stage Valuation 10

2. Valuations and Terms 10
   - Late-Stage Valuation 12
   - Deal Terms 12
   - Industry Choice 15

3. Best Investment Practices 15
   - Diversification 16
   - Due Diligence 16
   - Post-Investment Involvement 16
   - Venture Capital 17
   - Private Equity 17

4. Investment Vehicles 17
   - Angel Investing Networks 18
   - Crowdfunding 18
   - M&A 20
   - IPO 20

5. Returns 20

Conclusion 22

INTRODUCTION

Ideas dominate contemporary society. They feed our curiosity, govern our decisions and fuel our increasingly knowledge-based economy. The startup world houses an industry of ideas, providing mankind with cutting-edge solutions to everyday problems. However, not all ideas evolve past their formative stages. Some succeed and some ultimately fail. To investors, startups offer huge opportunities for high returns but alas, the gains exist only in tandem with substantial risk.

Each successful startup is its own 'Cinderella story': a tiny, homegrown startup undergoes a metamorphosis into a publicly-traded booming company, overcoming great odds - and the terrible stepmothers - of the business world. Any seasoned startup investor might offer a word of caution: not all startups engage in a rags-to-riches process with a happy ending. Success stories like Sequoia Capital's 12,000% return from their investment in Whatsapp (acquired by Facebook) should excite investors about the opportunity of getting in at the ground floor of the next big thing. However, it should also serve as a reminder that startup investing is an extremely risky asset class. The transformation to make it to happily ever after takes a lot of capital, effort and risk.

This is where investors, who are aptly called **angels**, enter. In the age of the knowledge-based economy, angel investors have increased in both involvement and number. Experts suggest that thousands of new ventures annually receive billions of dollars from angel investors.[1] Due to the rise of new platforms and availability of information online, individuals can now add this new asset class to their investment portfolios.

This ebook is a guide for people looking to enter the startup-investing arena. It's tempting to allow the imagination to wander towards the superstar success stories but the risk remains a very important factor in startup investing, so you must be willing to lose some in order to win in the long term. There exist various investment strategies to help investors "play the odds."

These strategies, which properly assess and manage risk, will be discussed at length in this ebook, allowing readers to better navigate the uncertain seas of startup investing. We will analyze these various approaches while also providing the basic nuts and bolts of startup vocabulary, giving you a working knowledge of the startup environment and its terrain, where to find growth and where to steer clear. We hope to provide you – no matter your background - with the tools to invest in ideas, the future, and, bottom line: the next Cinderella story.

1 http://sites.kauffman.org/pdf/angel_groups_111207.pdf

1. STARTUPS

What is a Startup?

Startups: You'll know them when you see them

Before discussing investment strategies (and analyzing margins for profit), let's first define and survey the startup world. The tricky part is that there is seemingly no official definition or concrete metric for the term **startup**.

Investopedia defines a startup as:

> *A company that is in the first stage of its operations. These companies are often initially bank rolled by their entrepreneurial founders as they attempt to capitalize on developing a product or service for which they believe there is a demand. Due to limited revenue or high costs, most of these small-scale operations are not sustainable in the long term without additional funding from venture capitalists.*[2]

At first glance, this definition provides a solid basic understanding of startups, but, with further inspection, it falls short of establishing a standard by which to distinguish startups from other types of companies and other stages in the business lifecycle. When is this "first stage" of operations? What is "limited revenue" or "high cost?"

By their very nature, startups greatly vary. Starting as a seed in somebody's head, ideas manifest themselves differently depending on the individuals involved and the relevant industry. Therefore, great disparities in revenue, profits, and employment numbers distinguish one startup from the next. Given these differences, time cannot solely be used as an objective definition of startup companies; however, time does play a role but largely because it is indicative of more definitive characteristics that distinguish startups.

In Forbes magazine, Natalie Robehmed opined that after about three years, most businesses lose their 'startup' branding because by then at least some of the following transitional events or characteristics have likely been realized: acquisition by a larger company, revenues exceeding $20 million, more than one office, more than eighty employees, over five people on the board, and founders who personally have sold shares.[3] At the end of the day, the profit and size of a company, often related to time, help us define which companies are true startups.

---

2 http://www.investopedia.com/terms/s/startup.asp

3 http://www.forbes.com/sites/natalierobehmed/2013/12/16/what-is-a-startup

The misconceived relationship between tech and startups

The degree to which companies focus on technology does not provide a standard by which to evaluate startups. A common misconception exists which equates startups to tech companies. While many startups innovate and rely on technology, startups are not synonymous with tech companies. A company that has developed a new, useful app, with a reported billion-dollar valuation, and with offices in four different countries is most definitely not a startup; it is a billion-dollar, multinational company.

The startup atmosphere: from T-shirt to necktie

Many founders of startups argue that a startup's status is based on an underlying attitude, a vibe. Because most startups are founded to address specific problems, they can no longer be classified as startups once the problem has been solved, the product distributed, the mission accomplished. Rather than relying on cold, unfeeling numbers to measure this accomplishment, some prefer to rely on sentiments like the working environment. From this viewpoint, once the fluidity and seeming freedom of a startup is lost, it is no longer a startup. A founder's switch from jeans and plaid button-down shirt to a tailored suit is indicative of the startup's entrance to a new life stage.

Taking Stock

As a company grows and employs more workers, a dynamic culture is harder to maintain. The numbers and the mindsets are strongly correlated. Therefore, a combined approach is necessary, drawing on both numerical standards and working environments to provide a definition of the word 'startup'. For our purposes here, we'll define startup in accordance with all of the techniques discussed above, drawing on the Investopedia and work environment definitions and backed by the concrete criteria.

OurCrowd's Definition of a Startup

Our working definition will assume that a startup maintains a fluid culture and mindset and that it has not achieved most of the following: acquisition by a larger company, revenues exceeding $20 million, more than one office, more than eighty employees, and founders who personally have sold shares.

Lifecycle of a Startup

The lifeline of any startup is accessibility to a consistent flow of capital. Throughout a company's life, they will raise multiple rounds of investment to grow into a thriving, profitable business. The first round of investment allows the idea to be translated into a tangible product or solution. Generally, the funding is bootstrapped from the innovators' own pockets along with, if they're lucky, a government or institutional grant.

Next comes the **seed stage**, where the investment circle expands to include family members and friends. The startup finally begins to take shape. Investors, usually previously complete strangers to the founder, begin to establish a relationship during this phase. The hope and expectation are that the profit will be substantial, and the reality is that the risks at this point are fairly sizable. As such, these early investors are considered **angels**. The category of angel investors includes **seed venture capital organizations** and **crowdfunding platforms**.

The seed germinates, and the startup enters a new stage called **Series A investment**. As the company continues to grow and begins to deliver some sort of product, the startup begins to offset some of the initial entry costs; at this point, the startup can enter a **Series B investment**. True venture capital dominates investment during this development phase, where venture money will often be referred to as **growth capital**. After this period of growth and profit, assuming the company has been successful up to this point, the startup eventually reaches **maturity**, where it goes forward and hopefully generates a substantial amount of profit, gets bought out by a larger company, or floats on a public exchange.

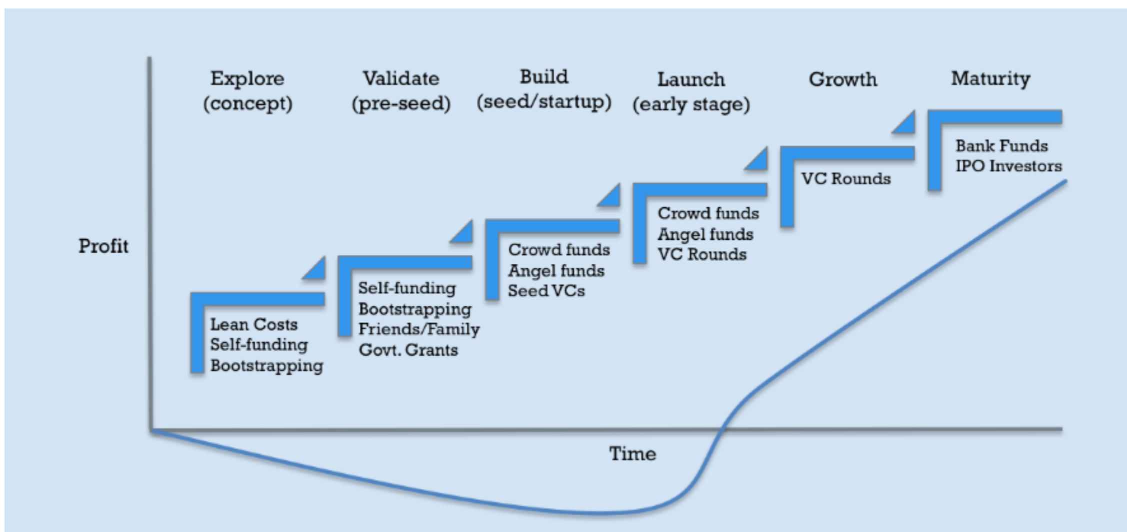


Figure 1-Lifecycle of a Startup (http://hoteliyo.com/tutorials/early-stage-funding-sources/)

Note the relationship between profit and time in *Figure 1*. Innovators must pay high entrance costs, often fixed, to enter or create a market. As the startup begins to produce some sort of good or service, it must also pay variable costs, dependent on the amount produced. Only later does the revenue of the company begin to offset the costs. Eventually, if all works to plan, a profit is generated. Then, after more time and growth, the profits can really begin to take off and investors start to feel a return on earlier investments.

What Makes a 'Hot' Startup Industry

The ideas that spark startups are generally formed in response to current problems in an industry, business model, society or location. The sectors that a startup enters often reflect shifting, timely demands. For example, many startups work to solve problems or create opportunities in the information technology sector. In this age of information, the rate at which we consume information and data – and become dependent on it – is incredible. We continually turn to mobile devices to access data more conveniently. Many startups develop apps pertaining to this thirst for information.

An even deeper example is the medical technology field. We employ startup culture to develop and design groundbreaking technology for the medical field; the need for this is certainly apparent as surgeries, for example, grow increasingly complex and diverse. Our medical capabilities have greatly grown from decades past and as more people live longer, the market for medical care has expanded. The inventions resemble a fantasy of the future, but are very much developed in the present; some examples include, ReWalk (NASDAQ: RWLK), a robotic exoskeleton that allows paraplegics to walk again, the Pillcam, a pill sized camera that will replace colonoscopies, medical alert systems, biochemical scanning devices, and more. As these technologies improve medical care, they enable more people to live longer, healthier lives, effectively growing its own market.

In 2012, the *Wall Street Journal* compiled a list of the top 50 startups. Many were in similar industries, namely information technology, business and financial services, and healthcare.[4] *Forbes* magazine also surveyed what it found to be the hottest startup industries. There was much variety between the industries. They included: corporate wellness services, consulting, relaxation beverages, social media games development, online surveys, and e-commerce. The list is quite diverse, and, what's even more exciting - the opportunities are endless.

---

4 http://blog.ourcrowd.com/index.php/2014/05/14/cashing-in-how-to-make-money-investing-in-startups

2. VALUATIONS AND TERMS

Now, the million-dollar question: How do you, the angel investor, pick the winners, the billion-dollar exits? Before committing a single dime, an investor must understand all of the terms and conditions of their investment. One of the most important stipulations to understand before committing capital to an early stage, private company is the company's value or worth based on a multitude of factors. In order to calculate investment amounts and to negotiate terms of investment, **valuations** must be considered.

Early-Stage Valuation[5]

In the early stage, valuing a startup proves quite tricky mainly because it lacks financial history and, often, revenue. Therefore, many qualitative factors play a considerable role in early stage valuations. A valuation is simply the financial worth of a company at any given time. Valuations are broken down into two categories. The **pre-money valuation** is the value of the company pre investment. The **post-money valuation** is the value of the company after investment (Post-money= Pre-money + investment).

The pre-money valuation is usually stipulated by the lead investor in the specific investment round and helps dictate the percentage of the company that the investor will receive in return for their investment. The factors that impact a company's valuation include comparisons with similar companies, competition within the industry, the management's experience and background, and the possibility of future capital needs. There exist various methodologies to determine valuations during a company's early stages, which are explained below.

Venture Capital Method of Valuation

The first and most popular method used by institutional investors is the **Venture Capital Method**, which relies on many quantitative factors generated by expectations. If one divides the suspected exit value by the expected return on investment, one derives a value for today's expected post-money valuation. The pre-money valuation is simply the expected post-money valuation minus the amount of money that will be invested. Harvard Professor Bill Sahlman first introduced this method in 1987.

(Expected exit value / expected return) – amount invested = pre-money valuation

The VC method will generally produce higher valuations because it is based on future projections. The next two methods are more focused on the current financial situation of the company.

5 http://blog.ourcrowd.com/index.php/2014/05/14/cashing-in-how-to-make-money-investing-in-startups

Berkus Method

The **Berkus Method**, developed by angel investor Dave Berkus in the mid 90's, adopts a hybrid approach blending qualitative and quantitative criteria. The appraiser begins with five qualitative characteristics:

1. Sound Idea (Product Risk)
2. Prototype (Technical Risk)
3. Quality Management Team (Execution Risk)
4. Strategic Relationships (Competitive Risk)
5. Sales (Production Risk)

A monetary value is assigned to each criterion, from $0 to $500,000. The appraiser then arrives at a valuation of the company by summing all of the assigned values.

Scorecard Valuation Method

The **Scorecard Method** also takes a hybrid approach but is more complex than the Berkus Method. First, valuations are noted for other pre-revenue companies in similar sectors and industries. These valuations are averaged.

Next, a venture score is assigned to pre-established qualitative factors similar to the ones in the Berkus Method. A company that proves average in a certain criterion when compared to similar companies receives a score of 100%. More impressive companies get larger scores.

These venture scores are then multiplied by pre-assigned weights to yield a factor for each qualitative criterion. The factors are then summed and multiplied with the average valuation of the comparable companies. This produces a valuation for the company of interest.

Comparable Companies	Valuation
Company 1	1,000,000
Company 2	2,000,000
Company 3	5,000,000
Average Valuation	***2,666,667***

Value Driver	Weight	Venture Score	Factor
Strength of Mgmt Team	30%	150%	0.45
Size of Opportunity	25%	125%	0.31
Product/Technology	15%	125%	0.19
Competitive Environment	10%	75%	0.08
Marketing/Sales Channels/ Partnerships	10%	100%	0.10
Need for Additional Investment	5%	100%	0.05
Other	5%	100%	0.05
Total			***1.23***

Valuation of Venture 3,266,667

*Source: Bill Payne, Scorecard Valuation Methodology

Late-Stage Valuation

Valuing a company proves even more definitive later on in a company's lifecycle. The previous valuation methods that we mentioned all had some qualitative, arbitrary method of calculation, due to the company's lack of financial history. As companies grow, they are able to produce a record of their past financial performance and more accurate future projections. Investors therefore can analyze this history and the company's revenue in order to generate more quantitatively based valuations. A simple Google search for 'discounted cash flow (DCF)' will produce formidable models that investors use to valuate these later stage companies.

As we mentioned in the introduction to this chapter, it is critical to understand a company's valuation before choosing to invest. Knowing the various factors involved in calculating a valuation can lead to better, more responsible investment decisions.

Deal Terms

After a startup undergoes a proper valuation, deal terms must be negotiated and agreed upon in a document called a **term sheet**. The terms give the valuation of the startup and the amount that the platform or individual will invest in the startup. If there are co-investors, their names and investment amounts are also listed. The form of investment and potential returns (which will be discussed in more detail later) are negotiated and recorded in the deal terms. Finally, protective rights and preferences are enumerated and reserved. Below is a glossary of all of the important deal terms to know before choosing to invest.

Dilution[6]

As a company grows and develops, so does the relationship between the company and its investors. Companies often initiate other investing and fundraising campaigns. These rounds increase the size of the pie, and more investors get pieces. If you invest $1,000,000 in a $1,000,000 company, you effectively own 50% of the company (Total investment / Post money valuation). If that company then enters another round of investment and you refrain from participating, your slice will get smaller if the round is successful. After this round, say the company accepts an additional $1,000,000 of investment, making the post money valuation $3,000,000, because you have not invested any more money your percentage of the company decreases from 50% to 33%. This change in percentage is known as **dilution**.

In itself, dilution does not change the overall value of your holdings. You merely own a smaller percentage of a more valuable company, but your net assets in the company are the same. But if you wish to keep ownership over the same percentage of a company over time, you must invest in subsequent rounds to avoid dilution. It is easier to maintain your percentage of ownership earlier, when each dollar is a larger percentage of a less 'valuable' company. After all, a dollar invested today is generally worth more than one invested tomorrow.

Anti-Dilution Rights[7]

Protective rights exist to shield early investors from dilution. There exist two main varieties of **anti-dilution rights**.

Ratchet-Based Anti-Dilution

If a company issues new shares at a price lower than that initially paid by the protected investor, the price that the original investor paid in an earlier round will be reduced to a new price. These new shares are then issued to the protected investor as compensation.

Weighted Average Anti-Dilution

Rather than fully reducing the original price per share (as in Ratchet-Based), an investor protected by weighted average anti-dilution rights will pay a price averaged between the original and the new price. The weighted average is "broad-based" in that it takes into account all options, warrants, and anything that could be converted into common shares and not only outstanding common shares themselves.

Bring-Along Rights[8]

In addition to anti-dilution rights, there are many other types of rights often reserved in deal terms. Bring-along rights are granted to majority shareholders who collectively hope to sell their shares of a company. These rights force minority shareholders to agree to sell their shares along with the majority shareholders and on the same terms.

---

6 http://blog.ourcrowd.com/index.php/2014/05/14/cashing-in-how-to-make-money-investing-in-startups

7 *OurCrowd* Term Sheet Dictionary

8 As above

Preemptive Rights[9]

Existing shareholders exercise their preemptive rights must be given the opportunity to maintain their percentage ownership interest in a company in the event of subsequent rounds of funding where new shares are offered to a third party.

Registration Rights[10]

Companies that are privately held do not need to register their shares until shares are offered publicly (an IPO). When individuals invest in startups (pre-IPO), the company is still privately held, and therefore, the shares are not registered and not transferable. Registration rights give investors the right to compel a company to register the investor's shares so that they can be publicly offered and therefore transferred.

F-3 Registration Rights

These rights allow companies to register shares without filing individual registration statements for each share and to complete this registration process prior to any sale of shares. This allows companies to raise large amounts of capital very quickly without concerning itself with registration and review by the securities regulatory body.
Be advised that registration rights are often limited by lock-up provisions, where the investor is not permitted to sell his or her shares within a certain amount of time following an IPO.

Demand Registration Rights

These rights give investors the right to force a privately-held company to become publicly traded.

Piggyback Registration Rights

When a company registers its shares, any investor may 'piggyback' off this registration by registering his own shares without having to use limited demand rights.

Alternative Forms of Investing[11]

There are other methods for financing and investing in companies beyond directly purchasing equity.

Convertible Loans

With convertible loans, rather than purchasing shares, the investor's investment works much like a loan with an agreed upon interest rate. In a future equity round, this loan, accounting for interest accrued, can convert into shares. This form of investment is often employed in early stage investments in order for companies to avoid declaring a set valuation. Convertible loans also may take the form of bridge loans serving to bridge the gap between two rounds of funding.

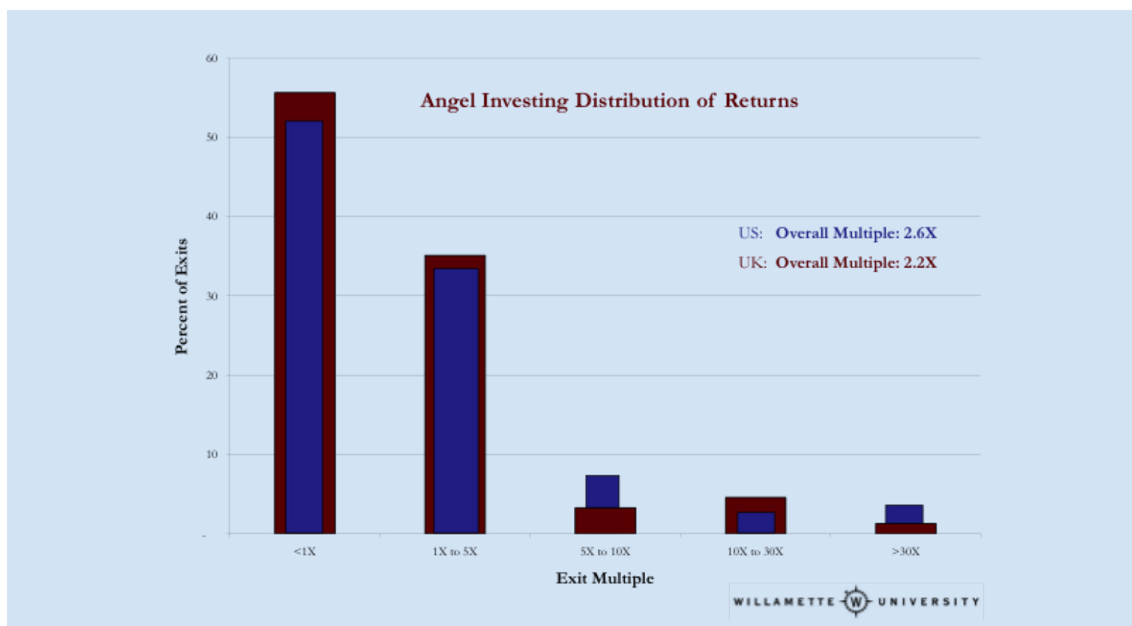
Warrants

In the form of a contract, warrants are options sometimes given to shareholders to buy shares in a company at a later date at a pre-negotiated price. The individual in possession of the warrant generally maintains this option for an agreed upon time period. Regardless, warrants do not directly translate into equity unless they are excersized.

9 *OurCrowd* Term Sheet Dictionary
10 As above
11 As above

3. BEST INVESTMENT PRACTICES

There exist various strategies and approaches for investing in startups to hedge some of the risks and maximize potential returns. A 2007 study led by Dr. Robert Wiltbank and Dr. Warren Boeker indicated that 52% of all exits returned less than the original amount of capital invested by the angel.[12] Yet, the true 'Cinderella stories' do exist, and 7% of exits studied returned over ten times the initial investment amount, composing 75% of the total returns in the market. This study demonstrates the risky but rewarding nature of angel investment. Some of these strategies will be discussed here.



Source: TechCrunch

Industry Choice

First and foremost, an investor can actively choose the investment, the startup, its targeted market, and its industry. For instance, some industries just might not make good investments at certain times given the surrounding market conditions. Some industries are just hotter than others. One must take into account one's view of society's needs and direction prior to picking investments. Additional factors come into play in determining investment in a given industry, primarily the investor's experience in that industry. If an investor is a doctor, he may possess certain insights about the medical world that prove valuable when investing. He therefore may want to consider investing in medical technologies. The previously mentioned Wiltbank and Boeker study showed that higher investment multipliers and investment returns were connected to investors' industry expertise.[13] Therefore, expertise can increase returns over the long term.

12 http://sites.kauffman.org/pdf/angel_groups_111207.pdf
13 http://sites.kauffman.org/pdf/angel_groups_111207.pdf

Diversification

Whatever an investor's expertise, one should always **diversify**, in any investment asset class. It is unwise – detrimental, even – to bet on just one or two startup companies; more often than not, startups return less than the initial investment amount. In order to improve the odds of finding a billion dollar winner, invest in more "competitors." These winners, with their whopping returns, can more than compensate for the losers.

Diversification in startup investing includes maintaining a portfolio that encompasses various startups in various industries with various business strategies. You should also diversify based on the age of a company, participating in some early-stage, some mid-stage, and some late-stage investments. Borrowing the numbers from the Wiltbank and Boeker study, only 48% of individual venture exits provided at least a 1X return, but 61% of investment portfolios had an overall multiple of at least 1X. Other industry experts have been quoted saying that 10 – 15 companies is the sweet spot for building a truly robust, diverse portfolio.

Due Diligence

It's a good idea to know what you invest in, that is to say – perform **due diligence**. Due diligence is the process of investigating a person or company prior to signing a contract. Spending time on due diligence positively influences investment outcomes. Wiltbank and Boeker found that the median of due diligence time spent by angel investors is twenty hours. While investors who reported spending less than the median of time on due diligence had an overall portfolio return of 1.1X, those who spent more than the median had an overall multiple of 5.9X . Time spent on due diligence appears to correlate with higher returns on investment.

Post-Investment Involvement

After making an investment, there are additional contributions that an investor may make in order to increase the likelihood of a higher return. Such forms of participation include: mentoring the startup, financially monitoring the startup, and helping establish business relationships on behalf of your investment. For this reason, many investors attempt to secure a board seat. These representatives better allow the investors to maintain a degree of post-investment involvement. According to the data collected in the study, angels who interacted with the ventures only a few times a year experienced an overall multiple of only 1.3X in 3.6 years while those who interacted a couple of times per month achieved an overall multiple of 3.7X in four years. The quality of interactions also prove important but are much more difficult to analyze quantitatively.

The prudent investor should incorporate a hybrid of these different investment strategies in order to increase the likelihood of a higher return on investment. As a general rule, investors should diversify, draw on previous experience, and do the legwork before and after investment to better ensure that a venture reaches its full potential.

4. INVESTMENT VEHICLES

There exist many different private asset classes through which to invest in private startup companies. These various platforms operate through different methodologies and regulatory frameworks, and they also generally tend to work with different time frames. Some are fund-based; others allow the investor to build his or her own portfolio through single-company investments. Venture capital and private equity are two common fund-based venues for investing in private companies. Angel investing and crowdfunding are popular examples of fund based investment vehicles, which allow investors to build portfolios.

Venture Capital

Venture capital is one of the oldest and best-known methods of investment in early stage companies. Like in other startup investing platforms, venture capital involves significant risks but also offers potentially above-average returns on investment. Funds like Sequoia Capital who invested in Whatsapp, Accel Partners who invested in Facebook (NASDAQ: FB) and Benchmark Capital, early investors in Twitter (NASDAQ: TWTR), all saw massive returns from their early stage, risky initial investments.

Venture capital firms (VCs) generally invest in later stage **growth** companies, often starting in B rounds where companies are just beginning to bring in revenue but not necessarily on a consistent basis. VCs assemble a portfolio from various ventures, or startups, usually raising funds from large institutions. VCs invest in very young companies and therefore adopt a “build-up” investment strategy. As quoted in Forbes magazine, Mark Kachur, former CEO of CUNO (which was acquired for over a billion dollars), opined, “in venture capital, you start with people, and then you try to figure out what numbers you can make.”[14]

Private Equity

While there are similarities to venture capital, **private equity** also displays somewhat distinct characteristics, particularly in mindset and investment approach. Instead of taking a “build-up” approach, private equity firms seek to build from the “top down,” restructuring what a company already has. VCs generally start with enthusiastic investors while private equity firms often begin with an under-optimized company.

According to Victor Hwang of *Forbes*:

> *In other words, private equity is usually about taking an existing company with existing products and existing cash flows, then restructuring that company to optimize its financial performance. When private equity works right, it can save poorly-performing companies from bankruptcy and turn them into profitable enterprises.*[15]

14 http://www.forbes.com/sites/victorhwang/2012/10/01/presidential-debate-primer-whats-the-difference-between-private-equity-and-venture-capital/

15 As above

According to the National Bureau of Economic Research, each dollar invested in a private equity fund returned on average 20% more than a dollar invested in the S&P 500. Investing in later stage companies may require a higher entrance fee, but the risk at that stage is substantially less.

Angel Investing Networks

Angel investing networks serve to connect investors with startups, with a character reminiscent of social media; they do not genuinely serve as financial intermediaries between investors and startups. These ventures are generally very early stage, often around the seed stage. In some ways, the format of investment totally differs from those offered by VCs and private equity firms. Angel investing networks allow potential investors to browse long lists and profiles of startup companies rather than buying a portion of a pre-organized fund. The most famous example would be AngelList, one of the largest online startup databases and syndicate networks. Compounding to the social media feel, these platforms allow investors to build networks with other investors in order to jointly fund startup ventures. There are also a few different types of angel investing networks.

Incubators, it might be said, act as angel investment networks. Incubators offer startups workspace and materials in exchange for a share of the company. In this way, incubators act as a forum to connect startups with angels and funding. Y-Combinator, a Silicon Valley based incubator founded in 2005, took part in cultivating famous companies like Dropbox and Airbnb.

Crowdfunding

Crowdfunding is an up-and-coming format for startup investment, allowing investors to build their own startup portfolios rather than buying into rigid funds. Crowdfunding collectivizes the startup investing process, allowing many individuals to invest smaller amounts, forming what is known as the "crowd." Crowdfunding platforms differ from angel investor networks in that crowdfunding platforms themselves organize and assemble the crowd instead of individual angel investors. Crowdfunding opens up startup investment to more people as the buy-ins for VCs and private equity firms are generally very large. There exist two main forms of crowdfunding: reward-based and equity-based.

Reward-Based Crowdfunding

Reward based crowdfunding is a cheap way for companies to test demand and build buzz around their products. In order to avoid sacrificing equity and control of a company, entrepreneurs often pre-sell their product or offer other rewards to entice people to fund their companies and product development. This process often takes the form of **reward-based crowdfunding** when this exchange of rewards and funding generates a funding "crowd." An excellent example of a reward-based crowdfunding platform is Kickstarter, where companies run all-or-nothing funding campaigns with a target amount and final deadline. Individuals can contribute tiny amounts of capital (generally a $1 minimum) to support the campaign. From the point of view of an investor, this sort of platform does not provide an outlet to achieve investment returns and make real money.

Equity-Based Crowdfunding

Equity-based crowdfunding is an entirely different animal, and here, real money can be made for investors and investment minimums are generally higher (but still much lower than in your typical VC). The investors fund startups and projects in return for equity rather than one-time rewards. Individual investors pledge various amounts of money to collectively reach a target goal to fund a company in return for equity that will hopefully be converted into publicly-traded stock in the event of an IPO. Crowdfunding generally fits in earlier than VC funding in a company's life. Like with VC, the risk is substantial, but there is potential for huge returns. At the same time, because the investment is composed of a multitude of investors, the crowd diffuses the risk across its many constituents rather than concentrating it in the hands of fewer, larger investors.

There are a number of leading equity crowdfunding platforms in operation today that all focus on different markets and sectors. OurCrowd is the leading global, equity crowdfunding platform by dollars invested through the OurCrowd platform. CircleUp is another equity crowdfunding platform that is focused on consumer companies in the United States.

Accreditation

In the offering of private, unregistered shares, there are significant regulations involved. Investment services providers, like VCs, private equity firms, or equity-based crowdfunding platforms, must work through existing legal frameworks of investor protection. The most common exemption that allows individual investors to purchase unregistered shares is the accredited investor exemption. Criteria vary by country for accreditation, but the general idea is the same across the globe: Accredited investors are wealthier and more experienced with regard to capital markets. They are more qualified to understand the risks of their investments and to be able to take the hit if the investment collapses. So, to invest in startups, most often investors are required to be accredited in order to participate.

OurCrowd

OurCrowd is a unique hybrid of the venture capital and equity crowdfunding models. OurCrowd may draw on a larger pool of investors in that its minimum investment amount is smaller than that of most VCs, existing somewhere between a true crowdfunding platform and true VC. OurCrowd operates like an equity crowdfunding platform by providing investors with vetted, individual startup companies in which to invest. OurCrowd conducts due diligence on the companies that appear on the website, so investors have the ability to build their own portfolio from OurCrowd's thoroughly researched portfolio companies. OurCrowd invests in a diverse group of startups in various rounds of funding, generally in slightly later rounds than many crowdfunding platforms. To date, OurCrowd and it's community of over 6,000 investors from 30 countries have invested $100M in 56 startup companies. ReWalk Robotics (NASDAQ: RWLK), an OurCrowd portfolio company recently floated it's shares on the NASDAQ, marking the first IPO of an equity crowdfunding backed company.

5. RETURNS

Regardless of the platform, startup investments offer various types of returns dependent on the company's performance and its potential to exit. There are many ways to exit the business, some positive and success-driven, others negative and failure-driven. Such exits include: M&As, IPOs, soft landings, and dissolutions. Sometimes companies also pay dividends, another immediate form of return on investment.

M&A

Mergers and acquisitions, or M&As, are a common exit strategy, particularly among Israeli startups. These events occur when small companies get bought-out by larger ones. Take Whatsapp for example. Facebook purchased the popular mobile messaging platform for $19 billion dollars in 2014.[16] Sequoia Capital, the lone venture capital investor in Whatsapp, invested $60 million over the course of three investment rounds. Their return from the Facebook acquisition was a humble $3.5 billion, a near 50X return on their initial investment.

As a startup begins to pick up momentum, gain share in the market, and bring in significant revenue, other, larger companies often look in at the startup's success and, much like investors, want a part of it.

The way to get this portion of a startup's success, its product, and market traction is through an M&A transaction. The larger company buys the startup. In general, the purchasing money is then divvied up pro-rata between everyone who owns a part of the acquired company, or shareholders. In this sort of exit, the acquired company often receives some of the money directly in cash and sometimes indirectly in the form of stock of the buying company. Notably, the cash is not generally transferred all at once or immediately; generally there is an agreed upon timeframe for payments in multiple installations.

IPO

News of companies going public, or undergoing an IPO, an **initial public offering**, is fairly common. When a startup grows large enough and has significant revenue, it may seek an IPO. The company must register its shares on the public market so that its equity can be traded publicly. This public trading then frees up earlier investors to sell their stock, ideally for much more money than their original purchase price.

An IPO must be properly timed. There must be a public demand for that specific company's equity, so that stock is sopped up quickly by the public in a manner consistent with the company's final valuation. In reality, IPOs are simply a liquidation event. Earlier in the company's lifecycle, an angel can't really get cash back on his original investment. After an IPO, he can—or, at least, eventually; most companies have a lockup provision, preventing investors from immediately dumping shares after an IPO, which would cause a liquidity crunch. Generally, investors are required to wait before they are permitted to sell their shares post-IPO.

16 http://www.bloomberg.com/news/2014-02-20/facebook-values-whatsapp-like-miracle-drug-real-m-a.html

Soft Landings

Soft landings are exit opportunities for companies to avoid falling out of the market. These exits do not confer large returns upon investors. Then again, these are not "crash" landings. Soft landings often allow investors to get at least a portion of their money back, allow team members to remain employed, and save founders from a slew of bad press. One type of soft landing is an acqui-hiring, a fairly recent concept. An acqui-hiring occurs when a larger, more successful company acquires a smaller company not for its product or ideas but for its skilled employees. The startup's asset is seen to be its team members, so companies acquire the startup and let it sputter out of gas leaving only its skilled workers. While soft landings save startups from much worse, more dramatic fates, they do not really offer much of a return to investors, who generally receive only a fraction or small return on their investment.

Dividends

Dividends are set payments issued by a company to its shareholders. Companies might distribute dividends for a number of reasons. When investors in the stock market seek to make money, they often buy dividend-bearing stock to get near-immediate income, often at the expense of long-term growth and added value.

Generally, if a company is performing extremely well and reeling in large profits, that company may redistribute those profits directly to investors in the forms of dividends rather than reinvesting excess cash to further grow the company.

Liquidation Preference

Liquidation Preferences refer to the process in which investors see a return on their initial investment. The operation and sequence of distribution during **liquidity events** depend on two major factors. First, returns are proportional to investment. Obviously, the number of shares one owns in a company determines the amount that the investor receives in a liquidity event. While this first principle is both simple and intuitive, liquidation preferences establish a certain hierarchy of distribution proving a bit more complex than proportional returns. There are different types of investments and different types of shares. A distinction exists between ordinary and preferred shares as well as between different classes of shares. For instance, an investor who purchases preferred shares in the A round owns what are called Preferred A Shares. Preferred shareholders are entitled to their corresponding percentage of dividends before ordinary shareholders receive anything. Furthermore, investors owning higher classes of shares receive their check before those with lower classes; for instance, C receives before A. In addition, there are also distinctions between shareholders and other forms of investors, like debt holders. Liquidation preferences determine the order in which investors are returned their capital.

CONCLUSION

The startup investment landscape is currently undergoing a renaissance. Individual investors now have unprecedented access to top startup investment opportunities that were once only available to a select group of investors. There are many different platforms, strategies and forms of returns that all must be researched and understood before deciding to invest. The risks are high; the rewards, enticing. To navigate this investment terrain, investors should be willing to diversify their portfolio, to hedge their bets, and also do the leg work of due diligence and market research.

OurCrowd is the leading, global equity crowdfunding platform. Our team handpicks top startups for investment, which are diverse across industry and age, appropriately managing the risk involved in startup investing. Before selecting the companies for investment, we carry out the market research, and complete the intense process of due diligence, which is eventually made available to our community of individual investors. To date, OurCrowd and our network of over 6,500 investors have invested $100M in 56 portfolio companies. At OurCrowd, we strive to incorporate the various strategies supported by the proven successes of the past. OurCrowd embodies the professionalism and diligence of most VCs, along with the flexibility and sense of community of an equity crowdfunding platform.

Investing in startups is inspiring, energizing, and, when done right, rewarding. Newly equipped with this information about startup investing, pursue your own chance to share in a Cinderella's success.

Visit www.ourcrowd.com to join our investment community and start to see all of our deal flow.