BUSTING INVESTMENT JARGON WITH SARAH & CLAIRE

24TH APRIL 2023

CLAIRE [00:00:00] Nothing in this podcast is financial advice, and when investing, your capital is at risk.

(Upbeat music builds)

SARAH [00:00:10] Welcome to the Obu podcast, a place for people who are changing what it means to be an angel investor. We'll be talking to business owners who have taken investment and angel investors who have put in their capital, their wisdom and their networks to work to grow diverse-founded businesses. The world of investment is changing, and we're inviting you to learn how. Welcome to the Obu podcast.

(Music gets louder then ends)

CLAIRE [00:00:41] Today, we're taking a look at some of the most confusing terms in the investment space and want to spend some time explaining these in plain English. Investment doesn't need to be confusing and we strongly believe that making sense of all of the jargon means that more people can make sense of the investment world and the role that they might play in it. So we visited the Obu Investment A to Z resource, which you can find on our website, to lift the lid on five of the most commonly used terms you're likely to hear.

(Segment music change)

CLAIRE [00:01:13] So, Sarah, when we look at the investment world, what we see everywhere is jargon. We see loads of acronyms. It can feel like a really daunting space just to even make sense of it all. So we've picked out today just a few terms that we know we come across all of the time and have frequently asked questions about. And we're going to start with angel investing. Like, what is an angel investor? Do they live in heaven? (both burst into laughter)

SARAH [00:01:40] Right? Well, they do feel like a Godsend sometimes (both laugh in agreement) when you're trying to raise. But you're totally right. And I think 'Angel Investor' is one of those ones that everyone throws around and just assumes everyone else knows what it means. But an angel investor, very simply, is someone who uses their personal wealth, personal cash that they have, to invest in start ups or early stage businesses. So our focus is always on early stage investment and for us, we talk about that as being investment rounds of up to £250,000. So when we talk about angel investors and with all of the people that we've interviewed on the podcast, we're talking about those individuals who will place some of their own private capital into a business in return for some shareholding. And that very simply is what an 'angel' is –

placing capital into a business for that return of shareholding. And I guess the way that we always talk about an angel investor and the way we kind of develop that – really you want angel investors who, yes, place capital but who are also able to place and invest their wisdom and their knowhow, their cheerleading and their support for that entrepreneur and that business, and also their networks. Now, those things aren't necessarily a given, but we know that angel investors will often look for businesses where they feel that they can play more of a role and that maybe it's an investment in a space where they've had personal experience or they particularly care or feel passionate about the focus of that business. So yes, capital, but for us at Obu, it's about so much more than that.

CLAIRE [00:03:19] Yeah, and that's so important because I think if you just read the dictionary definition, they would just talk about this exchange of money for shareholders.

SARAH [00:03:27] Right.

CLAIRE [00:03:28] But we know that for the changes we want to see in the world, it has to go beyond that. Maybe not every time with every angel, but, you know, if angels can turn up with the skills, experiences and networks you've described, there's so much more to be gained from those kinds of relationships.

SARAH [00:03:42] Right. And, you know, sometimes an angel might want to only place capital. Maybe they feel at that moment in time they haven't got capacity to go beyond that. So for us on our cap table – and we'll talk about 'cap table' in a bit – we have investors who don't play an active role in terms of knowhow and support and connections. But if we went and asked them, then they'd be really happy to do that. So there's a kind of spectrum, I guess, along that line of... level of wisdom, support, cheerleading that you might be able to offer at a certain point in time. But, you know, the dream investor brings all of those four things with them.

CLAIRE [00:04:22] And if we get into it just a little bit more detail and I've snuck in a couple of like subcategories.

SARAH [00:04:28] Nice love, a subcategory. (both share a laugh)

CLAIRE [00:04:32] Angels also come with some categorisations. So not only are you an angel investor, but we hear terms like 'high net worth angel investor' or a 'self-certified, sophisticated angel investor' also bandied around. So it would be great just to understand what specifically did those categories mean.

SARAH [00:04:51] And these are categories that are kind of put in place that are introduced by the FCA. So from a regulatory perspective, there is an ask for individuals who want to be an angel investor to then be able to identify as one of these groups. So high net worth sometimes seen as 'HNW'. High net worth means that your income is over £100,000 per year or that you have net assets worth £250,000 or more, excluding your house or any pension that you might have. And it's not always the case. But typically those look like individuals who are in senior management positions across a whole range of sectors. Maybe they're in C-suite roles, maybe they've inherited wealth, family wealth, or they could, for example, be an exited entrepreneur who then has capital available to them. So again, those aren't exclusive, but the formal clear

“We strongly believe that making sense of all of the jargon means that more people can make sense of the investment world and the role that they might play in it.

definition of 'high net worth' is those two pieces. So earning over £100,000 a year or net assets of over £250k, excluding your home and your pension.

CLAIRE [00:06:00] Thankyou, I think is really important just to keep saying it over and over again and all of this resource is available on our website so you can go find all of the details there still. But the more familiar we become with those terms, the easier we can relate to them and recognise that that might be us.

SARAH [00:06:20] Right, and we use this language a lot, but people can count themselves in then. Because often it's a term that gets thrown around and everyone just sort of nods in agreement when really no one knows what it actually means (both giggle in agreement). So the other term that you mentioned alongside high net worth was sophisticated investor. So this one is slightly different. So a 'sophisticated investor' is someone who has either been a director of a company turning over at least 1 million within the last two years. So that needs to have been in the last two years. Or a sophisticated investor can be someone who has made more than one investment in an unlisted company again in the last two years, or there is a third category here under sophisticated investor, if you don't meet any of those other criteria. But you have been a member of an Angel network for at least six months, then you could take the sophisticated investor box. And I think that's really important because it's another mechanism that enables people to count themselves in.

CLAIRE [00:07:24] Yeah.

SARAH [00:07:24] And it's why at Obu, we're creating an angel investor network for people who maybe don't quite tick one of those other boxes, but who do have some capital that they would like to invest. And actually, if they spend some time in the company of other angel investors learning about angel investing, being inspired about angel investing, then that means that they can count themselves in. And that's really important when we think about diversifying the angel investor pool in the UK and making angel investing more accessible to more people.

CLAIRE [00:07:57] Yeah.

SARAH [00:07:57] Because yes, angel investing is risky. There is risk associated with it. You know, you could lose the money that you invest, but actually you could also get a significant return.

CLAIRE [00:08:10] Yeah.

SARAH [00:08:11] So if someone can be a part of an angel network for six months and then they've saved up and they've got £5,000, £2,000 that they would like to invest, well they can still count themselves in. And because angel investing is a route and a pathway to wealth generation. Like we really believe, don't we? That that's something we need to make more accessible, which is why we're creating a community for people who say, 'Yeah, I want to count myself into this even though I don't quite tick these other boxes'.

CLAIRE [00:08:43] Absolutely. And I think it's important from the regulators perspective, what they're trying to provide is education. It's either you've got enough money to lose – let's be blunt about it. You've either got enough money lose or you've done it before so you've got some experience, or you've wrapped yourself in some knowledge and knowhow, so that when you step into angel investment, you have some understanding of what's involved.

SARAH [00:09:10] Right? Exactly that. I think sometimes people get a bit tied up and it's kind of regulation and therefore it feels scary. But actually that regulation is there to protect people.

CLAIRE [00:09:20] Yeah.

SARAH [00:09:20] And it's one of the reasons we were really excited to build our business in the way that we have, because you are absolutely right. That's exactly why those categories are there. It's just maybe the current incumbents haven't done an amazing job at describing what those categories are.

CLAIRE [00:09:37] No and that's why the A to Z exists. (both laugh in agreement)

SARAH [00:09:41] Right, exactly, exactly. So that's 'angel investing'. The next one that we wanted to take a look at was [00:09:46]'advanced assurance' [0.7s] – and world you know lots about in the world of Obu. So fill us in!

CLAIRE [00:09:50] To kind of give you the definition, it's a provisional green light from HMRC that any investment that you bring into your business would be eligible for tax relief, caveated always by providing the business and the angel both meet those investment criteria and the tax relief criteria. So if we just break down though for a moment what 'advanced assurance' actually is - it's a process that founders take their businesses through with HMRC. They will submit their pitch deck, business model, financial forecast, any details of investors that they've already had early promises from, and they basically make a case to HMRC that they have an investment-ready business and HMRC then agrees whether or not they believe that to be true.

SARAH [00:10:36] Right.

CLAIRE [00:10:37] It also is a rubber stamp process, which means that if you are in particular seeking SEIS or going through the EIS schemes and so your investors will be eligible for tax relief, again, it's a rubber stamp which gives more certainty and more reassurance to those investors because those schemes are really great. So if you can get those tax relief benefits, you would want to know that. It's a great process to go through. We really encourage founders to go through that process before they go out for investment because I think it really is a green light for proceeding with some certainty. There's also a lot of mystery around it. There are a lot of organisations who

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Capital .... wisdom, support, cheerleading .... the dream investor brings all of those four.

will charge you to take your business through advanced assurance. Our experience is that in reality, if you've got your business investment-ready, you'll have all of those documents in place anyway. You're filling out a form online and submitting it to HMRC. It's designed to be easy and straightforward. And there is cloak and dagger and mystery all around it, and there just really shouldn't be.

SARAH [00:11:48] Right, 100%. And I guess full transparency, we've always led our own advanced assurance, haven't we? Which isn't to say everyone should do the same, but I think your point of it's a process, understand the process. And if you're doing an investment round, you're going to be creating a pitch deck, you're going to be creating your financial forecast. So that's the hard bit.

CLAIRE [00:12:10] That's the hard bit. Right. You're 90% there! (both laugh in agreement)

SARAH [00:12:13] Right, right. Filling in that form and submitting to HMRC for advanced assurance is really the easy step.

CLAIRE [00:12:22] Yeah, it's all quite straightforward. So I think the benefits of advanced assurance actually works both ways. If you're a founder, you get that rubber stamp from HMRC. That means you can engage with your investors more meaningfully. You can talk about EIS and SEIS tax benefits as a part of your raise, so that's brilliant. And if you're an angel investor asking the question, have you got your advanced assurance yet? It's a great way to understand where the founder is at. Are they still going through the process? Are they waiting? It can take a few weeks to sometimes get a response. Have they secured it already? It gives you line of sight to where's the founder at and will I be eligible for the tax benefit.

SARAH [00:13:03] That's really helpful because I think, you know, we've talked about SEIS, so the Seed Enterprise Investment Scheme a lot. There is then the Enterprise Investment Scheme, both of which we're not diving into in detail today, but both of which are in the A to Z so people could go and take a look there. But as you've described, advanced assurance really help for both sides of that agreement, of that angel investing.

CLAIRE [00:13:29] Yeah, absolutely. So we know then that once a founder has taken investment, they have this thing called a 'cap table' and that's cap - C - A - P, not cat C - A - T!

SARAH [00:13:43] Been there! (burst into laughter)

CLAIRE [00:13:45] (Laughs whilst conversating) Been there, been on the receiving end of lots of emails that say cat table – it's easy to get mixed up though right? Again because what does even 'cap table' mean. So what does 'cap table' actually mean?

SARAH [00:13:57] Okay, so 'cap table' has basically been shortened from capitalisation table. So definitely much easier to go with 'CAP table!' And really simply it's basically a list of who has ownership of a particular business. So for example, when we co-founded our business, there were no other shareholders. So the only people who would have appeared on our cap table were you and I, showing 50% ownership between us. As though you take investment into your business, you add people to that cap table, and the cap table will show the breakdown of who owns what percentage of shareholding within your business. So practically for entrepreneurs, it's just a really helpful tool to keep track of who are your investors and what ownership do they have. Really helpful for if you're then going on to do future investment rounds because you've got that summary information which is always relevant to future conversations in terms of next round of investment. Also interesting though, for angel investors to be able to take a look and to kind of understand firstly what is the breakdown of that shareholding, but secondly, who else has invested? As we've talked about, investors can play a role beyond simply capital. And so knowing that there are investors who maybe have experience of your sector or who, I don't know, or maybe influencers in that space and therefore can help you achieve market reach. That can also be interesting because it just fuels a bit of confidence around who else is invested here. Again, it's why we want to see so much more diversity in the angel investor pool in the UK because those cap tables will then look more diverse and that's great in terms of the innovation that we fuel, the innovation that gets supported, economic output, productivity. We know that sometimes shareholders will also become board members for a business. And again, the more diverse a board is, the more productive a company is likely to be. So more diversity in cap tables is a real priority for us, that's a driver and a motivator for us. But very simply, a cap table is basically a list. It's basically a list of people and the shareholding that they have in that business.

CLAIRE [00:16:25] So we just call it the list. (Both laugh in agreement)

SARAH [00:16:26] Right, Exactly. Yeah. A list of shareholders.

CLAIRE [00:16:31] You are welcome. We have just got rid of an abbreviation for you. (both share a laugh)

SARAH [00:16:37] So next up – and it's another one that gets thrown around – is 'ticket size'.

CLAIRE [00:16:42] Ticket size! I remember the first time we came across that. I think we just both looked blankly at each other and were like, what on earth? Who's got a ticket? For what?

SARAH [00:16:51] Where are we going?!

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The more diverse a board is, the more productive a company is likely to be.

CLAIRE [00:16:53] Yeah! so again, ticket size is used a lot by both sides. So it's used a lot by founders and it's used a lot by angel investors. What it actually means is it relates to the size of an individual investment. Now, from a founder's perspective, so someone who's raising, they might say I have a minimum ticket size of £5,000. That means they're looking for people who will bring in at least £5,000 into their businesses.

SARAH [00:17:22] Yep.

CLAIRE [00:17:22] Now, the reason they might want to do that and they won't accept, for instance, a £500 ticket, is because their cap table could end up looking a bit unwieldy.

SARAH [00:17:35] Right.

CLAIRE [00:17:35] So very often if you're looking for smaller ticket sizes, you will go via a crowdfunding platform. Because that's where you will attract and where the audience sits that typically will do smaller investment sizes. It's not unheard of to do private investment sizes with smaller tickets.

SARAH [00:17:52] Yeah.

CLAIRE [00:17:52] But you sometimes don't want. I don't know... 150 people on your cap table. That's a lot of shareholders to communicate with. So if you're raising investment and you don't want your cap table to look too unwieldy, then you might just say I have a minimum ticket size of X, and you're then clearly stating to the world, if you are an angel investor and your ticket size is less than that, we're not the right fit.

SARAH [00:18:18] Right.

CLAIRE [00:18:18] And that's okay. It's okay to say we're not the right fit. Equally, if you're an angel investor, you might have ambitions to invest in 20 businesses this year, but each of those businesses, your ticket size is £1,000. So you're making a lot, but much smaller investment ticket sizes.

SARAH [00:18:40] Right.

CLAIRE [00:18:41] Equally. And as is typical in the UK, investment levels, ticket size is around 15 grand. So instead you might look to one to 2 to 3 investments over the course of a year. And you know that your typical ticket size is 10 to 15 pay. So then you might look for opportunities where you're perhaps going to get slightly larger shareholding because your ticket size is bigger and you might be looking to play a slightly more significant role in that business as a result. Again, not always but sometimes that's what the ticket size is – they want a slightly more active role in the organisation.

SARAH [00:19:15] And it's a really interesting way, isn't it, for business owners to provide an indication of who they're looking for. And so when we did our last investment round in September, we raised half a million and we were very clear that we were protecting £100,000 of that for smaller ticket sizes starting up five K upwards. And the reason for that was we wanted to diversify our cap table and we knew that we therefore needed to make investment into Obu more accessible for more people. So that was quite a deliberate action that we took and something that we communicated to the market to say, 'Yes, we want some larger tickets, investment sizes, but that we were going to protect the 100,000 for smaller ticket sizes', meaning we could diversify the cap table for Obu.

CLAIRE [00:20:07] Without it then ending up with a war and peace cap table. So it allowed us as much as the investors, for us to forge one-to-one relationships with our angel investors. And, you know, those relationships, I think, have really flourished over the last six months. We're really blessed with who's in the background supporting us – so it can pay off by being really explicit about what you want to achieve.

SARAH [00:20:32] Yeah, another one ticked off the list.

CLAIRE [00:20:35] Dun, dun duunn.... (Sarah giggles in the background) Okay, let's wrap this up. Let's get into it's quite a meaty area, actually. Let's talk about 'due diligence'. And again, it's a phrase that gets used a lot. I used to hear it all of the time in my corporate world. And then you transfer that across into entrepreneurial and investment landscape. Like, what are we due diligence-ing? What how do we apply it?

SARAH [00:20:56] And I think it's really interesting to, almost a bit like you did earlier, there's a dictionary definition and then then there's how we're thinking about it at Obu. So 'due diligence' is another step in the process of doing an investment round. It's something that ideally you would want an investor to be carrying out. So if you're considering becoming an angel investor, then understanding what you might look at during due diligence is really important. And so basically when an entrepreneur presents their pitch deck and their their financial forecast and any other supporting material that they might have, as an angel investor you want to carry out a review of - is this investment right for me at this point in time? And so there's a range of things the angel investor will look at in terms of the commercial potential of that business, its legal structure, looking at the founding team, looking at market growth. So kind of does the market growth that this entrepreneur in their pitch deck is suggesting, does that ring true with my own research that I can carry out? Looking at kind of any traction that that business has been able to achieve? So what product testing might they have done already and what the early indications from that product testing? So kind of covers quite a wide range of areas, which I think is why angel investors will often prefer to invest in businesses where they have a particular interest.

CLAIRE [00:22:24] Yes

SARAH [00:22:25] Or maybe they've had experience of that sector in their careers, because you do want to do a good job of that due diligence. You're going to be placing capital within that business. And so you want to be able to understand - 'Is what I'm reading in this pitch deck, is what I'm seeing in this financial forecast - does it feel like it rings true?' So that due diligence step is really important. At Obu, we take our businesses who come onto our platform through a really thorough due diligence process. We look at five key areas. We carry some of the weight of that activity for our angel investors who are on our platform. I think it's also really important to say when we talk about due diligence that with early stage investing, like it's early stage. There won't be a huge amount of evidence that says, 'Yes, this business has got thousands of thousands of customers' and 'Yes, they're generating millions of pounds already'. Kind of that's not what early stage investment looks like. So often due diligence at an early stage will be about the founding team.

CLAIRE [00:23:32] Yeah.

SARAH [00:23:33] And do I believe that there is a market opportunity? And do I believe that this founding team can deliver a product that will fill that market opportunity? We'll often talk about it as, you know, as an angel investor in this space, you're placing a bet on the businesses that you would like to see exist in the world. And so if that's a business you feel passionate about, often early stage investors will be driven as much by that as they will what they see through the due diligence process.

CLAIRE [00:24:07] Right. And I think you've said a couple of really important pieces there, which I think due diligence can often sound as though there is the right way to do due diligence and there is a correct outcome.

SARAH [00:24:19] Right.

CLAIRE [00:24:20] And regardless of who would do due diligence on a business, they would all end up at the same end point. And that's just not true. I think what you've really beautifully explained is actually the emphasis very much comes from the individual investor. Like what are their drivers, what are they interested in, where does their experience sit, how do their brains work, you know, what are they just curious about it and they will emphasise it. So everybody will come at due diligence with a different emphasis. Mostly unwittingly, like not knowing that they're doing it. But I think you've described that really well because I think it eases some of the pressure from what's the right answer.

SARAH [00:24:55] Exactly. And you're completely right. Person A versus person B can look at the same business and come out with a completely different answer. I guess what's important though, is due diligence is about testing those areas. I.e. having a conversation with that founding team, with that entrepreneur or entrepreneurs to understand what they've said in their pitch deck. To understand what their motivations are for starting this business, what experience they have within that space, what traction they've been able to achieve. And really importantly, you know, this stage of investment, what are they hoping it will unlock?

CLAIRE [00:25:35] Yeah.

SARAH [00:25:35] You know, so they're raising £250,000. Okay. What does that mean they want to achieve in the next six months or nine months? And then looking at does that plan feel achievable? You know, so if, for example, they were saying we're going to develop our marketing strategy, well, if they don't have plans to recruit someone in the marketing space, then that would be a red flag.

CLAIRE [00:25:58] Yeah.

SARAH [00:25:58] So it is really important, I think, to highlight that, yes, due diligence is about looking at the paperwork and the pitch deck and the forecast, but it's as much about having that conversation and starting to build that relationship, right.

CLAIRE [00:26:13] Yeah, because you invest in businesses that you really believe in. You have to start forging that understanding early as possible.

SARAH [00:26:21] Yeah.

CLAIRE [00:26:22] Okay. So let's do a really quick recap just to wrap it all up.

SARAH [00:26:26] Nice, a speedy recap? (Laughing whilst conversating)

CLAIRE [00:26:27] Speedy recap.

SARAH [00:26:28] Let's go.

CLAIRE [00:26:29] Okay, Sarah, go. Angel investor.

SARAH [00:26:32] Okay, so an angel investor is someone who wants to place their own capital into a start-up or early stage business. For us at Obu, that could also mean knowledge and network and cheerleading. Within that, we then also talk about 'high net worth' and 'sophisticated'. So 'high net worth angel investor' means your income is over £100,000 per year or you have assets worth £250,000 excluding your home and your pension. And 'sophisticated investor' also has a number of subcategories. This isn't so speedy, is it? (both giggle) So a 'sophisticated investor' is someone who either has been a director of a company turning over at least 1 million in the last two years, or you've already made an investment into an unlisted company in the last two years, or finally, that you've been a member of an angel network for at least six months.

CLAIRE [00:27:28] Perfect.

SARAH [00:27:29] Done. Handover.

CLAIRE [00:27:30] Handover, 'Advanced Assurance'. So 'advanced assurance' is a provisional greenlight from HMRC that an investment in a business will be eligible for tax relief as long as both the business and its investors meet all the necessary conditions.

SARAH [00:27:45] Nice. (Claire giggles in the background) So 'cap table' or 'capitalisation table' is basically a list showing what percentage of a company is owned by which people. So whether that's the founders, whether that's investors or other owners, it's basically a list of shareholders.

CLAIRE [00:28:03] 'Ticket size' is used frequently by both founders and angels and relates to the size of an individual investment.

SARAH [00:28:11] Slick! (Both share a laugh)

CLAIRE [00:28:12] I feel like we're getting the hang of this, five in.

SARAH [00:28:15] So due diligence is an index review of a business carried out by a potential investor to decide whether that investment is right for them. So again, it's as much about looking at the pitch deck and the financial forecast as it is about the conversation that you have with that individual.

CLAIRE [00:28:32] And we have a lot more to share. So we have created an investment A to Z, which you can find on the Obu website where you can dive into all of these in a little bit more detail. Plus you can get your hands on a whole bunch of other jargon and acronyms that you can now make sense of. And if you have any questions or if you think there's anything missing from the list, then please let us know. Get in touch on our socials or drop us a line via the website and let's have a conversation.

(Upbeat music builds again)

SARAH [00:29:09] For more on how we're reimagining investments and entrepreneurship across the UK, visit Obuinvest.com. More real conversations with entrepreneurs and angel investors who, with their capital and their businesses are changing the world for the better.

(Music gets louder then ends)