Friends and family round vs. angel round

Many entrepreneurs setting out to found a business believe they should begin by focusing on venture capital. That, however, is a misconception: in reality, venture capital comprises only a small percentage of startup financing. For startups, there are two common sources of early-stage financing.

This article briefly describes the differences between two common sources of early-stage financing for startups.

Friends and family round

In meeting their capital needs, founders typically obtain early financing from their own savings and from networks of friends and family. Typically, these investors are individuals willing to invest anywhere between $10,000 and $150,000 of their own personal finances because they feel loyalty and affection for the founders or are motivated by their startup idea. This type of early-stage financing is commonly referred to as a "friends and family" round.

The close personal connection of friends or family members to the founder makes them a convenient source of initial funding. Given this intimacy, entrepreneurs may be tempted to accept money from such investors without following the corporate formalities that institutional investors require. That could be a misstep. Even when monies come from those closest to you, entrepreneurs should always carefully document each investment. This will help to avoid future conflicts while ensuring there is a proper foundation for future investment, and may even help to maintain clarity in case there is a need to go back to the well. (For more about the documentation typically needed for a round of venture capital investment, see our article here).

Angel rounds

Angel investments are typically made through small entities that are formed for investment purposes or by wealthy individuals who are either entrepreneurs themselves or otherwise have experience investing in early-stage companies (for more about accredited investors, please see our article here). Angel investors look for companies that have already built a product and are beyond the earliest formation stages, and they typically invest between $100,000 and $2 million in such a company. Angel investors may not have a personal relationship with the founders; they are motivated by a return on their investment plus the opportunity to draw on their own knowledge to mentor or coach a budding entrepreneur.

Angel investments usually bridge the gap between a friends and family round and a Series Seed or Series A round. Most entrepreneurs appreciate the benefits of an angel round because it increases their startup's valuation before they seek Series A financing.

Key differences

This chart highlights the key differences between a friends and family round and an angel round.

Friends and family round	**Angel round**
Investor is usually a personal connection of the founder, is not necessarily a high-net-worth individual	Investor is usually a high-net-worth individual, is accredited, is often a part of an angel network of repeat

and lacks industry knowledge to objectively evaluate the structure of the startup, its technology, or opportunities, but is willing to invest anyway	angel investors and is equipped with industry knowledge to evaluate the startup and help it grow (often by taking on a director or advisory board member role)
Average investment is around $23,000	Average investment is around $75,000.[1]
Valuation of the startup is usually between $0.5 and $1 million	Valuation of the startup is usually between $1 million and $3 million and requires that the board retain at least around 10% of the total equity
Takes a shorter time to close, usually around two months, so it provides a speedier solution to the startup's immediate financial needs	Takes a slightly longer time to close, usually between three and six months; if the investment is through an angel group, then time to close can be longer, because there is usually a more structured pitch and review process
Often turns into a continuous, long-term financing opportunity because of the pre-existing relationship	Usually is not repetitive, because angels do not typically make follow-on investments in the same company to avoid over-concentration in their portfolios
Costs less than other rounds because of reduced transaction fees and lower legal fees due to the lack of due diligence and complex documentation	May cost slightly more due to transaction fees, especially if done through an angel group, but the benefits of industry knowledge and coaching from an angel investor can sometimes counterbalance the transaction cost associated with their investment

Throughout the different stages of a startup's lifecycle, different sources of financing may be available, with each round presenting a unique set of challenges and considerations to entrepreneurs. When a business is brand new, angel rounds and friends and family rounds are popular financing sources.

Not every startup will pursue a friends and family round or angel round, but some startups may do both, and do so multiple times. Budding entrepreneurs should keep them in mind.

[1] For a full breakdown of startup funding sources, see a helpful infographic here.