

George Brown, Business Angel

Imperfect markets?

By 1982, when George Brown came from America to live in Oxford, he had built an international investment banking firm specializing in asset finance, and in 1986 he retired. Even running a two-man business making very large structured finance deals once or twice a year did not occupy him enough.

"I had a lot of free time, got bored out of my mind, and came under the sway of a guy called David Swenson. He was an economics professor at Yale who took over the Yale Endowment Fund in 1994. He pulled the whole Yale Fund out of listed equities and bonds, partly because, he said, he had no advantage over other investors. Listed securities are about the most efficient market there is, Swenson said, and neither I nor my advisers know what General Motors is going to do better than anyone else - unless they have illegal inside information. Swenson said he was going to invest only in imperfect markets where he had an advantage, because he would get boutique companies to advise him and share the risk. And one of the areas Swenson then got into was private equity in early stage companies. He beat the bull market of the nineties hands down, and when it crashed he was up 9%."

"Once I was here in Oxford, all my neighbours were investing in early stage companies, and I thought, well, this looks just like an imperfect market I'd be interested in, and so got involved. Unlike listed securities, knowledge about early stage companies is not widely dispersed. Word of mouth and personal relationships play a large part and the founders, usually technical rather than commercial people, do not have a clear idea about the business side of their proposition. This means I often can see value where they don't and can have a significant impact on the value of the company by modifying their business plan to make it more commercial."

"Apart from the imperfect markets aspect, early stage investing has other, more emotional satisfactions. In the first place, it's intellectually fascinating: you're dealing with bright people and learning about whole new technologies and industries. That's great. I hate to go on doing the same thing. In the second place, you can have a real impact on the success of a company, and so get the satisfaction of having helped create something new. In the third place, you're usually mentoring younger people, which is very satisfying. Personally, I believe that older people have an evolutionarily-evolved drive to mentor younger people, which gives the mentors great emotional satisfaction."

University spin-outs and academic entrepreneurs

George Brown has now invested in twenty-two early-stage companies. They are mostly university spin-outs, and not only from Oxford. He belongs to angel groups in London (at LBS, UCL and Imperial College) and Cambridge. He is also Chairman of the Combined London Colleges University Challenge Fund, which specializes in very early University spin-outs. "It takes over your life."

However, working with academic entrepreneurs, and would-be entrepreneurs, has its frustrations. "It's a real problem, because very few think commercially or in terms of what the customer wants. They are much more focused on producing academically rigorous research which they can publish and in pursuing the truth, rather than commercial value. They can be too enamoured with the novelty of the technology, while ignoring the fact that nobody will really be interested in paying anything for it. And then, of course, most of them want to remain academics, which is probably a good thing - so they become consultants rather than employees of the company - but being Gods in their own department, they think they know more than anybody else about how to run the company and try to do so from the sidelines - especially when the employees of the company are former staff of the academic. And occasionally university politics intrudes, such as the time a University authority put pressure on a related investor on the grounds that the academic had brought in millions in grants, so they had to keep him happy. I always try to get my companies off of University property as soon as possible to insulate them from the academics."

Many of the companies that George Brown is asked to consider are biotech companies. "I really like biotech. I think it's less of a business and more of a technology play. If you've got a technology that works well, somebody will use it. It's less of a business, where you have to go out and package and market the product, continually revising your plans based on feedback, so that consumers will buy. With biotech there's an established route to market – the joint venture with big pharma. Unfortunately, biotech is dying in the UK and Europe. The reason is that since the European countries, including Britain, have controlled drug prices, most of the profits of pharma companies are in the US now. So big pharma has moved most of its research to the US to be close to the FDA and the ultimate market, so if you want to form ventures with big pharma, it's much easier in the US. In addition, the US (for cultural and other reasons) is where most of the venture capital investors are and also where the most profitable IPO opportunities are. There's tons of early stage money in the US; in fact some think there's a bubble in the US now for angel investors in biotech. But, being fairly provincial, most US investors won't invest in a foreign startups, where they can't keep a close eye on their investment.

You have a relatively small number of VCs in the UK and they are very conservative, make maybe one biotech investment a year each, at most, and get together to form cartels to squeeze early stage companies when they need more money. And biotech needs huge amounts of money. No matter how successful the company is, the angel investors are guaranteed to be squeezed by the VCs. So I now tell biotech companies I won't invest unless they flip into the US, i.e., have a US parent with a UK research subsidiary."

Are business angels optimists?

"The problem is, the British are wonderful at finding ways things won't work. Maybe they're realistic. I mean, 19% of Americans think they're in the top 1% of income, and another 20% think they're going to be there. They're terribly optimistic, which means they'll risk their money on punts, whereas British find reasons not to."

Is he an optimist?

"I'm very optimistic but I try not to be... It's a characteristic of humans to be optimistic. In fact, clinical psychologists say that the most objective people are the clinically depressed, and the psychologists measure when someone is getting well by how over-optimistic they are becoming. So I try to guard against over-optimism.

One of the ways is to avoid at all cost at making decisions based on intuition.

I've been greatly affected by a book I read about twenty five years ago by Stuart Sutherland, called '*Irrationality*.' Almost every study shows that intuition is terrible. Intuitively, we all think our intuition is great, but we are terrible at making judgments from past experience unless we do it very logically and mathematically. Take judging people. Everybody thinks, oh, I can judge people, once I see them face to face – well, the studies all show that you can judge a person much better over the phone than in person. You can tell a liar better on the radio than you can on TV. So I try to avoid meeting the founders until very late. I look at the business plan, see if it holds together logically. I read their CVs and talk to people who have worked with them. Only after I have decided I'm interested in the company will I talk to the person and then initially only over the phone. I try to reduce as much as possible the emotional side."

Once George Brown has invested in a company, he does not invariably take a seat on the board.

"It depends. Sometimes they might ask me to look at something in an emergency, because I'm a lawyer – help negotiations, or documents, something like that. But often I stay off, and you can have almost as much influence as a lead investor or an observer. But where I've brought other investors in, sometimes I feel I have to be on a board to represent them. Anyway, I think it's very difficult to be active on more than five or six. Too many, and you're not doing a good job. A lot of the work is done between board meetings, because you're called up and asked to help with strategy – things like that.

One of the most important but most difficult to accomplish thing is to fire people quickly enough. Because there are so many things conspiring against an early stage company, you need absolutely outstanding management to succeed. The problem is that UK employment laws are designed primarily to protect the mediocre – and the mediocre aren't going to make it in small companies. You've got to get rid of them before that first year is up, and usually within three months. It doesn't help anyone, including the mediocre, to keep them around, give them repeated warnings, all that.

I believe in letting the CEO make the decisions. I don't force my ideas on him, even if I think he's making a mistake. For the company to succeed, the CEO, the man on the ground, has to be taking responsibility for the decisions and not running off all the time to someone else for approval. If he's responsible, then he's going to learn to think things through."

Angel networks

How often do business angels see each other?

"I'm very active. I'm in a lot of groups – a lot of meetings, so I see a lot of angels. Sometimes when I'm looking at deals, I'll call up other angels and say: are you looking at this deal? And we'll all get together. In one deal I did last year we formed a group to negotiate the deal. I handled the document negotiation, someone with marketing expertise reviewed the business plan, one guy who knew software reviewed the software, and one young investor was designated as the person to communicate with the relatively young founders. It worked out perfectly, because we all complemented each other. In fact, it was written up in the Wall Street (Europe) Journal, front page, with a title like 'Even angels are getting tough'. We had accomplished VC terms for an angel deal.

I belong to a Cambridge angel group which is really stimulating. A group of twenty entrepreneurs get together roughly once a month, and at their meetings one or two companies present, sponsored by a member. After the presenters go home, we sit in a large circle eating dinner, a different college each time, and everybody is arguing with the sponsor who is defending the company. By the end of the dinner, you really understand this deal – the market, everything. There's not anything quite like that in Oxford or in London."

How would a well-functioning angel network operate, does he think?

"Ideally, a University tech transfer office should start with a small group of very active, knowledgeable angels. You'll get far more expertise both before and after the company is founded than from the guy who comes to a mass presentation and says 'I've got some extra £25,000 I want to put into something'. When you need to raise a lot of money, your core group of angels will easily raise the money from all their angel friends. And if an angel I know is already in a deal, I'm much more likely to invest myself. "

Christine Holmes and Douglas Hague, November, 2004