

How to perform due diligence on your investors

Why is due diligence important?

Strict due diligence was not always necessary.

In the past, if you wanted to find investment for your business, your options were closely tied to the reach of your personal network.

This had the following consequences:

On the one hand, any investor you were introduced would most likely have come from a referral you trusted. As a result, trusting the prospective investor and their credentials was relatively easy. Most of the due diligence was accomplished via the intimacy of the referral.

On the other hand, your reach would have been limited to your network. And as a result, many businesses would have failed to find funding because their entrepreneurs weren't linked to any 'Old Boys' Club' or similar.



Today, the rise of networking and connection sites like [LinkedIn](#) and more specifically, [Angel Investment Network](#), means that you can now access investors from all over the world. Investors whose network would never have overlapped with yours.

This democratisation of access means that more and more people are receiving investment, irrespective of background. This is, of course, great news (though there is still much work to be done).

However, this brings its own dangers.

Entrepreneurs looking for funding are often in a vulnerable state. They have invested time, effort, passion

and resources into a project, but they need financial support to take it further. As a result, they can be overeager to accept funding from wherever it is offered which can be a bad idea.

This is where simple due diligence work can help entrepreneurs to easily avoid the pitfalls of scammers and con-artists.

What is due diligence?

Due diligence is the general term used to describe any background check on a company or individual to see if they are legitimate and suitable to do business with.

Basically, in the case of angel investment, it's checking that an investor is who they say they are and can help you in the ways they suggest they can.

This process starts, in a loose sense, from the moment you connect with a prospective investor as that's when you start forming an impression of them. But you only need to formalise the process when you are sure they are interested.

In this sense, due diligence is a complementary part of investor relations.

You don't then need to carry out full due diligence on every investor you speak to. But, when the relationship progresses to the point of meeting and discussing deal terms, then it's a good idea to make sure you know exactly who you're dealing with.

How do I perform due diligence on investors?

1. Talk to the investor

It is a good idea to be upfront and tell the investor that you want to research them.

This is such a simple course of action. But too many entrepreneurs are afraid of annoying their investor leads and scaring them away.

A good investor will not only understand why you want to check but will be reassured that you want to. It shows that you are diligent and professional.

Remember, they want to trust you too if they are going to invest in your company!

You can tell a lot from an investor's reaction to this. If they help you in your research, then you're onto a winner. They should provide you with links to their online profiles and emails addresses for people they have worked with.

If they are not happy with your desire to investigate them, it suggests they may have something to hide. A red flag for sure!

2. Conduct basic research online

A lot of investors will have websites, blogs, and profiles on sites like LinkedIn, Facebook and Twitter. They may be found in articles or have written articles themselves. These can all be found easily on Google.



Of course, a digital presence is more likely in different parts of the world and depends to some extent on the age demographic of the investor. So, you should factor this in.

3. Examine their business and financial status

You should ask the investor and anyone s/he puts you in touch with about their industry experience and about any previous investments. This will give you an idea of their authenticity as an investor and how useful they could be for you beyond simply financial help.

You will also want to find out where their funds are coming from – money from offshore accounts should be avoided unless they can give very good reasons (which you can verify with a lawyer).

You should also do a routine credit and criminal check.

4. Speak to any entrepreneurs the investor has worked with

A legitimate investor will let you which companies they have been/are involved with, and will give you a way to contact them. So, make sure you ask!

However, you may also want to do some research and approach people not referred by the investor.

You should dig into what the investor is like to work with and whether there were disagreements, and if so, whether/how they were resolved.

Try to do this in person as you'll get a more detailed response. (Obviously, this won't always be possible.)

5. Speak to other investors or brokers

If you can, speak to other investors (whether they have invested in your business or not). Ask them for a second opinion on your prospective investor.

Sometimes their reputation (good or bad) precedes them and other investors/brokers on the scene may be able to give you some useful insights.



6. Avoid upfront fees

Another major warning sign is if an investor asks for upfront fees before they invest. Fake investors will come up with all sorts of plausible reasons for the fee. These should be ignored without exception.

At Angel Investment Network, we constantly try to reiterate this to entrepreneurs on our platform:

No genuine investor will charge an upfront fee.

Conclusion:

While the danger is real, awareness of the information in this article and others like it, should provide every entrepreneur with a framework for spotting an investor who is not genuine.

They will, therefore, be able to process the situation rationally and to not act hastily in desperation to close their funding round.

There is a world of possibility out there for entrepreneurs. If it is treated with respect and due caution, it will yield its rewards.

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Publisher:

URL: