

Global Entrepreneurship Monitor
GEM Australia 2006
Data Report on Finance



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The GEM Australia project is based on annual research – principally the annual GEM Australia national adult population survey – that presents its results using a matrix approach developed in: Hindle, Kevin 2006. A Measurement Framework for International Entrepreneurship Policy Research: from Impossible Index to Malleable Matrix. *International Journal of Entrepreneurship and Small Business*, Vol. 3, No. 2, 139-182. This approach breaks *total entrepreneurial activity* into six components (*participation, motivation, innovation, growth, finance* and *entrepreneurial capacity*). Each component is discussed in its own Data Report with respect to three stages of owner-operated business: *start-ups* (businesses actively starting and no more than three months old); *young firms* (from four to 42 months old) and *established firms* (owner operated businesses greater than 42 months old)¹.

Accordingly this data report is one of six that, together, comprise a portrait of entrepreneurial activity in Australia in the calendar year 2006. It is best read in conjunction with the other five data reports and the wide range of other documents and materials, which comprise the multi-faceted GEM project, available at www.gemaustralia.com.au.

The full and correct academic citation for this paper is:

Hancock, Gary, Lindsay, Noel, Hindle, Kevin and Klyver, Kim 2007. Entrepreneurial Finance in Australia in 2006: A Summary of Salient Data from the 2006 GEM Australia National Adult Population Survey. *Australian Graduate School of Entrepreneurship Research Report Series*, Vol. 4, No. 5. Melbourne: Swinburne University of Technology. ISSN 1448-7128

At an international level, the [GEM Global Executive Report](#) provides the global context for the Australian research by presenting key findings of differences found in comparing the entrepreneurial activity of nations taking part in the GEM project. This year, 42 nations were represented. A full description of the [GEM Global Research Methodology](#) can be found in the [How GEM Works](#) section of the [GEM Australia website](#).

Key Words: investment, equity, business angel, venture capital

Aim of this paper: To examine the finance environment for business start-ups in Australia within the limits prescribed by the data available in the 2006 GEM Australia national population survey. Some comparisons are made with the 2005 data.

¹ Readers should be aware that the Global Executive team and other countries use different terms to describe these business stages in their respective reports. Please refer to [GEM Global Research Methodology](#) section for a description of these differences.

FINANCE

Start-up and young businesses are financed in a variety of ways. The amount and sources of finance may vary depending on a number of issues such as infrastructure, culture, and entrepreneurial capacity (see the Data Report on Entrepreneurial Capacity in this series) because, all other things being equal, the supply of entrepreneurial talent influences the supply of investment-worthy opportunities. Finance for start-ups may come from debt or equity funding. The great majority of debt funding is based on the owner's, or sometimes a guarantor's, asset base. The GEM Australia national population survey indicates that banks or financial institutions finance 61 percent of all start-ups. Equity finance occurs when the provider of finance assumes an ownership stake in the business and this accounts for the remainder of the finance sources for start-ups.

Equity Finance

The GEM study reports two types of equity investment participation. First, individual informal investors, (known as business angels) invest in privately owned businesses and usually do so in an industry with which they are familiar. Second, venture capital (VC) firms invest in high potential businesses using a portfolio approach and expect returns via equity sales or initial public offerings. According to the GEM 2004 Financing Report (Bygrave and Hunt, 2005), there are fewer than one in 10,000 start-ups who have venture capital in hand when they open their doors for business. This illustrates that angel finance is far more important than venture capital to the vast majority of start-up businesses even though venture capital can be a key element of success for a relatively few high-aspiration, high-growth ventures.

Informal Equity Investment

Informal investors, known as business angel investors, typically invest less than \$1 million. They invest in privately held firms and take an equity stake in the business. The 2006 GEM data show that the great majority (53.6 percent) of all informal investors commit less than \$50,000. This is consistent with past results. Table one provides a breakdown of the investment amounts in 2006 and compares them to the 2005 figures.

Table 1: Angel investors over last three years by amount of investment

Investment amount	% of total business angels 2006	% of total business angels 2005
< \$10,000	36.2 %	43.2 %
\$10,001 to \$50,000	17.4 %	14.9 %
\$50,001 to \$100,000	13.0 %	13.5 %
\$100,001 to \$250,000	5.8 %	5.4 %
\$250,001 to \$500,000	1.4 %	4.1 %
\$500,001 or more	5.8 %	1.4 %
Did not respond	20.3 %	17.6 %
Total	100.0 %	100.0 %

There continues to be a difference between the investment required and investment provided as discussed in the 2005 Finance Report (O'Connor and Hindle 2006). The breakdown of the amounts that business start-ups require is shown in Table 2. They indicate that there is still a greater demand for amounts less than \$50,000 than any other bracket. There are some differences in the higher brackets, but due to the small number in the sample sizes no conclusions can be drawn from these figures.

Table 2 - Start-up entrepreneurs seeking capital by amount of capital in last 12 months

Investment amount required	Percentage of start-ups requiring investment range 2006	Percentage of start-ups requiring investment range 2005
< \$10,000	15.4 %	29.5 %
\$10,001 to \$50,000	38.5 %	18.9 %
\$50,001 to \$100,000	5.1 %	9.8 %
\$100,001 to \$250,000	7.7 %	9.0 %
\$250,001 to \$500,000	2.6 %	6.6 %
\$500,001 or more	7.7%	4.1 %
Did not respond	23.1 %	22.1 %
Total	100.0 %	100.0 %

RELATIONSHIP BETWEEN INVESTOR AND BUSINESS OWNER

The relationship between the investor and business owner continues to indicate that there is a strong correlation between the closeness of the relationship and likelihood of investment behaviour. Table 3 shows that only 5.8 percent of all investors are not known to the business owner prior to the investment being made. Furthermore, as illustrated in Table 3, even when we examine larger amounts (greater than \$100,000) the relationship is consistent with lower amounts.

Table 3 – Business Angel / Investee Relationship

BUSINESS ANGEL: RELATIONSHIP TO INVESTEE		
	All Angels	Angels investing > \$100,000
CLOSE FAMILY	50.7%	45.2%
OTHER RELATIVE	1.4%	3.2%
WORK COLLEAGUE	11.6%	16.1%
FRIEND: NEIGHBOUR	24.6%	16.1%
STRANGER	5.8%	9.7%
DON'T KNOW	2.9%	6.5%
REFUSED	2.9%	3.2%
Total	100%	100%

RETURN ON INVESTMENT EXPECTATIONS

There are some interesting differences between the expectations of investors and entrepreneurs in the payback amount of investments. Table 4 shows that investors and entrepreneurs both expect very similar payback times. There are, however, a higher proportion of investors who anticipate never receiving a payback than entrepreneurs.

Table 4: Expected payback time for entrepreneurs and business angels

Expected Payback Time		
	Entrepreneur	Business Angel
6 MONTHS	18.5 %	15.0 %
1 YEARS	29.6 %	20.0 %
2 YEARS	20.4 %	25.0 %
5 YEARS	22.2 %	17.5 %
10 YEARS	4.6 %	7.5 %
20+ YEARS	1.9 %	2.5 %
NEVER	2.8 %	12.5 %
Total	100	100 %

The expected payback amount, expressed in multiples of the investment, appear to be very different between investors and entrepreneurs. The investor appears to be considerably less optimistic than the entrepreneur in their expectations for their return on investment. Table 5 indicates that as much as 49.1 percent of all business angel investors expect no payback at all from their investment, whereas only 4.5 percent of entrepreneurs expect no payback.

Table 5: Expected payback amount for entrepreneurs and business angels

Expected Payback Amount		
	Entrepreneur	Business Angel
NONE	4.5 %	49.1 %
HALF	1.1 %	3.6 %
ABOUT AS MUCH	3.4 %	10.9 %
ONE AND HALF	20.5 %	3.6 %
TWICE	22.7 %	14.5 %
FIVE TIMES	22.7 %	7.3 %
TEN TIMES	25.0 %	9.1 %
TWENTY TIMES	4.5 %	1.8 %
Total	100 %	100 %

REFERENCES

O'Connor, Allan and Hindle, Kevin 2006. Entrepreneurial Finance in Australia in 2005: A Summary of Salient Data from the 2005 GEM Australia National Adult Population Survey. Australian Graduate School of Entrepreneurship Research Report Series, Vol. 3, No. 5. Melbourne: Swinburne University of Technology