Global Entrepreneurship Monitor

Westpac GEM Australia 2005: Data Report on Finance

Kevin Hindle and Allan O'Connor
Australian Graduate School of Entrepreneurship, Swinburne University of Technology

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 which 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 2005. 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.

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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, 35 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 portray selected aspects of the finance environment for entrepreneurial business owners in Australia within the limits prescribed by the data available in the 2005 GEM Australia national population survey and to make selected comparisons with data available from the 2005 GEM Global Executive Report and other sources.

Acknowledgement: The Australian GEM team would like to thank the Australian Private Equity and Venture Capital Association Limited (AVCAL) for the provision of data to inform the Classic Venture Capital section of this Data Report.

[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

The fifth critical component of national entrepreneurial activity is the ability to finance new and high-growth ventures. Financing start-up and young businesses is partly an infrastructure issue, partly an issue deeply rooted in a nation's culture and is in part a function of national entrepreneurial capacity (see the sixth Data Report in this series) because, all other things being equal the supply of entrepreneurial talent influences the supply of investment-worthy opportunities. The data discussed in this report focuses predominantly on two types of equity investment participation: that of the informal investment market where individuals, (known as business angels) invest in privately-owned businesses, and the 'classic' venture capital market where professional venture capital (VC) firms invest in high potential businesses expecting a return through an equity sale in a relatively short term (three to seven years). 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 businesses although venture capital can be a key element of success for a relatively few high-technology, high-aspiration and high-growth ventures.

INFORMAL INVESTMENT

A good way to gain a perspective on the utility and sufficiency of the business angel market relative to the capital needs of new businesses is to compare what angels are prepared to give with what new venturers think they need. GEM data facilitate this comparison. In the following discussion, informal investment by business angels is considered as a 'rule of thumb' to be an equity investment below the range of one million Australian dollars. However, in the 2005 GEM Australia national adult population survey, there were very few respondents who claimed either as business angels or as start-ups to fund or require funding respectively in excess of one million Australian dollars. Investments of this magnitude more properly fall within the range of venture capital and were therefore excluded from the angel investment discussion. For the record, in 2005 survey, there were only one angel investor and six start-ups excluded from the informal investment data set on this criterion.

The basic angel investment story of 2005 is that start-up business are requiring more capital as angels are prepared to give less.

In the 2005 GEM Australia national adult population survey, the average investment reported by business angels (over a three-year investment period) was $62,254. This is substantially less than the $152,423 average reported in the 2004 survey. In 2005 the average funds reported as being required by start-ups were $122,566. This represents an increase of 27% on average funds reported as required in 2004. In 2005, on average, a start-up owner reported investing $80,425 of her or his own funds in the venture. This amount reflects a rise of just over 21% on the 2004 data.

The 2004 Westpac GEM Australia report indicated the existence of a finance gap between the amounts required and the amounts available to support high-growth, high-potential ventures, (Hindle & O'Connor, 2005). Table 1 provides the data that indicate the continued existence of this important finance gap. It first presents the profile of angel investors with respect to the amount of funding they have provided into the informal investment market (over a three-year period culminating at the date of the 2005 survey) and then provides the comparative 2004 figures. The table reveals a similar pattern in both years. It is note-worthy that nearly 60% of all angel investment is of $50,000 or below with just under 11% of angel investors committing between $100,000 and $1m.

Table 1 - Angel Investors over last three years by amount of investment

Investment Amount	% of total Business Angels 2005	% of total Business Angels 2004
< $10,000	43.2%	48.8%
$10,001 to $50,000	14.9%	20.9%
$50,001 to $100,000	13.5%	2.3%
$100,001 to $250,000	5.4%	7.0%
$250,001 to $500,000	4.1%	7.0%
$500,001 to $1m	1.4%	0.0%
Did not respond	17.6%	14.0%
Total	**100.0%**	**100.0%**

Table 2 reports the start-up capital requirements claimed by start-up business owners over the last twelve months preceding the survey date. In sharp contrast to angel investor willingness it can be seen that 48.4% of start-ups seek capital of $50,000 or below and 19.7% report requiring between $100,000 and $1m.

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 2005	Percentage of start-ups requiring investment range 2004
< $10,000	29.5%	30.2%
$10,001 to $50,000	18.9%	27.0%
$50,001 to $100,000	9.8%	15.1%
$100,001 to $250,000	9.0%	7.9%
$250,001 to $500,000	6.6%	8.7%
$500,001 to $1m	4.1%	9.5%
Did not respond	22.1%	1.6%
Total	**100.0%**	**100.0%**

It is important to recognise that GEM's definition of an angel investor may be overly broad. The 'blood' or 'family' relationship between an angel investor and the investee to whom they supply funds is an important issue in the entrepreneurship literature. GEM permits family members to be classified as 'angels': other studies and scholars do not. Table 3 reports the relationship between 2005's GEM Australia angel investors with their investee.

The predominance of family relationships is obvious. Roughly sixty percent of all reported 'angel' investments went to some form of family member or relative. Alarmingly, this 'family favorite' situation does not alter to any large extent with respect to the higher level of investment that might be typical of a high-growth venture, (the 11% of angel investors committing funds between $100,000 and $1million).

Table 3 – Business Angel / Investee Relationship

	All Angel Investors	Angels investing between $100,000 and $1m
CLOSE FAMILY	58.1%	61.5%
OTHER RELATIVE	2.7%	0%
WORK COLLEAGUE	6.8%	7.7%
FRIEND: NEIGHBOUR	17.6%	0%
STRANGER	4.1%	7.7%
OTHER	2.7%	7.7%
DON'T KNOW	1.4%	7.7%
REFUSED	6.8%	7.7%
Total	**100.0%**	**100.0%**

This situation then can be summarised in the following manner. For every one angel investor that invested in the last 3 years there were approximately 4.9 entrepreneurs seeking funding across that same period. Reversing this amortisation logic, for every 100 start-ups who sought between $100,000 and $1m in the twelve months prior to the survey there were approximately 11 angel investors making investments of that magnitude in that period. In this same investment band, of those eleven angel investors nearly seven of them (approx. 60%) invested in a close family member. The four other investors then would have been left to service the finance needs of the 93 remaining potentially high-growth start-ups or in other words this type of start-up business, with no investment friendly family connection, could optimistically expect a 4% chance of securing angel funding. We say 'optimistically' because the assumption here is one of perfect distribution but in reality there is no such thing.

CLASSIC VENTURE CAPITAL

A second form of funding pertinent to an important minority of entrepreneurial businesses is 'classic' venture capital, which is defined as equity investments made to support the seed, start-up, early-stage, expansion and later stage funding requirements of privately held businesses by professionally organized equity investors. VC funding is most often for far higher amounts than angel finance typically starting from a low end of one million Australian dollars. Before proceeding to the data reported below, readers should note that the VC figures reported in this document have been gathered by courtesy of the Australian Private Equity & Venture Capital Association Limited. The figures are not 2005 figures and they are not comparable with classic VC data in previous GEM reports. In the 2005 calendar year, only figures for the Australian fiscal year July 2003 - June 2004 were available. Historically, the classic VC figures reported in GEM Australia have been reported for the *calendar* year prior to the GEM report year. Given both the break in data consistency and the lag in reporting periods, comparison with previous years and, indeed all figures pertaining to classic VC, must be considered with great caution.

For the given period (fiscal year July 2003 - June 2004) classic venture capital investment activity represented 0.083% of Australia's GDP. Investments were made in 122 companies with an average sum of US$3,780,980 (AU$5,728,144) per company. This figure is more than twice that reported in the 2004 Westpac GEM Australia report.

Another interesting perspective on the venture capital market is provided by considering the distribution of funds between various stages of a businesses life and other financing areas for such things as buyout or acquisition. Table 4 reports the percentage split between four categories. Seed, start-up and early stage investments only attract 31.4% of the total venture capital market.

Table 4 – Investment percentage by business stage

Seed/Startup (Percent)	**Early Stage/ Startup**	**Expansion/ Late stage**	**Buyout, Acquisition or Other**
21.8%	9.6%	46.8%	21.8%

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