

Attracting investment needs more than a good idea

Many entrepreneurs are dreaming if they think investors are lining up to give them money, writes **Mark Fenton-Jones**.

Entrepreneurs who believe that a great idea backed by upbeat predictions of future revenue growth will attract flocks of investors who want a share of the business should think again.

A study out this week highlighted that aside from finding suitable opportunities, many professional investors do not invest in growing companies because they are not set up to attract investors, their founders are inflexible or the valuations are too high.

The second quarterly Wholesale Investor national report sought to gain an insight into the trends in the wholesale and sophisticated investor market by surveying its database of more than 4200 individuals and firms.

The responses from private equity firms, venture capital firms, ASX-listed and large private companies seeking investments and acquisitions, as well as 1900 wealthy investors who like to invest in private and small listed companies, are a wake-up call for entrepreneurs looking for capital.

Wholesale Investor, a business matching service, receives 20 to 30 inquiries a week from individuals and businesses wanting to raise money, says director Reuben Buchanan.

But many entrepreneurs have unrealistic expectations, which Buchanan blames on a massive communication problem between entrepreneurs and investors.

"And that is what we are trying to address with the survey," he said.

The source of many failed attempts to raise capital, according to Buchanan, can be laid at the feet of entrepreneurs who fall into "the classic mad inventor" mould.

"They are so excited and so caught up with their idea, they think the world wants to get involved with them, and that is just not the case."

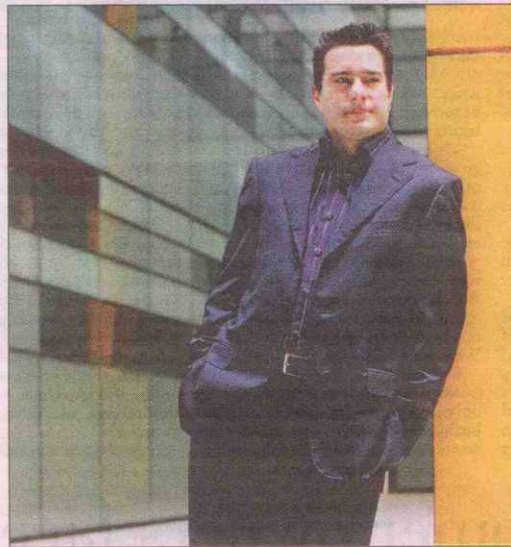
Closely associated with that inward-looking view of their business world, are the three- to five-year forecasts that are regularly trotted out at investment pitches and which Buchanan describes as obsolete.

"There is a belief by entrepreneurs that the bigger the numbers they put in front of investors, the more excited investors will get and the more chance they will invest in the company. And it is the complete opposite," he says.

"The company that introduces three- to five-year forecasts in the business plan for investors is being very poorly advised or they've got no idea what they are doing," Buchanan says. "Because public companies won't even give 12- or 18-month forecasts."

"For a start-up entrepreneur to say that in five years' time 'we are going to do this' decreases their credibility with investors."

He warned that investors can



Reuben Buchanan, above, and Dominic Carosa say it's a good time to get involved with small companies.

Photos: MICHELE MOSSOP, JESSICA SHAPIRO

demand the inclusion of clauses in the contracts allowing them to acquire more equity if benchmarks are not achieved.

The survey is interesting reading for anyone seeking to raise capital, particularly as it indicates that investors are loosening their purse strings.

In May, 24 per cent indicated it was the best time ever seen to invest, but that crept up to 26.5 per cent in August. During the same period, the percentage who thought it was not a good time to invest fell from 4 per cent to 1 per cent.

Although investors are more interested in investing in private companies, entrepreneurs are advised not to be greedy. In the past 18 months, valuations of businesses have declined and investors are aware of that.

"If companies try to get high valuations they won't get them. And that is why investors are so optimistic; they do know they can get value at the moment because of the way the market is," Buchanan says.

In the past 15 months, Domenic Carosa has invested in or acquired 14 internet or mobile communication-based

businesses, either through his private company, Dominet Digital Technology, or pool development fund Future Capital, of which he is the managing director.

"A million dollars today has the same buying power that \$5 million had a couple of years ago," Carosa says.

"I'm seeing asset valuations that are one to two times EBIT

Valuations of businesses have declined and investors know that.

[earnings before interest and tax], where a couple of years ago we were looking at nothing less than five times EBIT.

"Valuations have come right down. Some people are realistic when it comes to valuation, but there are still some entrepreneurs out there with completely unrealistic expectations."

Carosa has taken a minority stake in Wholesale Investor. "Australia has a burgeoning internet industry and in my

view, a very immature venture capital industry, with not many VCs understanding this space [the internet].

"Given this paradox, I recently invested in and joined the board of Wholesale Investor," Carosa says.

The survey also provided a profile of the average wholesale investor as being a 51- to 60-year-old male, private investor, who considers about five deals a week in which to invest up to \$500,000, to buy less than 5 per cent equity in a private company as a passive investor.

"A lot of companies think investors want control of the business but that is actually a myth," Buchanan says.

The most important attribute that will influence the investment decision is the entrepreneur's management team (77 per cent) followed by proof of concept (51 per cent), the industry sector (51 per cent) and the exit strategy (45.5 per cent).

The most popular sectors for investors are green and clean technology (50 per cent), internet and IT (41 per cent) and financial services (35 per cent).

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