Venturing into a new era

For those seeking venture capital, Australia has a reputation as an arid continent.

Banks have long avoided this area of investment as risky and adventurous, even in years when the banks became involved in the businesses that, arguably, often involved them in greater risk than they should have wished. But the tide, some say, is now changing. A larger number of "angels" — those much-desired, highly-prized saviours of those seeking venture capital — seem to be emerging on the Australian scene.

Despite this turn of the tide, many lenders continue to link the concept of venture capital with uncharted territory, with no track records to guide investment decisions. Recent turmoil in "new economy" industries has done little to reassure them, even though volatility in the performance of venture capital projects is a given.

Slowly, though, evidence is accumulating that high returns are achievable in such "venture" industries as information technology, healthcare and winemaking. Venture capital has also come to be associated with cutting-edge areas such as high-tech and bio-tech, fields largely populated by bright, young entrepreneurs capable of building companies through vision and a dash of daring.

And this raises another factor frequently cited as a deterrent to lenders and investors in venture capital: they are largely backing an individual, rather than a company or an industry. This heightens the risk and underscores a mantra of venture capital financing: when everything is going well it couldn't be better but when there is a development for the worse, things can go bad very quickly.

The investor in venture capital has to be prepared for some failures to counterweight the wins. Those who have enjoyed success say that it is essential to back the right individual, in the right industry and with the right company. And be ready to be there for the long haul.

Some venture capitalists operate with a three-to-five-year plan and never deviate from that. If the venture has not struck pay dirt by the end of the defined plan, they follow a predetermined exit strategy. Others are prepared to give a venture as much as 10 years before contemplating an exit in some form.

One interviewee in the superannuation industry commented on the role of "group think" which colours superannuation funds' perceptions of venture capital. Another noted the presence of 'reputation risk', where trustees and asset consultants avoid endorsing investment strategies that may be regarded by their peers as too unconventional.

By definition venture capitalists are strong believers in cycles, knowing that what is unfashionable today may well be the bonanza of tomorrow, or the day after. A crucial factor is mutual individual trust. To win that from a potential backer means that the party seeking the capital must undertake painstaking research and present a persuasive business plan.

But as two contributors to this issue of *JASSA* demonstrate, venture capital providers need to do more than sit and wait for the right investment to appear. Brendan Shaw argues that venture capitalists should be more willing to see themselves as an industry and be more ready to form alliances to spread risk, skill and opportunity.

Commenting on the low levels of venture capital investment in Australia, particularly compared with those in the US, Shaw points to the part played — or not played — by superannuation funds.

"One interviewee in the superannuation industry commented on the role of 'group think' which colours superannuation funds' perceptions of venture capital," he writes. "Another . . . noted the presence of 'reputation risk', where trustees and asset consultants avoid endorsing investment strategies that may be regarded by their peers as too unconventional."

In a comprehensive overview of the venture capital scene, Nicholas Humphrey describes its concepts and mechanics, focusing on the complexity of deal structures. Innovative financing techniques are essential because traditional debt finance is unsuitable for startup companies, he says.

"The business plan often requires large amounts of money to be spent early to establish the business before a revenue stream can be established, and the company may not be able to make the regular interest payments demanded by debt finance and may not have the assets necessary to secure a loan."

He also highlights the ways in which venture capitalists can add value to the projects in which they invest, through mentoring, team-building and introducing strategic partners. J