'From a technical standpoint, the stock looks like a falling anvil.'

Uri Landesman, a media investor at Arlington Capital, describes the action on AOL Time Warner Inc. shares, which slumped more than 15 per cent on news that the U.S. Securities and Exchange Commission has launched an inquiry into the accounting practices at the on-line unit.

More angels should tread in investing

BY ROGER MARTIN AND HENRY VEHOVEC
PERSONAL OPINION

In a recent speech in Toronto, Paul Martin referred to angel investing as the "Death Valley in Canadian finance." The mere mention of angel investing to the assembled crowd of 400 Bay Street types is indicative of the growing awareness of the pivotal importance of angel investing in the formation and growth of emerging companies, and ultimately the economy.

The "Death Valley" reference is unfortunate, as it evokes images of hopelessness and futility. Worse still, it seems to indicate that there really is no policy or plan to bridge this often-referred-to "gap."

It is true that emerging companies seeking $1-million or less have a difficult time finding funds. The gap is that portion of the financing spectrum that falls between "love money" — raised from friends and family — and venture capital. Too much money for family or friends to finance, too small for venture capitalists to look at.

If companies don't get themselves over this hurdle, they never get to be the initial public offering candidates that the VCs thrive on. Although this problem is challenging, it is not unfathomable.

While Mr. Martin called for innovation in the financial services industry to help in this and other areas, the actual presence of a gap is debated by some.

Some may say that there is no venture capital gap — there is actually a quality gap. Fund only quality projects, they say; the others are undeserving.

Others may say there is a management or a leadership gap. Others still will claim there is an innovation gap.

The reality is that there are usually gaps in getting a business to the next level, and

The reality is that there are usually gaps in getting a business to the next level, and
funding can help to fill them. There are about 5,000 Canadian companies attempting to cross those gaps. Let's say that they are each looking for $1-million — that's a $5-billion gap. Is $5-billion unthinkable?

Not really. Think how many of those 5,000 companies, armed with $1-million, could get themselves investment-ready to actually be considered as candidates for venture capital and downstream growth. And let's also think about what happens to the financial services food chain if these companies do not get funded, as is often the case now.

Should the $5-billion come from government? No. It is not the role of government to assume risk at microeconomic levels. It is the role of entrepreneurs, operators, innovators, and early stage investors to take those risks and reap the associated awards.

It's up to the private sector to supply the capital. At least 2 per cent of the Canadian population has a net worth in excess of $1-million. High-net-worth individuals in this country have a cumulative net worth well in excess of $600-billion. The dreaded venture capital gap represents less than 1 per cent of their net worth.

What portion of a soundly managed financial portfolio can be safely assigned to speculative investments? Certainly more than 1 per cent. So the private sector in this country clearly has enough money to bridge the venture capital gap.

The question is, why doesn't it? Some of the barriers to bridging this gap are structural, some are cluster-specific and some are cultural.

Unfortunately, it is not as easy as simply coming up with $5-billion. That money has to be deployed with surgical precision by knowledgeable angels and operators to entrepreneurs that will be motivated by the opportunity for financial reward, and then be encouraged to reinvest.

Do we have enough of these candidate angels in this country? The answer is a resounding yes. Do we have the most encouraging environment for these people to operate in? Not really, but Mr. Martin's comments at least indicate that angel investing is on the radar screen.

Certainly the tax recommendations that the Canadian Venture Capital Association is advocating would be helpful. And reducing national operating overhead by creating efficiencies in regulatory bodies would also be useful.

As challenging as these items have been historically, our biggest difficulty may be cultural. Until the value, importance and roles of angels, entrepreneurs, innovators and operators are more fully recognized and appreciated by our culture, we will have problems improving our ranking in various measures of economic success and competence.

Roger Martin is the dean of the University of Toronto's Rotman School of Management. Henry Vehovec is the chairman of the 2002 Angel Investor Summit, which is scheduled for October, 2002.

Vox will return in August.