

The Chinese University of Hong Kong



The Chinese University of Hong Kong

Centre for Entrepreneurship

Informal Investors in Hong Kong and Shenzhen —
Findings of the Global Entrepreneurship Monitor

香港及深圳的私募投資 —
「全球創業觀察」的研究結果

Kevin Au and Michael Kwan

Centre for Entrepreneurship and Department of Management

Chinese University of Hong Kong

May 2005

Fourth Draft

Address all communications to Kevin Au, Department of Management, Chinese University of Hong Kong, Shatin, N. T., Hong Kong (Tel: 852-26097802; Email: kevin@baf.msmail.cuhk.edu.hk). This paper and other reports about the Global Entrepreneurship Monitor are available at the CUHK Centre for Entrepreneurship (<http://www.cuhk.edu.hk/centre/entrepreneurship>).

Abstract

Informal investors are important for entrepreneurship in Hong Kong and Shenzhen, just as they are in other parts of the world. They provide much more investment than that of venture capitalists (a ratio of 12 to 1 in Hong Kong; 54 to 1 in mainland China). They also provide the seed capital and expansion capital for entrepreneurs when no other sources are available. We studied this important group based on the data from the Global Entrepreneurship Monitor, an international research consortium. Telephone surveys were conducted on about 8,000 adults in 2003 and 2004. We found that informal investors stand at 2.8 - 3.0% in Hong Kong and at 6.6 - 8.8% in Shenzhen, compared to the international average of 3.4 - 4.2%. They invested in ventures of their friends/neighbors rather than those of strangers' (Hong Kong: 56.8% vs 0%; Shenzhen: 68.9% vs 1.3%). The informal investors of other countries did not show such a large difference (27.7% vs 7.7%). Between the two cities, Hong Kong investors are older, less educated, more likely to be a blue-collar worker or a proprietary owner than their Shenzhen counterparts. Recommendations to boost informal investment in Hong Kong and Shenzhen are discussed.

摘要

在香港及深圳，私募資金投資對創業十分重要。私人投資者提供的資金比風險投資基金為多（香港為 12 比 1；中國大陸為 54 比 1），這些投資幫助了創業家，在企業萌芽初期獲得從其他途徑未能取得的初始資金。本研究根據一個按年評估創業活動的國際研究組織「全球創業觀察」的資料，去檢視這些被忽略的投資群。在 2003 及 2004 年通過電話訪問，我們抽樣調查了約八千名香港及深圳的成年人，發現非私人在香港及深圳分別於 2003 年佔百分之三及百分之六點六，於 2004 年佔百分之二點八及八點八。而全世界在 2003 年平均是百分之三點四，在 2004 年則是百分之四點二。他們投資於朋友或鄰居的百分率較全世界平均數高（香港：56.8%；深圳：68.9%；全世界：27.7%），但投資於陌生人的卻較少（香港：0%；深圳：1.3%；全世界：7.7%）。比較兩個城市，香港的投資者年紀較大，學歷及工作地位較低。我們在報告結果後提出了在香港及深圳鼓勵私募投資的建議。

Founders and informal investors, including families, friends, and private investors or foolhardy strangers, contribute to investment in start-up companies. Foolhardy strangers are also called ‘business angels’. The term originated in the early 1900’s. At that time wealthy individuals salvaged Broadway productions in last-minute investment.

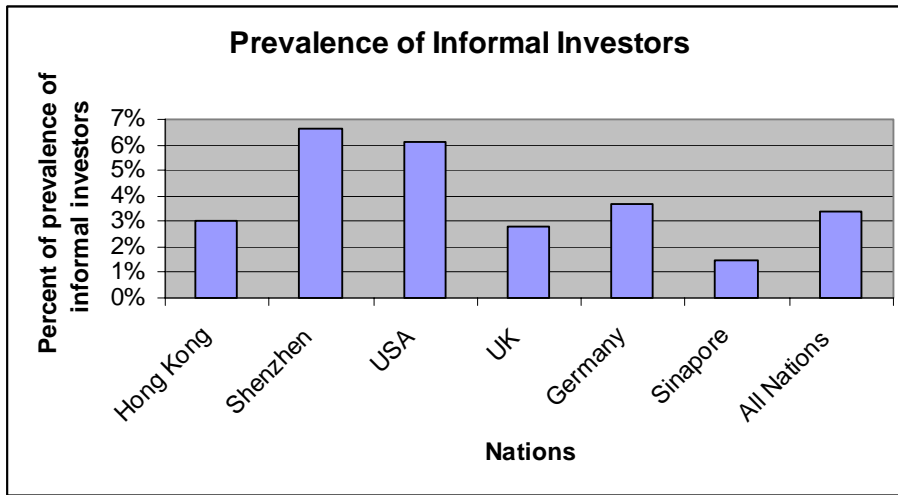
The importance of informal investors to entrepreneurship and new business venturing is often overlooked due to the exposure of venture capitalists in the public media. It is true that venture capitalists were behind the success of high-profile ventures. The amount of their investment was, however, greatly overstated when compared to that of informal investors. According to GEM, informal investors supply the majority of capital for over thirty countries it studied. Informal capital contributes 34.2% and venture capital only provides 0.01% of the total amount of investment in all the economies being studied when entrepreneurs themselves offer 65.8%. Informal investors provide much more investment than venture capitalists do (a ratio of 12 to 1 in Hong Kong; 54 to 1 in mainland China).

Informal capital is also important in another way. New ventures are being developed in a number of stages. Most founders cannot afford the resources for developing a marketable product simply using his/her sources of capital, but venture capitalists seldom invest in early stages to facilitate the process. They invest more often in the later stages to facilitate ventures to scale up their production or to go for IPOs. Informal investors are, thus, indispensable in filling the resource gap for entrepreneurs. This is not to ignore the fact that informal investors provide valuable advice on management, finance, and other matters.

Using GEM data of 2003 and 2004, we study informal investors and offer some insight into their characteristics. In the end, we will give some recommendations for policy

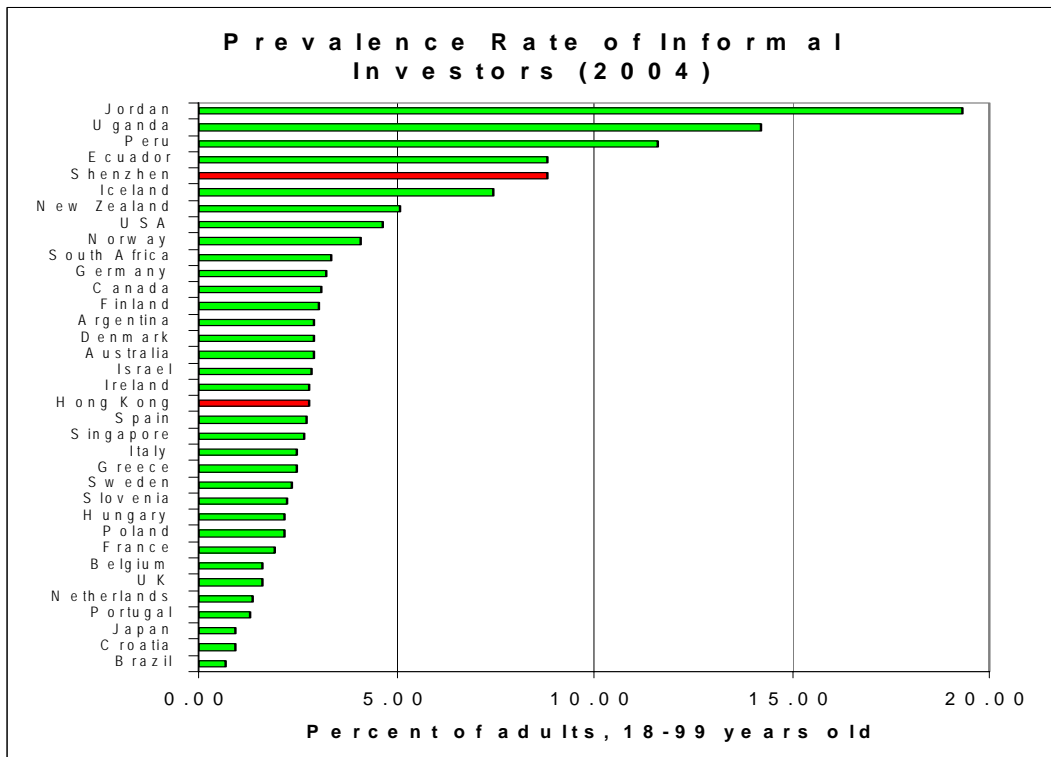
makers and parties who are interested in promoting entrepreneurship. Figures 1 & 2 illustrate the prevalence of informal investors in Hong Kong and Shenzhen, compared to other countries and the average of all nations in GEM. People in Shenzhen are more active to invest informally than those in the rest of world. Hong Kong people are slightly lower than the GEM average, but higher than Singaporeans and the British.

Figure 1: Prevalence of Informal Investors (2003)



(All nations represent 29 nations)

Figure 2: Prevalence of Informal Investors (2004)



Characteristics of Informal Investors

- Informal investors in Hong Kong and Shenzhen have similar gender profiles with the rest of the world; about two-thirds of them are males.
- Just like other nations, about one-third of informal investors in Hong Kong are between 35 and 44. Informal investors in Shenzhen are younger probably because the new generation become rich and are more willing to invest in new ventures.

Figure 3: Age of Hong Kong Informal Investors (2003-4)

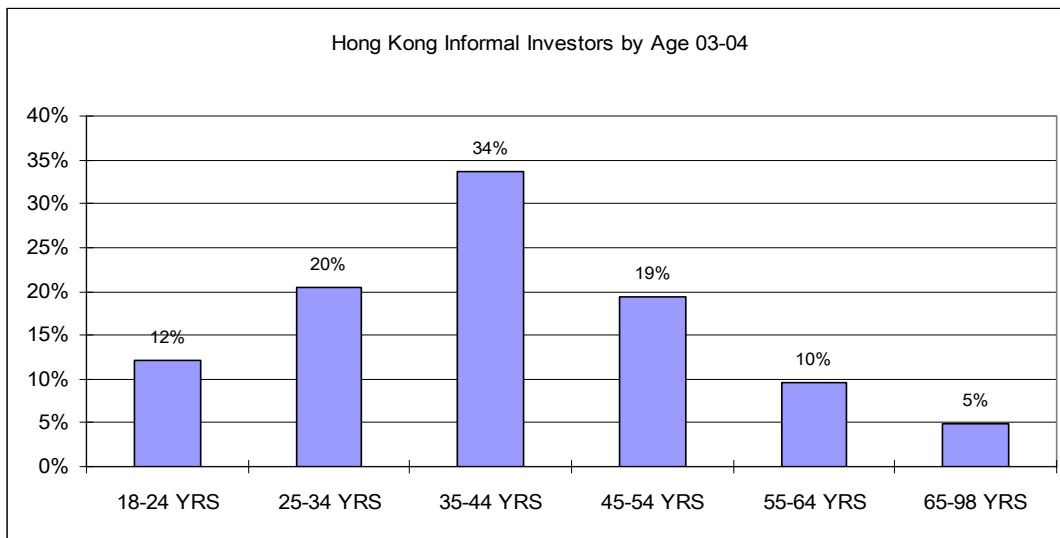
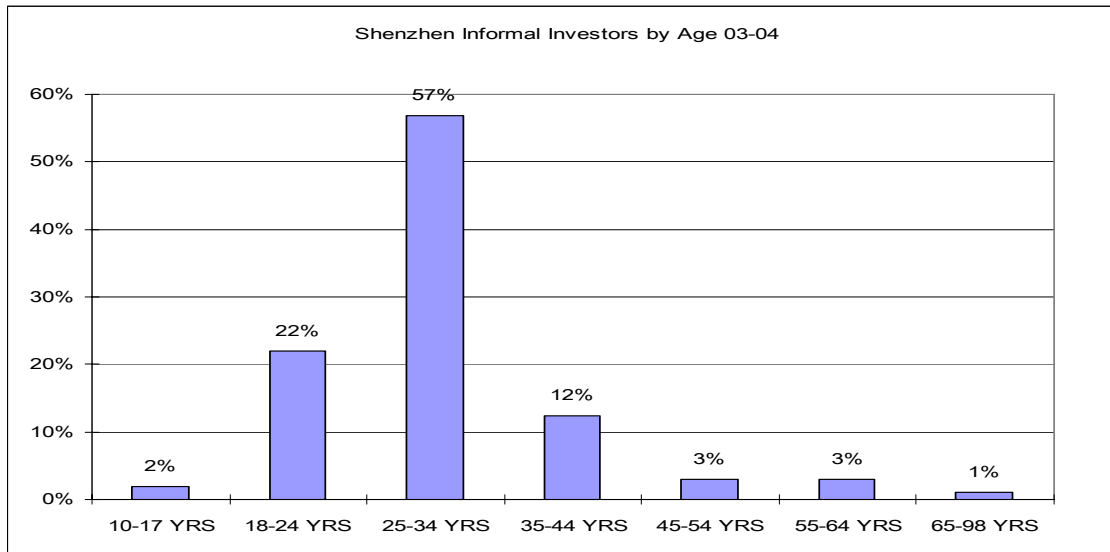


Figure 4: Age of Shenzhen Informal Investors (2003-4)



- In Hong Kong, most informal investors are secondary-school educated and have a full time job. Sole proprietor, blue-collar and clerical are the three main occupations. In Shenzhen, most of business angels are college-educated and have a full-time job while white collar, department manager and owner/partner are the three main occupations. Hong Kong informal investors are relatively less educated and working in less privileged jobs than their Shenzhen counterparts.

These findings may be a result of several reasons. As the income in Shenzhen is relatively low, the working class in Shenzhen does not have extra savings to invest in new companies. In comparison, Hong Kong is wealthier and famous for its entrepreneurial tradition, so even the working class has resources and courage to make investments. Alternatively, as people socialize with others similar to themselves, Shenzhen entrepreneurs, who tend to have higher education (see GEM report), would find investment from professionals. On the other hand, entrepreneurs are less educated in Hong Kong, so their informal investors are likely the same.

Figure 5: Educational Level of Informal Investors in Hong Kong (2003)

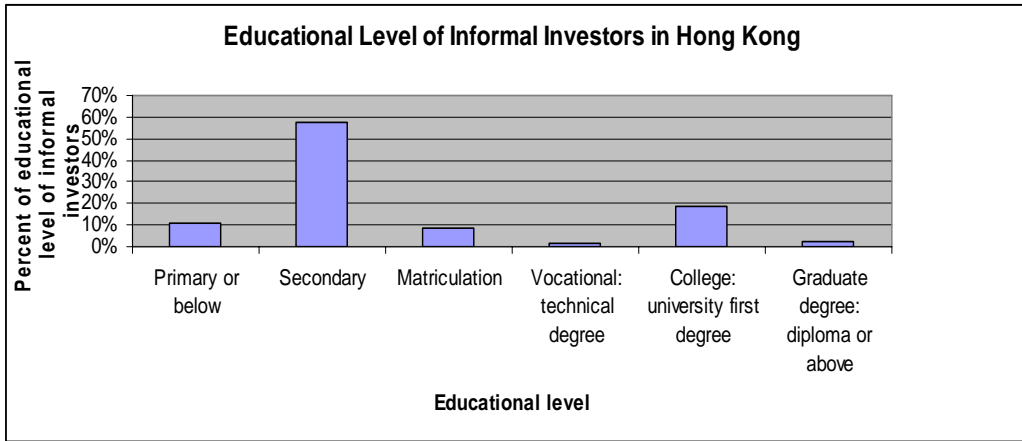


Figure 6: Educational Level of Informal Investors in Hong Kong (2004)

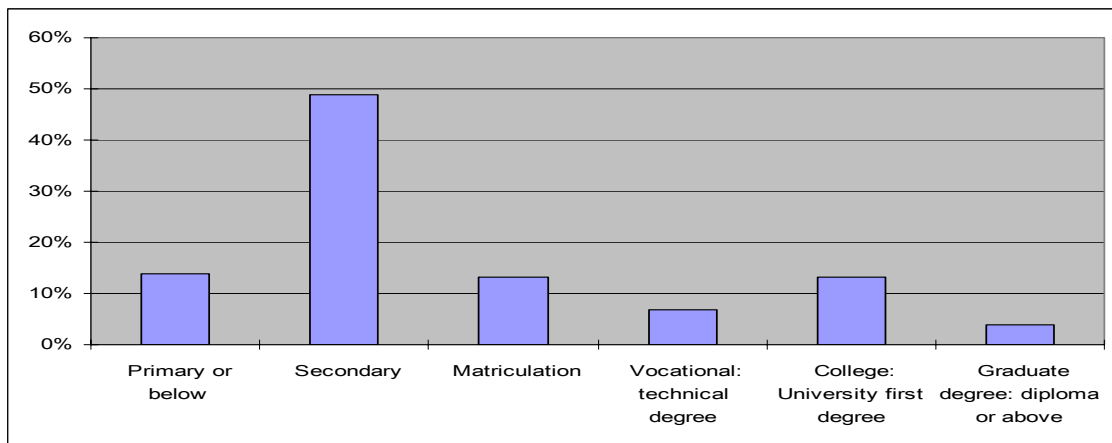


Figure 7: Educational Level of Informal Investors in Shenzhen (2003)

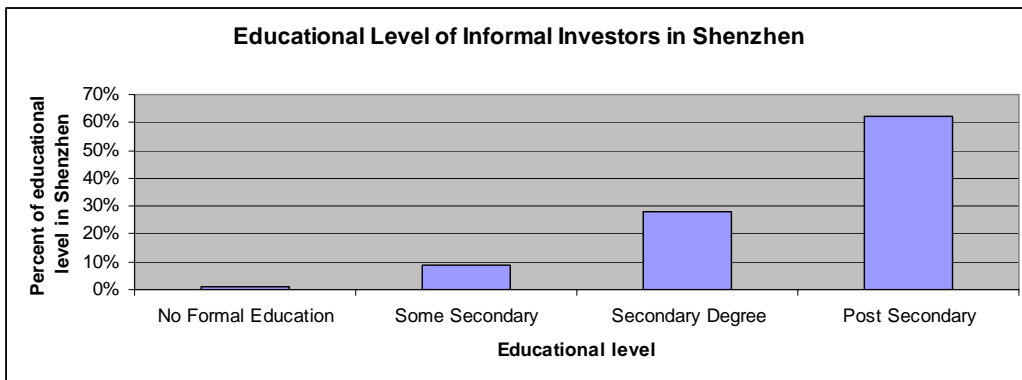


Figure 8: Educational Level of Informal Investors in Shenzhen (2004)

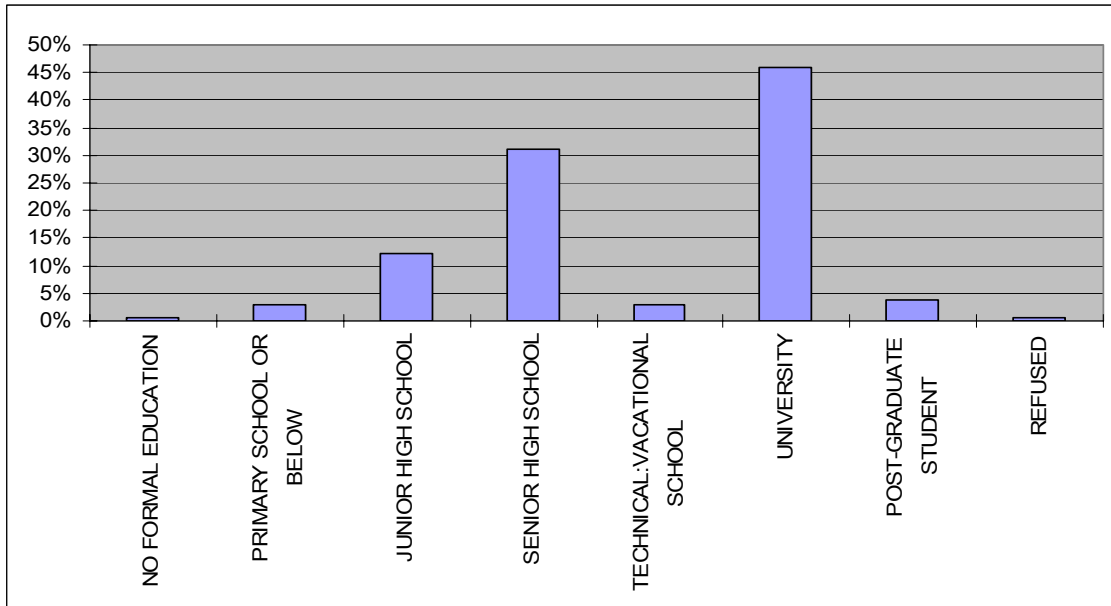


Figure 9: Labor Force Status of Informal Investors (2003)

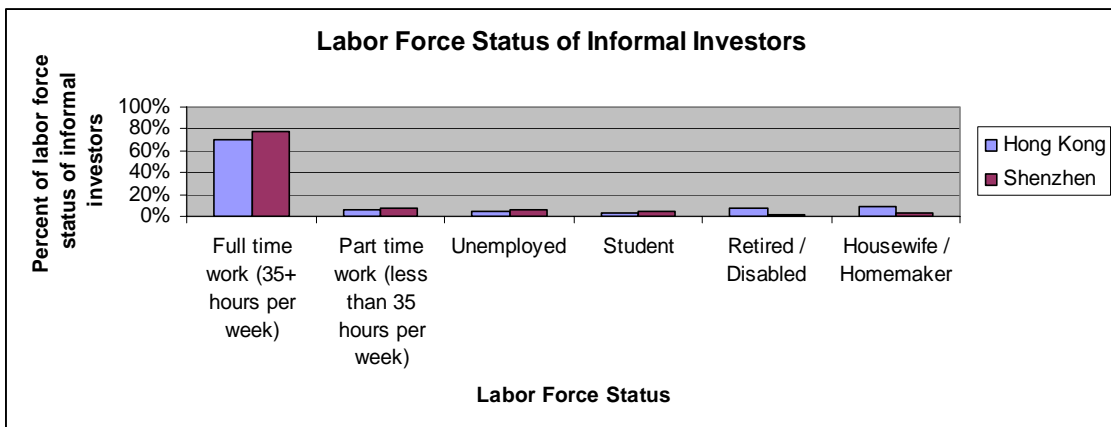


Figure 10: Labor Force Status of Informal Investors (2004)

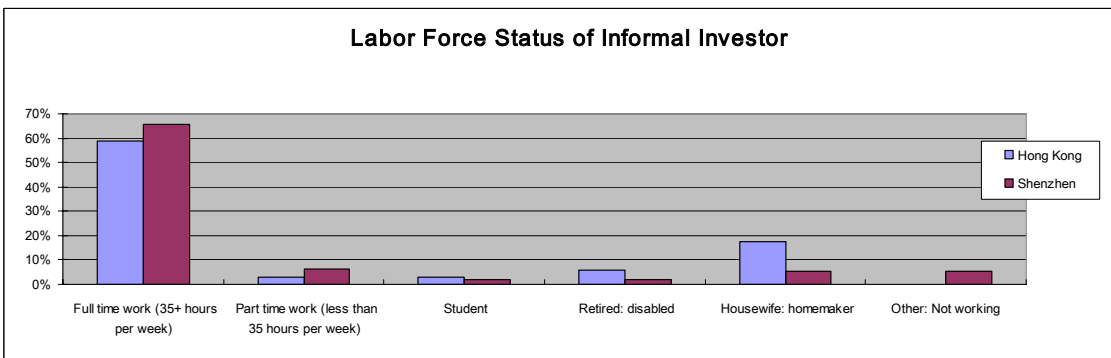


Figure 11: Occupation of Informal Investors in Hong Kong (2003)

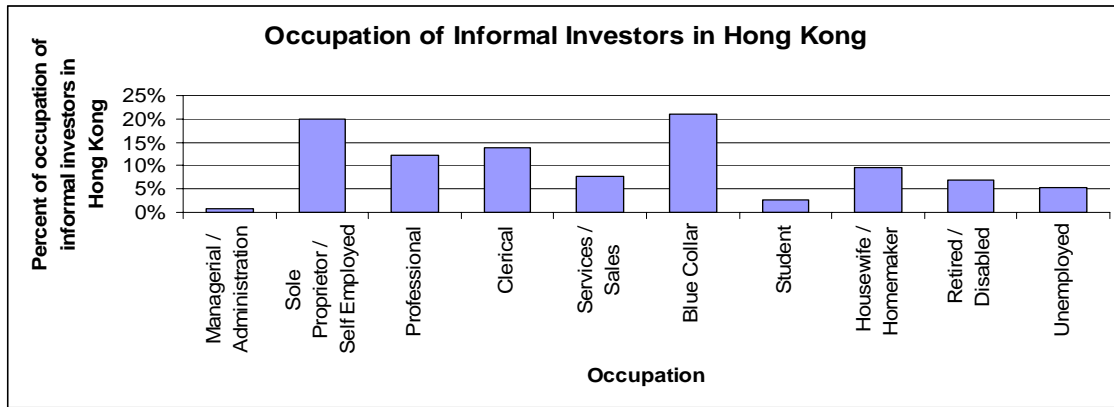


Figure 12: Occupation of Informal Investors in Hong Kong (2004)

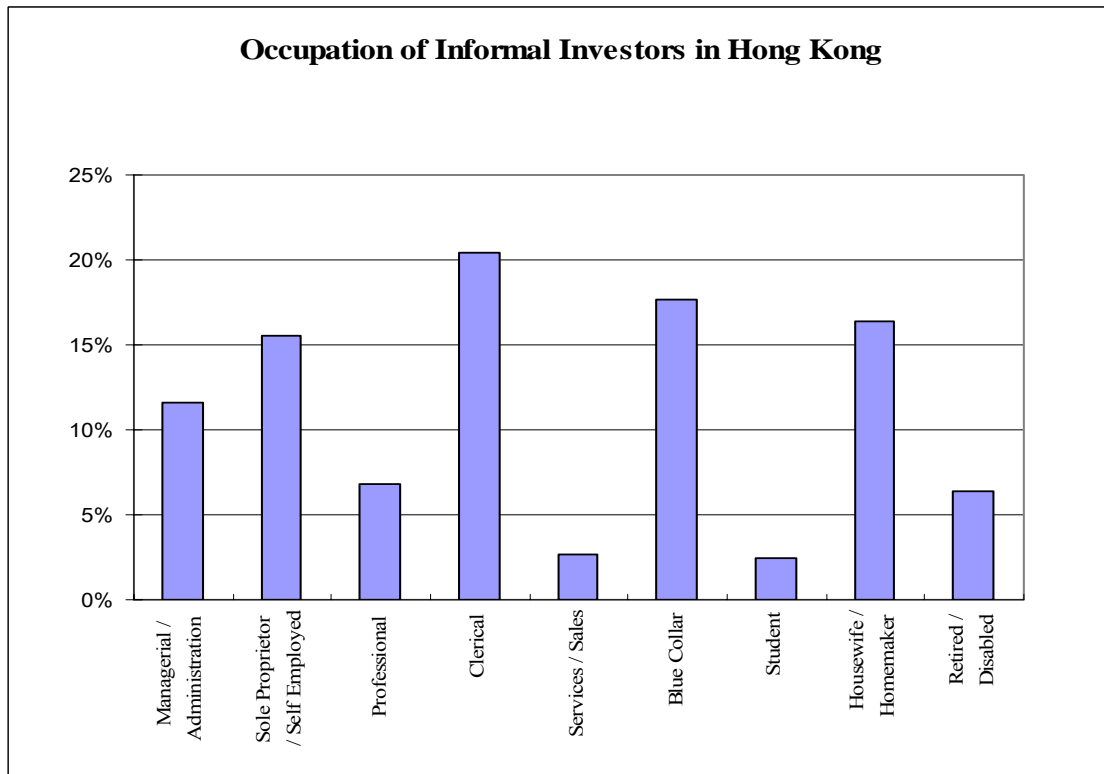


Figure 13: Occupation of Informal Investors in Shenzhen (2003)

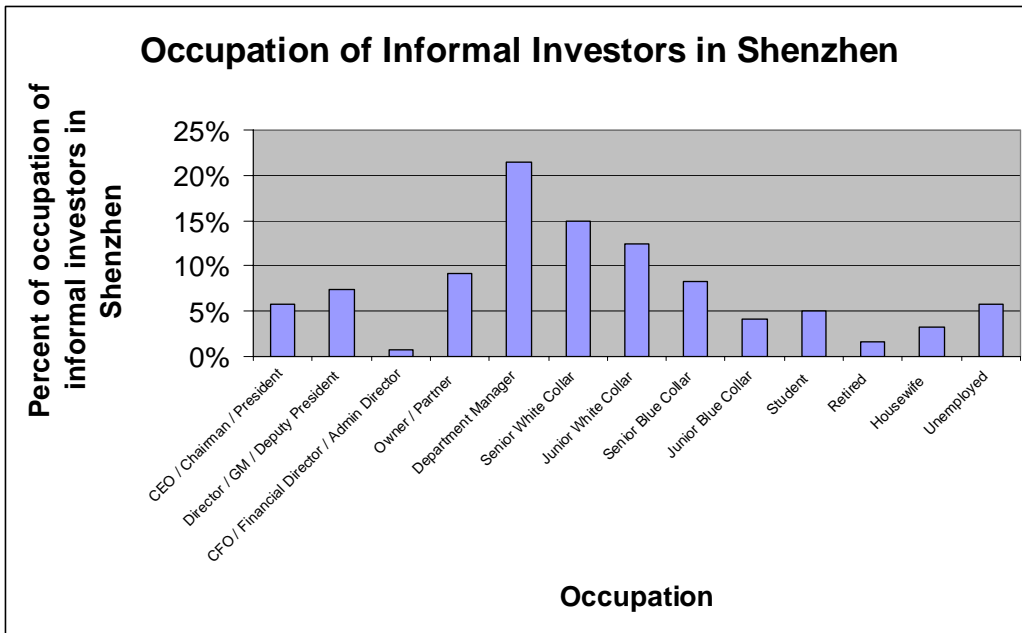
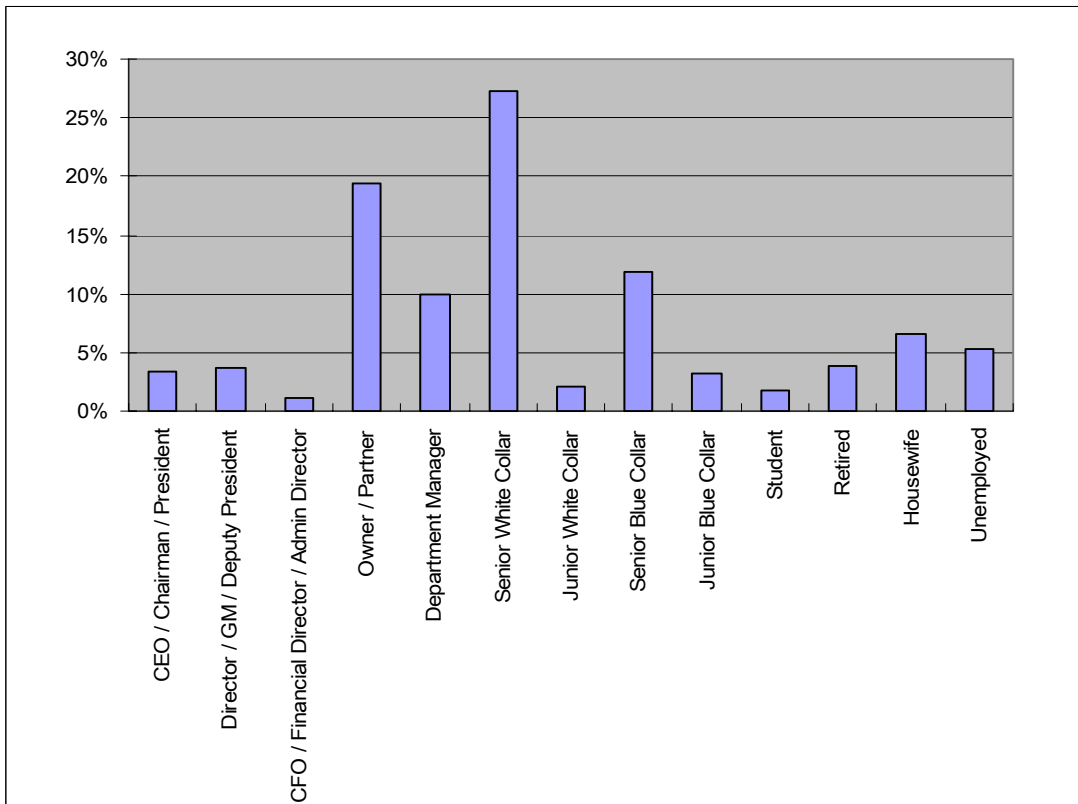


Figure 14: Occupation of Informal Investors in Shenzhen (2004)



- Informal investors are rich individuals (see Figure 15 and 16). In Hong Kong, over 47% household in 2003 and 39% household in 2004 have monthly income of at least \$240,000 a year. In Shenzhen, over 37% household in 2003 and over 39% household in 2004 household have monthly income of at least RMB 120,000 a year. In year 2003 the GDP per capita in Hong Kong is HK\$181,527 and in Shenzhen RMB45,470 respectively.

Figure 15: Household Monthly Income of Informal Investors in Hong Kong (2003)

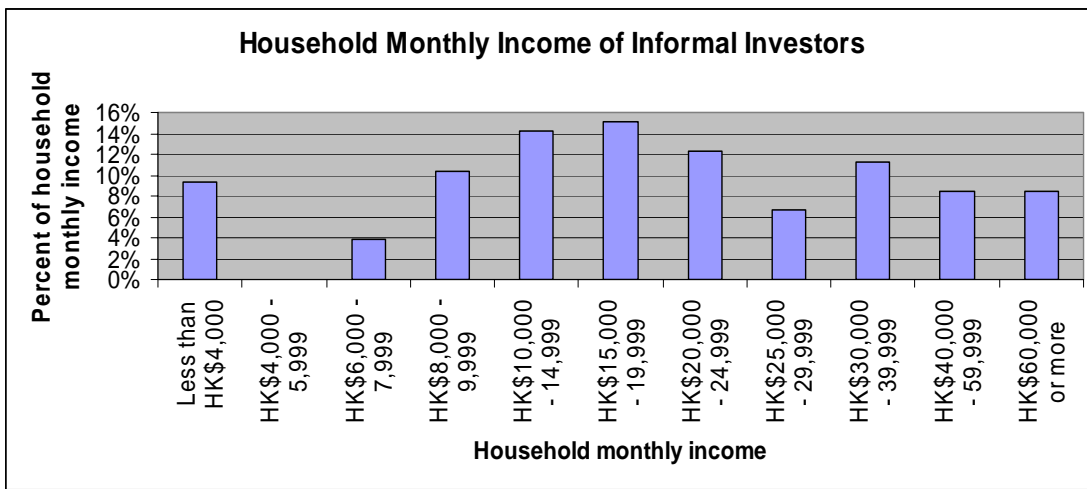


Figure 16: Household Monthly Income of Informal Investors in Hong Kong (2004)

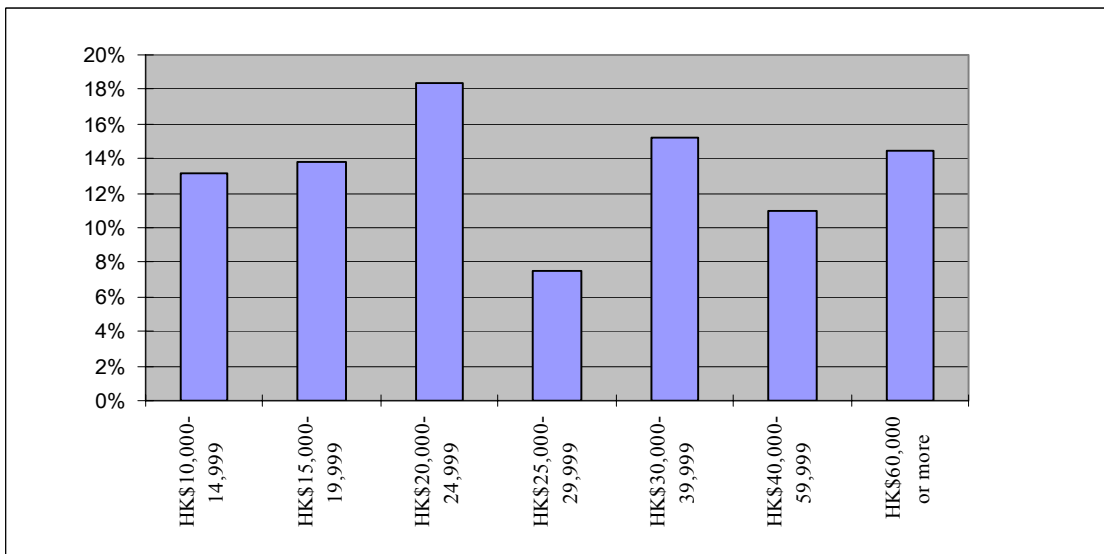


Figure 17: Household Monthly Income of Informal Investors in Shenzhen (2003)

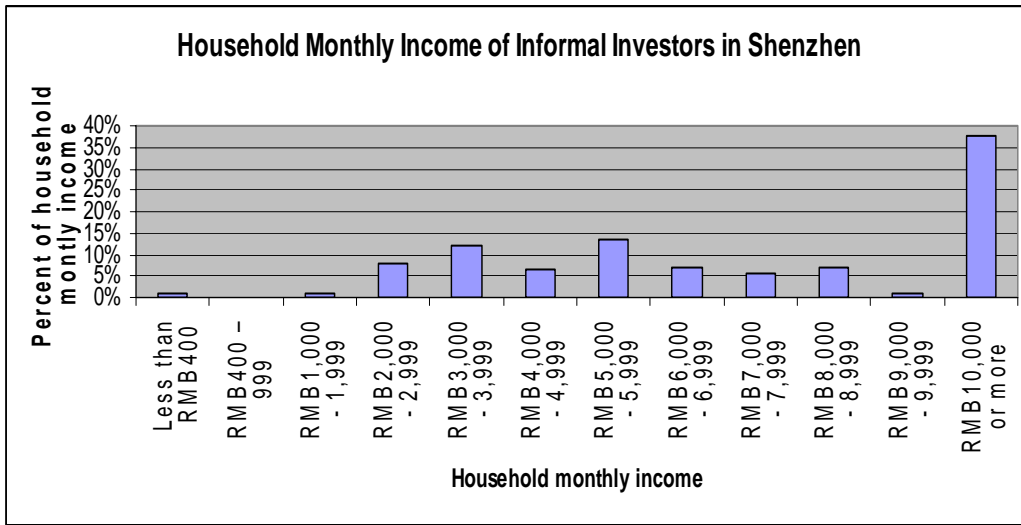
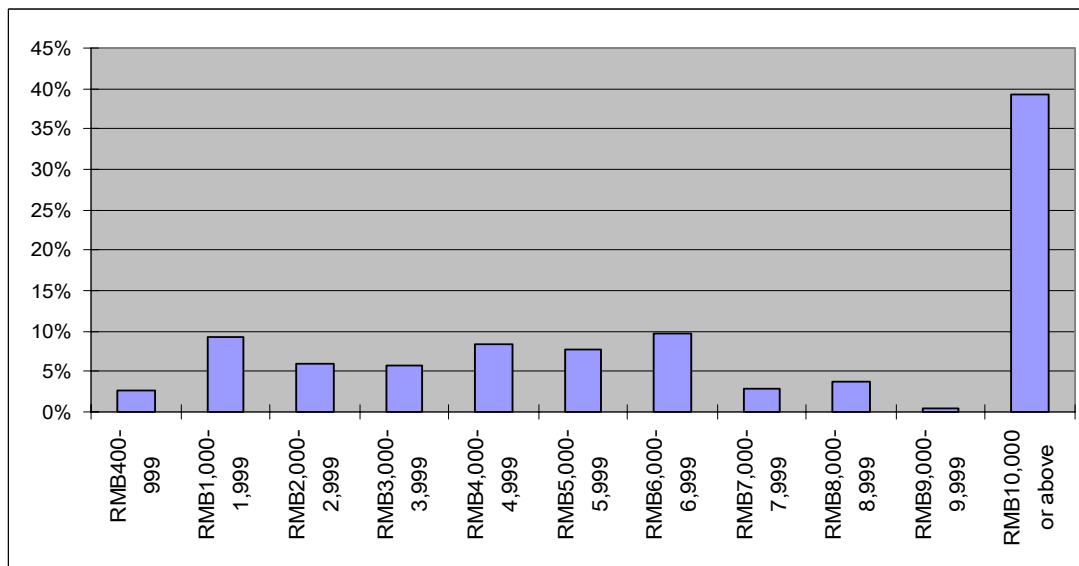


Figure 18: Household Monthly Income of Informal Investors in Shenzhen (2004)



Characteristics of Investments made by Informal Investors

- The amount invested by each informal investor in the past three years is shown in Figures 19 and 20. The largest division of invested amount is below \$50,000 in Hong Kong and Shenzhen. Hong Kong investors are more likely to invest the amount over \$100,000. It is probably because Shenzhen has a lower level of income and start-up costs are lower in Shenzhen than in Hong Kong.

Figure 19: Average Amount of Investment Made in Hong Kong (2003-4)

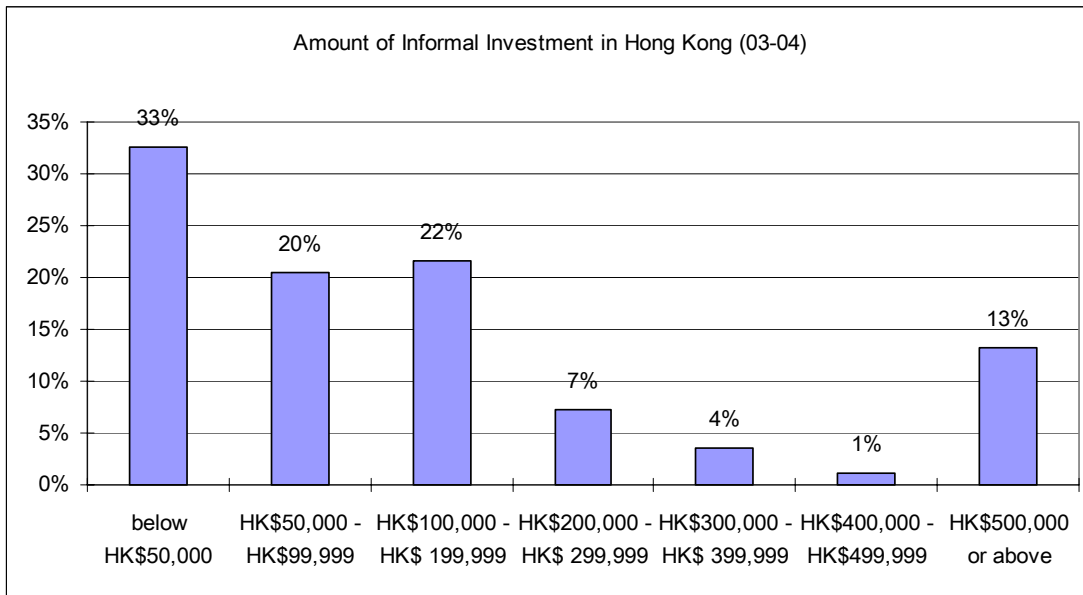
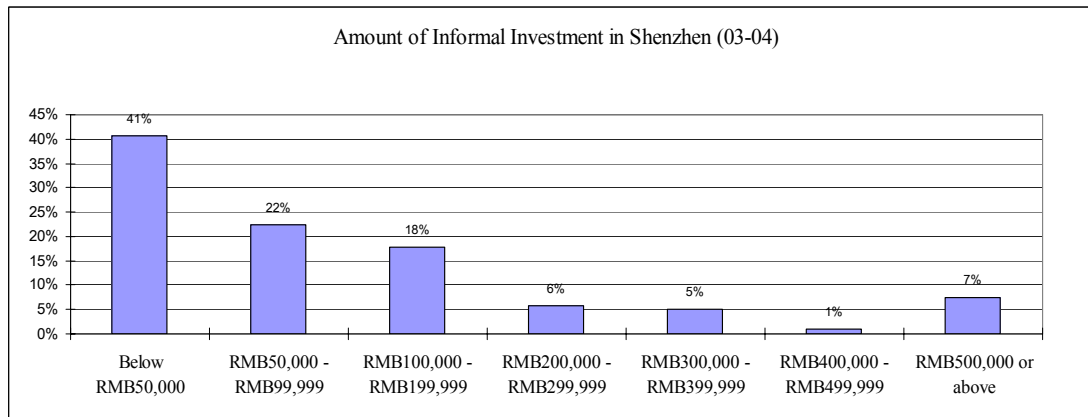


Figure 20: Average Amount of Investment Made in Shenzhen (2003-4)



- As shown in Figures 21 & 22, about 50% informal investors in Hong Kong and Shenzhen invested in consumer oriented sectors.

Figure 21: Industries of Investment in Hong Kong (2003-4)

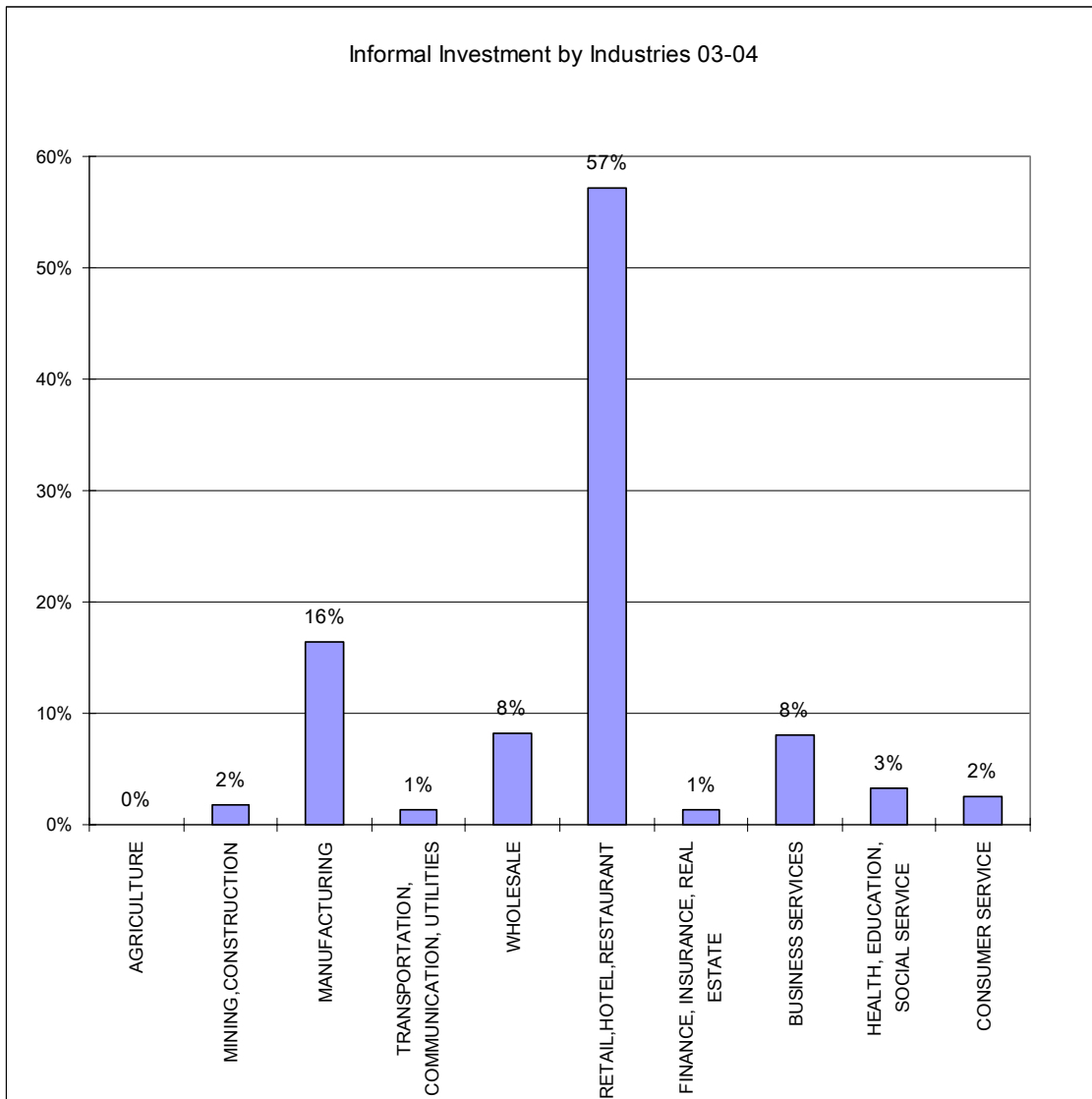
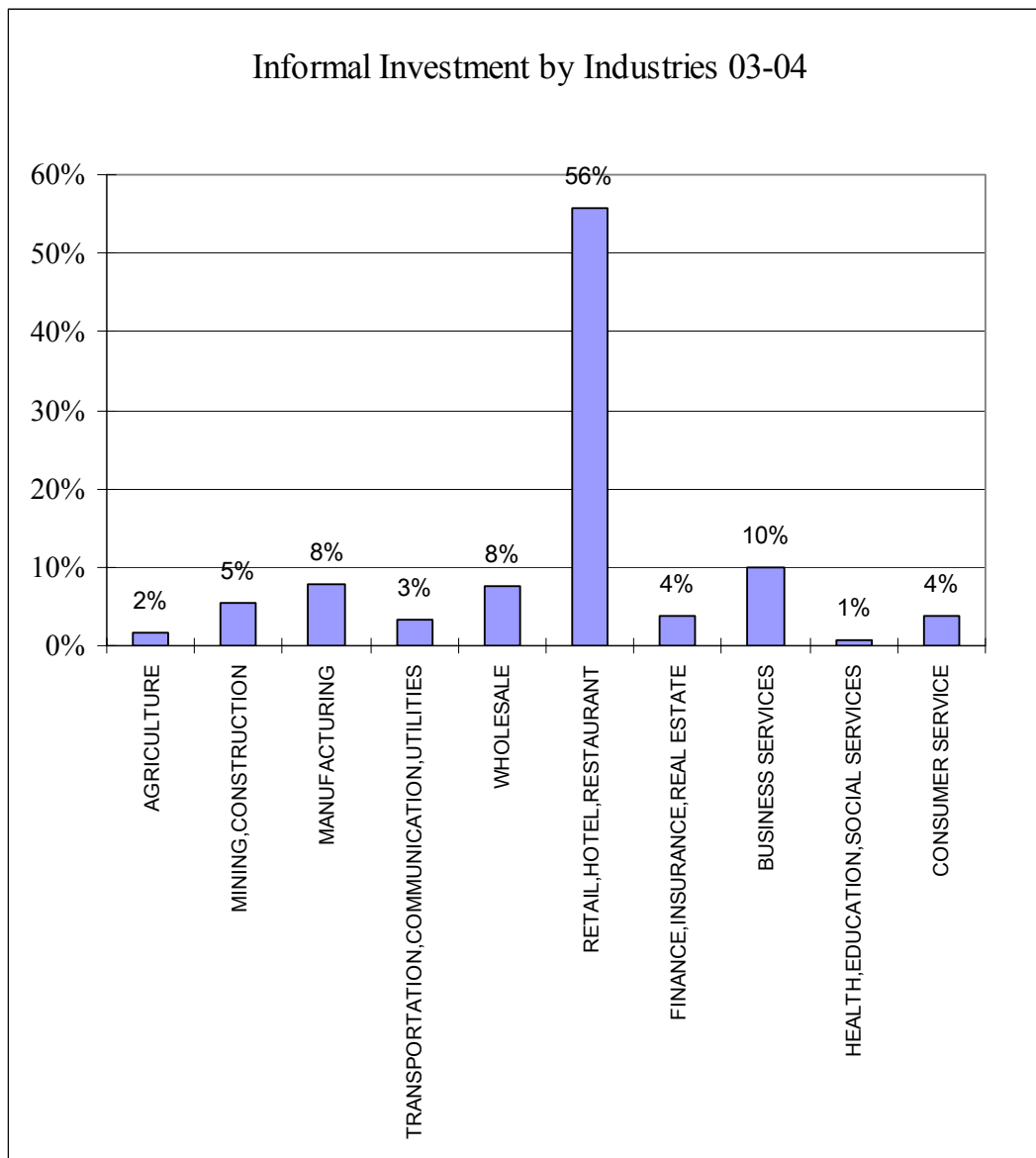


Figure 22: Industries of Investment in Shenzhen (2003-4)



- As shown in Figures 23, 24 and 25, 56.8% of Hong Kong investors put their money into businesses started by friends or neighbors while close to two-fifth of them invested in businesses started by family members (30.5%) or other relatives (11.6%). In Shenzhen, 68.8% invested in friends or neighbors' business and about one-fourth invested in businesses started by family members (8.8%) or other relatives (15.7%). These results are different from other nations where most of the investment are made to startups of

close families. These findings are surprising, as one would expect Chinese to invest more often in family business. Chinese family members are supposed to be close, and family businesses are popular in Chinese societies.

Figure 23: Relationships between Informal Investors and Investees in Hong Kong (2003-4)

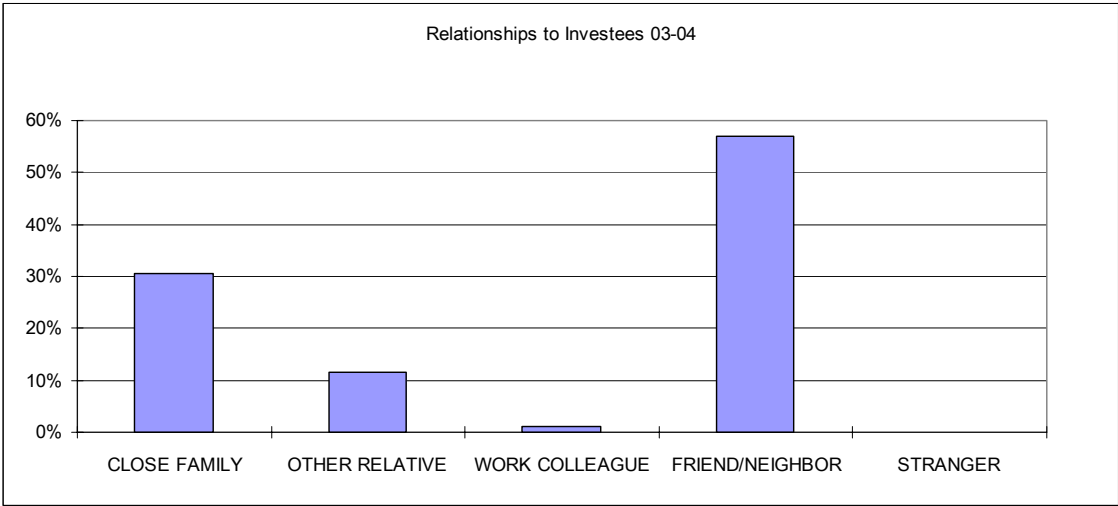


Figure 24: Relationships between Informal Investors and Investees in Shenzhen (2003-4)

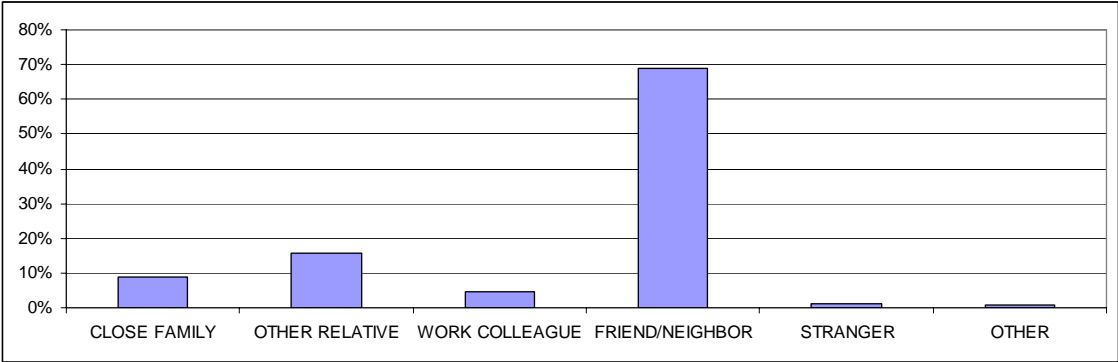
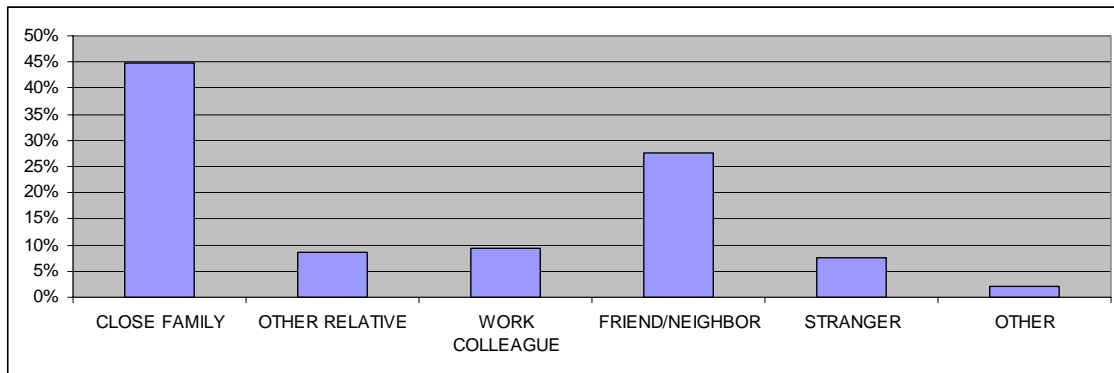


Figure 25: Relationships between Informal Investors and Investees in All Nations (2003-4)



We may speculate on why there is a high level of involvement on ventures of friends or neighbors. One reason is that friendship is particularly important to Chinese. Chinese may feel a stronger responsibility to help friends and neighbors financially whereas people from other countries may feel less obliged. Another reason is that the high involvement may just be a consequence of the lack of support from other sources. Only a few of the informal investors put money in ventures of strangers in the two cities. Informal investors organize at most a handful of associations and networks like those in other more developed countries, such as Bands of Angels in the U.S., to facilitate their investment. Besides, not enough legal support and incentives are available to facilitate wealthy individuals to invest in new ventures.

Closing Remarks

This study is a first effort to raise the awareness of informal investment to the public of Hong Kong and Shenzhen. Still, entrepreneurs, informal investors, and other public bodies may learn something from this study.

- **Entrepreneurs.** Friends and neighbors are the main sources to obtain seed money. Close family members are the next target. Entrepreneurs should have a realistic expectation concerning the amount of investment and be prepared to approach them. The average amount of investment per year from friends and neighbors is about

HKD100,000 in Hong Kong and RMB41,000 in Shenzhen, and from close family members is HKD67,000 in Hong Kong and RMB44,000 in Shenzhen.

- **Informal Investors.** We found that informal investors seldom invest in ventures of strangers. Cultural beliefs and institutional environment may both be the reasons for this finding. Building relationship with strangers incurs uncertainties that Chinese are not willing to face. This difficulty can be overcome by institutional support that boosts trust on strangers and support informal investment. We recommend informal investors in Hong Kong and the Pearl Delta to form associations, so that they can share risk and learn from each other on how to invest in new ventures.
- **Educators, Public Media.** Apart from focusing on entrepreneurs' success, they can also publicize the success and stories about informal investors and their investments.
- **Banks, Lawyers, and other Professionals.** They shall help to bridge entrepreneurs and informal investors making use of their wide span of networks.
- **Government.** It should assist founders and informal investors to organize among themselves and invest in new ventures by giving tax breaks, establishing regulations that certify accredited investors like the U.S. does, and facilitating the education of informal investment.