



The Role of Angel Investor at Entrepreneurship Sector in Indonesia: A Theoretical Study

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Abstract.

According to the Ministry of Cooperatives and Small Medium Enterprises' data in 2010, 99 percent of the number of small and middle business units in Indonesia can create as employment around 99.4 million workers which contribute 56 percent to the Gross Domestic Product (GDP) of the MSME sector. This condition has made SMEs as an important sector that contributes to the growth of the Indonesian economy in general.

SMEs in Indonesia in general are initiated from young entrepreneurs who are trying to pioneer a new business by creating new products or innovating the creation of products. This step was taken to create employment which aims to improve the welfare of individuals who provide added value to the community.

However, there are several obstacles faced by SMEs. One of the biggest obstacles facing entrepreneurs in order to transform the idea into a profitable company is when personal savings or funds of the family are no longer able to sustain and grow the business. And at the same time, these businesses lack collateral to obtain financing or investment of institutional capital providers, then that is the perfect time for angel investors to contribute. The angel investors counted as senior entrepreneurs can help young entrepreneurs by providing more than just financial support, but also with a mentor who can share experience, knowledge and contacts.

This paper proves the strong role of angel investor to help stimulate growing entrepreneurship sector in Indonesia.

Keywords: *Young Entrepreneur, Entrepreneurship Sector, and Angel Investors*

INTRODUCTION

Based on Badan Pusat Statistik Indonesia data, number of workforces in Indonesia on February 2012 is 120.4 million people, which is increasing 3 million from August 2011, 117.4 million people. This number of workforces should be supported by the availability of employment; therefore, the number of unemployment is not going to rise. The number



of unemployment in year 2012 is 7.6 million people which are distributed in different levels of education and, surprisingly, diplomas and bachelors contribute a fair amount. One of the factors which cause unemployment for diplomas and bachelors is the lack of employment in formal sector.

There is a phenomenon in Indonesia that most people are looking for jobs and dependent on the jobs in formal sector. This condition often creates comfort zone for young generations; young generations are too lazy to innovate and create employment independently; moreover, this condition sooner or later will also diminish risk-taking, hard work, creativity, and innovation among young Indonesian people (Aria, 2012). When formal sector does not offer certainty for the future, it will be the time that entrepreneurship spirit will develop to create employment for Indonesians.

Entrepreneurship sector is strongly supported by government to popularize and generate entrepreneurship spirit; moreover, government has also declared President's Instruction (*Instruksi Presiden*) number 4, year 1995. The reason behind this instruction is to cultivate entrepreneurship spirit among young generations and to help them become entrepreneurs. In the future, these entrepreneurs will become pioneers in country development, such as participating in reducing unemployment in Indonesia. The improvement in our country development should be based on our determination and hard work. Therefore, the role of entrepreneurs is very important in determining the future of Indonesian nation and state. The development in Indonesia will be better completed if the development process is reinforced by persistent and strong-willed entrepreneurs since government has a limited capability to provide new employment (Wardhani, 2012).

Nurrokhman (2012) stated that the roles of entrepreneurs in the development of a country can be listed as followed:

1. The business activities of entrepreneurs increase government's revenue by tax payment through their activity.
2. Entrepreneurs set up an environment in which country's economy is autonomous and not dependent on capitalist economic system.
3. Business activities of entrepreneurs also increase GNP (Gross National Product), which is the overall of goods and services produced by citizens wherever they are (inside and outside Indonesia).



From the three roles mentioned above, we conclude that the purpose of entrepreneurship is to improve the society's economy and, in general, to improve Indonesia's prestige and dignity among all nations in the world.

In reality, it is not easy to achieve independent entrepreneurship; entrepreneurs often unable to develop their businesses because of capital problem. In the middle of their business process development, they often stop because of financial problem. The most happened condition and the biggest obstacle for entrepreneurs is equity gap, which is the situation where personal savings or funding from families and friends are unable to maintain and cultivate their businesses. At the same time, their businesses lack assurance and track records needed to obtain institutional funding or investment from financiers. This is where the angel investor can help fill the equity gap by making investment (Lingga, 2011).

McKaskill (2009) defined angel investors as personal or group of investors who help by giving funding to entrepreneurs who are having difficulties of financial problems in order to maintain their businesses. Not only do angel investors inject funding, but they also become mentors who are ready to advise young entrepreneurs about their business decisions.

Statistical data proved that the presence of angel investors could cultivate the growth of young entrepreneurs. Successful case studies of angel investors happened in USA and Singapore. Moreover, the presence of angel investors is also expected to improve the entrepreneurship sector in Indonesia.

The objective of this article is to provide a critical overview of theoretical on the role of angel investor in supporting the development of entrepreneurship in Indonesia.

DEFINE ENTREPRENEURSHIP

The term 'entrepreneur' is originally a French word – *entreprendre* – that means to undertake (Mamede). Trunodipo (2009) stated that entrepreneurship in the perspective of a dynamical process is a creative process which adds values to the high-effort and take-time achievement by estimating proponent funding, physical resources, and social risks; furthermore, the process shall receive rewards which are money, personal satisfaction and independence.

The previous definition has become a perception that seems to be shared by many other researchers and scholars. It is the definition adopted from Mamede:



“Entrepreneurship is the ability and willingness of individuals, both on their own and within organizations, to:

- Perceive and create new economic opportunities (new products, new production methods, new organizational schemes and new product-market combinations);*
- Introduce their ideas in the market, in the face of uncertainty and other obstacles, by making decisions on location, form and the use of resources and institutions;*
- Compete with others for a share of that market.*

To some economists, the entrepreneur is one who is willing to bear the risk of a new venture if there is a significant chance for profit. Others emphasize the entrepreneur's role as an innovator who markets his innovation. Still other economists say that entrepreneurs develop new goods or processes that the market demands and are not currently being supplied.

In the 20th century, economist Joseph Schumpeter (1883-1950) focused on how the entrepreneur's drive for innovation and improvement creates upheaval and change. Schumpeter viewed entrepreneurship as a force of “creative destruction.” The entrepreneur carries out “new combinations,” thereby helping render old industries obsolete. Established ways of doing business are destroyed by the creation of new and better ways to do them.

Business expert Peter Drucker (1909-2005) took this idea further, describing the entrepreneur as someone who actually searches for change, responds to it, and exploits change as an opportunity. A quick look at changes in communications—from typewriters to personal computers to the Internet—illustrates these ideas.

Besides being simple and direct, this definition synthesizes the key historical aspects of entrepreneurship such as risk, uncertainty, innovation, perception, decision-making and change. Additionally, it seems to be broad enough to incorporate entrepreneurs from small and independent firms to large corporations, leaving also room for the entrepreneurial behavior within organizations.

Most economists today agree that entrepreneurship is a necessary ingredient for stimulating economic growth and employment opportunities in all societies. In the developing world, successful small businesses are the primary engines of job creation, income growth, and poverty reduction. Therefore, government support for entrepreneurship is a crucial strategy for economic development.



Regarding the contribution of entrepreneurship to economic development in terms of wealth distribution, it does not matter 'who' is in fact the entrepreneurial agent, but 'what' kind of activities are being developed and 'how', or to 'what extent', they are perceived as a social gain.

Through careful analysis of entrepreneurs' successes and failures, there are key factors for up-and-coming business owners to consider closely. Taking them into account can reduce risk. In contrast, paying them no attention can precipitate the downfall of a new enterprise. (U.S Department State)

- **Motivation:** What is the incentive for starting a business? Is it money alone? True, many entrepreneurs achieve great wealth. However, money is almost always tight in the startup and early phases of a new business. Many entrepreneurs do not even take a salary until they can do so and still leave the firm with a positive cash flow.
- **Strategy:** What is the strategy for distinguishing the product or service? Is the plan to compete solely on the basis of selling price? Price is important, but most economists agree that it is extremely risky to compete on price alone. Large firms that produce huge quantities have the advantage in lowering costs.
- **Realistic Vision:** Is there a realistic vision of the enterprise's potential? Insufficient operating funds are the cause of many failed businesses. Entrepreneurs often underestimate start-up costs and overestimate sales revenues in their business plans. Some analysts advise adding 50 percent to final cost estimates and reducing sales projections. Only then can the entrepreneur examine cash flow projections and decide if he or she is ready to launch a new business.

THE ROLE OF ENTREPRENEURSHIP IN ECONOMIC DEVELOPMENT

According to Benard Okun and Richard W, Richardson (1961), "Economic development may be defined as a sustained secular improvement in well being, which may be considered to be reflected in an increasing flow of goods and services". According to this definition, economic development implies continuous secular increase in national output for promoting material welfare of the society. It stresses on three important aspects of development; a) Economic development is a dynamic and long term phenomenon; b) It implies improvement in material welfare and c) National output



is the measuring rod of material welfare. And the purpose of development is to reduce poverty, inequality, and unemployment (Seers, 1979).

Based on the definition above, if a country successfully focuses its objective on achieving economic development continually, the country shall be called a developed country. However, efforts to carry out economic development are not easy. Difficulties faced by poor countries, wherein low average income is a limiting factor of savings and investments, tend to reinforce each other in what is known as the vicious cycle of poverty, in which low saving and investment is followed by a low pace of capital formation, that results in low levels of productivity, which does not allow improvements in the levels of average incomes (Saini, 2001). This is where we can prove the role of entrepreneurship. We start from a new firm creation, innovation and competition, which are in fact the three major aspects through which entrepreneurship can contribute to economic development (Mamede).

- New firm creation is in fact crucial for economic development. Entering the markets with their innovations entrepreneurs challenge the dominating firms. Their 'willingness' is motivated by the desire of creating wealth for themselves, and to succeed they strive for the product/solution they believe in. If successful in creating demand for their innovation they expand their business for new markets and in so doing they also influence the economic structures in their country.
- Innovation. Through a strong belief in the entrepreneurs' ideas and dedicated effort, they manage to allocate resources in a better way, develop a greater appeal to buyers and succeed in creating demand for their new products/solutions. The commercialization of their ideas makes the business viable and as the sales and revenues increase investments are possible to be made, allowing the expansion of the business. Through a continual repetition of this dynamic process, as new innovations are introduced in the market wealth changes hands and often changes places. Once more the entrepreneur, now as an innovator, has contributed to economic development.
- Competition is one of the most important forces in the market, and quite often, a determining factor for the future of many enterprises. The success of these firms is in a large extent associated with the way they assess their business environment, trying to adequate their activities in terms of business organization and strategy in order to meet the needs of the



market. The competition that creates and distributes wealth is the one that results from innovation and new firm creation. The one that is led by entrepreneurs eager to create wealth for themselves as an outcome of a great idea and a lot of work; entrepreneurs who are willing to “pay the price” assuming the risks of their choices. This competition that equitable mechanism of economic development.

DEFINE ANGEL INVESTOR

Shane (2008) mentioned that an angel investor is a person who provides capital, in the form of debt or equity, from his own funds to a private business owned and operated by someone else who is neither a friend nor a family member.

On the other hand, research results from McKaskill (2009) stated that angel investors historically have been high net-worth individuals who have privately invested in new start-up firms or in the early formative stage of emerging ventures with little publicity of their involvement. They typically kept quiet about their wealth and discretely searched for deals to invest in. Angels were very wealthy individuals who invested widely across many ventures.

Today the situation is somewhat different. Over the past 50 years the number of angels has greatly increased. Some of this increase has come from greater spending power in the established professions; much has come from cashed up entrepreneurs from the explosive growth in high-tech industries and some from golden handshakes of senior executives retiring or being made redundant.

Business angels are far from the only source of external capital entrepreneurs can tap. The entrepreneur's friends and family, institutional investors such as venture capitalists and banks, trade creditors, and a host of other entities provide capital to private businesses. Therefore, it is important to differentiate angel investors from other sources of capital. To minimize the confusion about who is an angel investor and who is not, the following definitions are provided:

- Institutional investor: A corporation, financial institution, or other organization (e.g., venture capital firm) that uses money raised from another party to provide capital to a private business owned and operated by someone else.
- Friends and family investor: An individual who uses his own money to provide capital to a private business owned and operated by a family member, work colleague, friend, or neighbor.



- Informal investor: An individual (not an institution) who uses his own money to provide capital to a private business owned and operated by someone else. The most important point about angel investing that comes from these definitions is the following: every angel is an informal investor, but not every informal investor is an angel. That is, informal investors are made up of two different groups of investors, angels and friends and family.

Another important point that comes from these definitions is the heterogeneity among angel investors, which we can divide as follows (Shane, 2008):

- Unaccredited and Accredited Investors

Unaccredited angel investor: An individual who does not meet the Securities and Exchange Commission's (SEC) accreditation requirements and who uses his or her own money to provide capital to a private business owned and operated by someone else, who is neither a friend nor a family member.

Accredited angel investor: An individual who meets SEC accreditation requirements and who uses his or her own money to provide capital to a private business owned and operated by someone else, who is neither a friend nor a family member.

- Some angels are early-stage capital providers that would make angel investment without looking at the entrepreneur's business plan, while others put money into businesses that are cash flow positive at the time of investment.

- Active and Passive Investors

Active angel investor: An individual who uses his or her own money to provide capital to a private business owned and operated by someone else, who is neither a friend nor family member, and who invests time as well as money in the development of the company.

Passive angel investor: An individual uses his / her own money to provide capital to a private business owned and operated by someone else, who is neither a friend nor a family member, but who does not invest time in the development of the company.



- Some angels are quite knowledgeable about investing in private companies, while others are quite naïve about entrepreneurship.
- Some angels take high risks to earn high returns, while others seek lower risks and lower returns.
- Individual Angel and Angel Group

Individual angel: A person who acts on his / her own to provide some of his money to a private business owned and operated by someone else, who is neither a friend nor a family member.

Angel group member: A person who acts as part of a group to provide some of his or her own money to a private business owned and operated by someone else, who is neither a friend nor a family member.

THE ROLE OF ANGEL INVESTMENT

Number of angel investors in developed countries is quite significant; for instance, John A. May, a representative of angel investors association in USA, stated that in USA the number in year 2011 is 318,480 people (Kontan, 2012); there is a 20% increase from previous year. Roles of angel investors have more and more been seen after the financial crisis in year 2008 happened. At that time, financial institutions broke and the only way to help the funding of these start up entrepreneurs were the angel investors. Since then, funding from angel investors has been growing rapidly; a venture research center in USA identified that the total investment value of the angel investors in year 2011 was US\$22.5 billion or increasing 12.1% from the previous year.

The most successful country in South East Asia who creates roles of angel investors in helping the funding of young entrepreneurs is Singapore. Based on the results from Global Entrepreneurship Monitor (GEM) Singapore from 2000 – 2006 (Wong, 2011), we conclude that the percentages of number young entrepreneurs and angel investors are increasing; moreover, they have achieved 3% from total number of productive population.

Roles of angel investors cannot be neglected in helping the entrepreneurship sector from a country. For young firms, access to credit is particularly difficult due to their lack of tangible assets, and therefore collateral, and their higher risk profiles. Often entrepreneurs start their ventures with informal financing, their own funds and those of



friends and family, depending on the size and scope of the venture, entrepreneurs may need other external sources of seed capital, such as angel investing.

Finally, the presence of angel investors in a country will support entrepreneurship in that country and, eventually will increase the economic development of that country.

CONCLUSION

Entrepreneurship can be seen as one of many ways to increase development of a country (Reynolds et al. 2005 in Carree and Thurik). Therefore, entrepreneurship sector should get attention from the government. Government has realized how important the presence of entrepreneurship sector for country's economic growth by declaring President's Instruction (*Instruksi Presiden*) number 4 in 1995; the message from government was to cultivate pioneers' spirit among young generations in order to become entrepreneurs.

However, Indonesia has not fully developed an integrated development strategy for entrepreneurship yet (Pinayani, 2006). Moreover, the biggest obstacles facing entrepreneurs in order to transform the idea into a profitable company is when personal savings or funds of the family are no longer able to sustain and grow the business. And at the same time, these businesses lack collateral to obtain financing or investment of institutional capital providers.

To bridge between these problems, initiatives from some individuals and groups to become angel investors has been implemented; for example, the realization of GEPI (*Global Entrepreneurship Program Indonesia*) and MEKAR entrepreneurship program (Program Kewirausahaan MEKAR) from Putera Sampoerna Foundation, and many more.

Angel investors programs which have been started in Indonesia, hopefully are able to gain supports from more and more companies, specifically from financing early-stage and growth companies.

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