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Venture Capital Markets in APEC Economies

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Venture Capital in APEC Economies

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Venture Capital

- Private equity in U.S. versus *venture capital*
 - Typically funds managed for institutions are exempted from Securities and Exchange Commission restrictions due to their “sophisticated” nature of investors
- Several forms of private equity
 - High risk investments (distressed debt, leverage buyouts)
 - Venture capital



Small-Firm Finance

- Traditional lenders (banks) solved many problems with collateral and other terms
- Challenge of *informationally opaque* investments
 - Little or no collateral available
 - Unproved technology
 - Untried product market
 - Production challenges
- Typical examples
 - Biotechnology, software, communications



Venture Capital Attributes

- Private equity and venture capital in United States has evolved freely in largely unregulated markets for capital
- Investors in private equity are dominated by pension funds and wealthy individuals
- Managers of venture capital raise pools of funds in the form of *limited partnerships* typically with a limited life (e.g. ten years)



Venture Capital Management

- Venture capital is usually in the form of equity or convertible issues
- VC managers take an active role in management
 - Seats of board of directors
 - Role in management changes
 - Strategic, financing, and other advice
- Preferred exit strategy is initial public offering (IPO) that restores control in part to entrepreneur, but trade sales common



Small-Firm Finance in U.S.

Sources of Funding		
Sources of Equity	(\$ million)	Of Total
Principal owner	\$ 524.3	31.3%
Angel finance	60.0	3.6%
Venture capital	31.0	1.9%
Other equity	215.2	12.9%
Total Equity	\$ 830.6	49.6%
Sources of Debt		
Financial Institutions		
Commercial banks	\$ 313.8	18.8%
Finance companies	82.1	4.9%
Other financial institutions	50.1	3.0%
Nonfinancial business and government		
Trade credit	\$ 264.1	15.8%
Other business	29.2	1.7%
Government	8.1	0.5%
Individuals		
Principal owner	\$ 68.5	4.1%
Credit card	2.4	0.1%
Other individuals	24.5	1.5%
Total Debt	\$ 842.9	50.4%
Total Equity + Debt	\$ 1,673.4	100.0%



Private Equity After Asian Crisis

- Rapid growth in both foreign investments and local funds since Asian Financial Crisis
- Largest private equity/venture capital pools in Asia are Hong Kong, Japan, Singapore, Japan, Korea and China
- Degree of special policies (regulation, taxation, government funding) varies greatly in Asian economies



Funds Raised in Asia (\$millions)

Economies	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Australia	78	175	248	451	378	388	399	486	1,052	643
China	583	677	898	1,028	294	96	166	540	2,028	821
Hong Kong,										
China	710*	787*	3,097*	1,980*	621	1,920	3,132	5,321	3,160	2,416
Indonesia	0	31	117	29	45	265	39	38	0	9
Japan	870	605	1,688	1625	1,572	1,006	1,237	4,865	4,624	2,264
Korea	151	97	269	889	1,040	277	549	1,495	1,812	830
Malaysia	69	23	20	228	9	19	55	205	169	250
New										
Zealand		14	33	11	2	47	56	130	144	81
Philippines	11	33	33	42	35	25	52	75	83	16
Singapore	42	306	634	1,055	721	1,146	620	2,352	1,810	1,057
Chinese										
Taipei	28	65	46	154	416	568	1,096	1,139	1,507	794
Thailand	25	7	14	29	33	39	15	40	285	81
Vietnam	12	109	115	53	22	17	10	40	22	18



Private Equity in Pacific Rim 2001

Economies	No. of Venture Capital Funds/Companies	Number of Venture Capital Professionals	Venture Capital Under Management (US\$ million)
Australia	169	431	4,742
China	200	360	6,044
Hong Kong, China	177	631	26,019
Indonesia	31	105	153
Japan	232	1,531	21,515
Korea	180	483	6,251
Malaysia	41	95	811
New Zealand	30	68	587
Philippines	18	59	291
Singapore	117	509	9,754
Chinese Taipei	165	437	6,261
Thailand	16	58	580
Vietnam	7	21	114

Source: Asian Venture Capital Journal, *The 2003 Guide to Venture Capital in Asia*



Policy towards Private Equity

- U.S. and Hong Kong have no special regulations or tax privileges for private equity or venture capital
- Korea and others have extensive special regulation for small-firm and venture capital financing
- Malaysia and others have special programs for funding high-tech investments



High-Tech Investment in Asia

	Australia	China	Hong Kong China	Indonesia	Japan	Korea	Malaysia	New Zealand	Philippines	Singapore	Chinese Taipei	Thailand	Vietnam
Computer related	5.8%	27.4%	9.9%	1.2%	7.3%	8.3%	9.4%	14.0%	9.3%	7.9%	20.0%	7.7%	4.7%
Electronics	1.0%	4.2%	7.2%	17.8%	9.9%	8.5%	14.1%	5.5%	6.0%	10.1%	17.8%	6.3%	0%
Information-technology	9.3%	7.7%	9.9%	10.5%	5.3%	10.3%	16.8%	14.4%	15.6%	14.1%	16.5%	9.8%	6.5%
Medical/Bio-technology	6.0%	3.8%	5.0%	3.4%	1.9%	1.4%	3.5%	7.5%	0%	8.8%	6.3%	2.6%	7.5%
Telecommunication	6.1%	7.4%	15.3%	8.1%	10.8%	10.7%	10.2%	17.1%	11.9%	16.9%	9.0%	12.4%	0%
High Technology (Total)	28.2%	50.5%	47.3%	41.0%	35.2%	39.2%	54.0%	58.5%	42.8%	57.8%	69.6%	38.8%	18.7%
Other industries	71.8%	49.5%	52.7%	59.0%	64.8%	60.8%	46.0%	21.5%	57.2%	42.2%	30.4%	61.2%	81.3%
Total Disbursement to Industry (millions)	\$5,524	\$5,675	\$10,287	\$89	\$9,226	\$5,823	\$516	\$248	\$143	\$4,195	\$3,717	\$296	\$107

Source: Asian Venture Capital Journal, *The 2003 Guide to Venture Capital in Asia*



Venture Capital in U.S.

	Dollars (millions)			Percent of Total		
	1998	1999	2000	1998	1999	2000
Online specific	3,284.7	18,513.1	25,246.1	17.1%	38.5%	31.0%
Communications	3,318.5	8,335.4	17,627.8	17.3%	17.3%	21.7%
Computer Software	3,834.7	7,500.9	14,374.3	20.0%	15.6%	17.7%
Medical and Health	2,392.2	2,457.0	3,613.7	12.5%	5.1%	4.4%
Semiconductor	827.0	1,740.2	6,098.8	4.3%	3.6%	7.5%
Computer Hardware	556.2	1,303.8	2,279.2	2.9%	2.7%	2.8%
Biotechnology	1,030.1	1,182.2	2,763.8	5.4%	2.5%	3.4%
Technology (Total)	15,243.4	41,032.6	72,003.7	79.3%	85.4%	88.5%
Other Products	2,443.7	4,551.9	6,279.4	12.7%	9.5%	7.7%
Consumer Related	1,083.7	1,710.4	1,665.6	5.6%	3.6%	2.0%
Industrial & Energy	441.1	751.1	1,423.8	2.3%	1.6%	1.7%
Total	19,211.9	48,046.0	81,372.5	100.0%	100.0%	100.0%

Source: Gompers (2001), Table 1



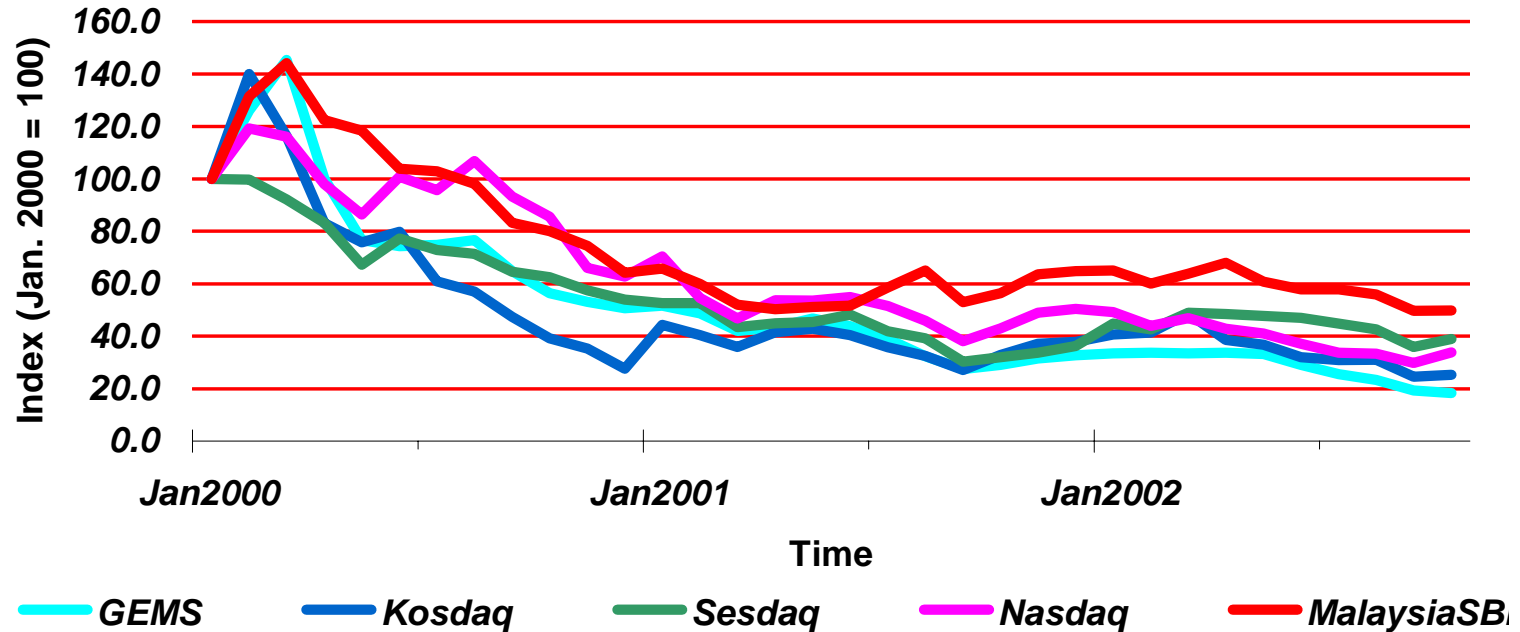
Observations

- Asian Financial Crisis stimulated development of private equity markets in Asia at the same time as banking systems in crisis economies were severely damaged
- Development of second board markets facilitated exit strategies for smaller firms but current values and activity below peak levels



Second Board Markets

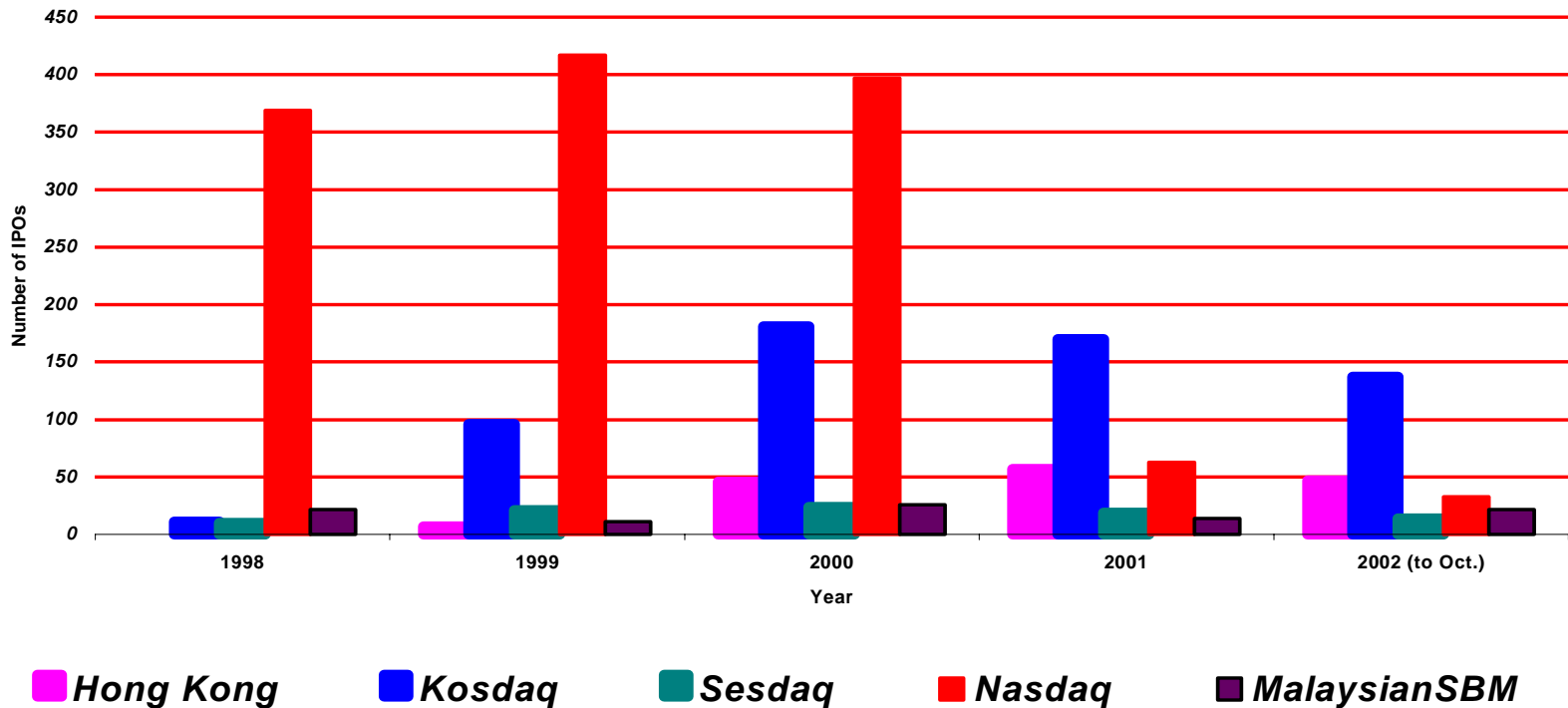
SBM Indices since Jan. 2000





IPO Activity in Selected Economies

Annual Total IPOs





Recommendations

- Investment allocation programs for small firms should not distort economic incentives for investment and repeat historical errors
- Enable small-firm finance to evolve in free markets in response to opportunities and economy-specific problems to be solved
- Focus on problems facing basic lenders (banks, etc.) to repair severely damaged standard channels for financing small firms and industrial restructuring



Regional Cooperation

- Harmonize foreign ownership rules with aim of reducing restrictions
- Strengthen and standardize protection of minority investors
- Harmonize tax treatment and investment authorities of institutional investors (like insurance companies and pension funds)
- Facilitate innovative structural forms (e.g. preferred and convertible issues)