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Venture Capital in Asia

Investing in Emerging Countries

William Scheela

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Abstract

This book is one of the first to analyze the development of private equity, to include venture capital and business angel investing in emerging Southeast Asian economies of Thailand, Philippines, Vietnam, Indonesia, and China. The book analyzes the investment strategies of both types of private equity investors who face significant challenges when investing in emerging economies lacking the legal and financial institutions needed to support effective private equity investing. With the author's detailed field research in Southeast Asia, as well as recent private equity research in China, you will learn about investment strategies (whether you are a venture capitalist or business angel) in emerging markets. This investment strategy is based on significant networking that is used to build social capital, in-depth due diligence, and hands-on postinvestment monitoring

Keywords

business angels, China, emerging countries, private equity, Southeast Asia, venture capital

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Preface

This book is about venture capital and business angel investing in emerging Asia. I have been studying the development of these two types of private equity investors since 1987 when I took my first trip to Asia as a visiting lecturer for one academic year at the Chinese University of Hong Kong. It was in Hong Kong where I was introduced to both Asian and Western venture capitalists who were beginning to do deals in Southeast Asia and China and I began to interview them. Later, I was privileged to be a visiting professor at National Economics University of Vietnam in Hanoi (1994, 1998, and 2009) and the Asian Institute of Management in Manila, Philippines (2009). These opportunities allowed me to work with local collaborators to expand our private equity research to Vietnam, Philippines, Thailand, and Indonesia, where we were able to interview both venture capitalists and business angels. Given the lack of legal protection for minority shareholders in emerging Asia, I was surprised to find them and, subsequently, very curious to find out how they were surviving.

We have published our research in academic journals and presented our findings at both academic and practitioner conferences, primarily in Asia. As our field studies and publications increased, I have been contemplating writing a book on venture capital investing in Asia focusing on emerging Southeast Asian countries and China. Unfortunately, there has been a dearth of published research on this topic until recently. More specifically, until this century there was minimal published empirical research studies about private equity investing in emerging Asia. With our publications being the first to analyze private equity investors in emerging Southeast Asia and, along with recent publications, about venture capital and business angel investing in China, a book grounded in the data was both possible and, in my opinion, desperately needed.

Acknowledgments

This book would not have been possible without the significant contributions of my coauthors in Southeast Asia. I am very grateful for their hard work and leadership in developing the field studies in each of the following countries: the Philippines—Edmundo Isidro; Thailand—Thawatchai Jittrapanun; Vietnam—Nguyen Van Dinh, Nguyen Thi Thu Trang, and Tran Thi Van Hoa; Indonesia—Janti Gunawan. Last, but not least, I want to thank my two most favorite "coauthors"—wife Riki and daughter Jennifer who find it difficult to understand why I want to spend part of my summers in the hot and humid tropics of Southeast Asia instead of enjoying the cool summers of Northern Minnesota's lake country. Maybe this book will help them understand.

CHAPTER 1

Venture Capital

Ben and Emiliano[1]

747 Pilot and Entrepreneur

After a successful 38-year career as a commercial airline pilot and senior executive at Philippine Airlines (PAL), Ben Hur Gomez was able to quickly expand his business interests. Ben had been an entrepreneur throughout most of his adult life; in many cases, running multiple businesses simultaneously besides being a pilot. Currently, Ben was actively involved with four businesses: Omni Farms (which raised chickens for the San Miguel Foods division of San Miguel Corporation), Carpa Reality Development Corporation (which managed Gomez Mansions, two residential apartment buildings), Island Aviation, Incorporated, formerly A. Soriano Aviation (which provided professional air transport to island resorts), and a flight-training school called Omni Aviation. Ben explained the origin of his name, "Ben Hur:"

> The first *Ben Hur* movie was shown in 1931 and was a silent one without talkies and the leading man Ramon Navarro, was my grandfather's favorite actor… . *Ben Hur* was also his favorite story and I happened to be born on December 15, 1931. It was only logical that I was named after the movie.

Throughout most of his life Ben had always persevered against significant odds. He successfully earned his commercial pilot license with instrument and multiengine ratings plus an airplane and engine mechanic license at the age of 19. Ben joined PAL in 1953 and ultimately attained the rank of captain and chief 747 pilot and vice president for safety and

[1] Information from this section taken primarily from Scheela (2009a, 2009b).

security during his impressive 38-year career; all accomplished with only a high-school diploma. He indicated that some fellow executives questioned his promotions because he was not educated. Ben countered, "I was not schooled, but I am educated while they were schooled, but not educated. I could outthink and outperform any of them anytime." Ben did not suffer from a lack of confidence.

One of Ben's passions was business and after he retired from PAL he spent long hours every day, six or seven days a week, focused on his various business interests. Ben always carried three mobile phones so as to never be out of contact due to dead zones, which could render one of his phones inoperable. Ben was also active in volunteer activities including working as a director on many boards of education, advising religious and educational organizations, and worked with foundations. Ben also founded a cooperative credit union, a condominium corporation, a mutual aid fund, a pilot's retirement fund, and was Chairman of the first Clark Investors and Locators Association.

In April 2009, Ben Hur Gomez was stressed because of the challenge of managing the explosive growth of one of his companies, Omni Aviation. The Omni Aviation Corporation was located in the Clark Freeport Zone, near Angeles City, Philippines (80 kilometers north of Manila). Omni provided pilot training for prospective private and commercial pilots. In the last 15 months it had experienced a significant increase in demand, which resulted in almost triple the number of airplanes used for training. Ben was running out of space and capacity.

Unfortunately, the Clark Freeport Zone Authority, from which Omni leased an airfield, would not allow further expansion. Relations between Ben and "the Authority" had not been pleasant for many years. Ben's airfield had significantly increased in value and Clark wanted to shut Omni down and take over the property, so it could be made available to foreign investors. Not surprisingly, Ben was considering relocating his entire operations in order to meet increasing demand and have more control over his business. Also, at the age of 77, Ben was aware that he had to be thinking of an exit strategy, but had no clear plan on how to do it.

By 2012, Omni had continued to grow because of increased demand for commercial pilots throughout Southeast Asia, but the conflict with Clark was still ongoing and represented a major challenge to Ben on a daily basis. As Ben celebrated his 80th birthday, he was approached by

a venture capitalist (VCs) who was interested in purchasing Omni Aviation. “Hmmm,” Ben thought, “What’s a venture capitalist and what do they do?”

A Man of the World

Emiliano Zulberti was much younger and less experienced than Ben Gomez, yet he was truly a citizen of the world, having been born in Colombia of Argentine parents, raised primarily in Kenya and attended universities in Canada, the United States, and Europe. He embarked on a professional career working in Europe, the United States, and Asia. At age 29, Emiliano decided to forsake a promising corporate career and become an entrepreneur. He uprooted his wife and two young children from Singapore to move to Makati, Philippines, most of all because he believed in Direct With Hotels (DWH); a business model that capitalizes on the talent and technology infrastructure strengths of the Philippines, while building the core operation in a low-cost economy.

Emiliano’s passion for traveling and his frustration with the reservation experience offered by many accommodation providers, drove him to create, with his father Carlos, DWH (www.directwithhotels.com). As acting president and CEO, and having recently secured institutional funding from the Philippines’ most successful venture capital (VC) firm, Emiliano focused on recruiting A-level talent to build a world-class, global brand.

Direct With Hotels was founded in 2005 and the business model is to be the primary provider of an online booking engine that enables accommodation providers to sell their rooms directly to their guests via their own website. To further maximize its hotel clients’ revenues and profitability, DWH offers their clients online marketing and revenue maximization services at no additional cost. This has enabled accommodation providers of any size with the marketing, technology, and performance management services that resulted in maximum bookings secured direct via the accommodation provider’s own website.

Emiliano decided to locate their corporate headquarters in Manila (Makati City), Philippines because he was familiar with the high-quality, low-cost work force in the Philippines through his previous job in Singapore. He was also attracted by the high quality of life for his family.

Emiliano also knew that private equity (PE) money was available in the Philippines. Unlike Ben Gomez, Emiliano knew what VCs do and he was also familiar with what business angels (BAs) can provide to a high-growth potential, start-up company desperately in need of early-stage funding.

Emiliano developed a global strategy for DWH from the new venture's very beginning. By early 2008, DWH had established a presence in 15 countries, most recently in Sri Lanka. Initial funding for DWH's start-up was provided by Emiliano, Carlos, and a BA investor who invested $350,000. Soon after commencing operations, Emiliano began talking to VCs about potential investments in DWH. Emiliano said it was critical to find a VC firm he was comfortable with and "had the integrity to do business right and discipline to get things done." He met various VCs for a year before focusing on the Investment and Capital Corporation of the Philippines Venture Partners (IVP). He said it was important for an entrepreneur to conduct thorough due diligence of potential strategic investors, seeking insights into some of the "soft" attributes (beyond the more obvious "hard" attributes) of an investment firm. For example, which investors specifically would take seats on the board and the executive committee? How would their personalities play out in good times and challenging times? What would they contribute besides money? That is, would the VCs be active, hands-on investors, providing value-added management experience, and advice?

Emiliano was convinced that IVP was the best funding match for him because of their professionalism in "ethics first when doing business" and deal structuring, which he described as "second to none" in the Philippines. He believed that he was getting Tier I (which describes the top-level U.S. venture capital firms) value-added investment from one of the relatively few VC firms in the Philippines. DWH began serious negotiations with IVP about the terms of the deal (term sheets) in September 2006 and concluded negotiations in December 2006. It was Emiliano's first time to negotiate a term sheet (typically 10 to 20 terms must be negotiated or agreed upon by both parties) from the perspective of an entrepreneur, which he found to be challenging but critically important as these terms form the foundation of the partnership; truly a marriage in the making.

Early-stage VC funding of $1 million was provided by IVP in early 2007. IVP is the lead investor, but not the only institutional investor with DWH. Other strategic investors included Anscor Corporation

(part-owner of Amanpulo, the only Aman resort in the Philippines), NTT (Nippon Telegraph and Telephone) Finance (a Japanese PE branch of NTT Group, which would enhance DWH's development of a mobile phone platform for customer reservations), and DFJ (Draper, Fisher, Jurvetson) Vina Capital (a U.S.-Vietnamese VC fund that was introduced by IVP to DWH). The total investment provided by all parties, excluding Emiliano and his father, was $2.55 million. Emiliano could have easily answered Ben's inquiry about VCs, but, unfortunately, they never met each other.

An Overview

In 2013, for the first time, emerging countries like the Philippines, collectively, comprised more than 50 percent of global Gross Domestic Product (GDP) compared to developed countries, based on purchasing power. According to *The Economist* this rapid growth of emerging countries over the past two decades represents the biggest economic transformation in modern history (The Economist 2013). Private equity (PE) investors have taken notice. Impressively, during the past decade, PE funds investing in emerging countries have outperformed U.S. PE funds (Bliss 2012). Not surprisingly, since 2001 the amount of PE (to include leveraged buyout and VC funds) raised for emerging markets' investments grew tenfold with emerging Asia being the most popular region (Lerner et al. 2012). Venture capital, which has provided much-needed equity for high-growth potential new ventures in the Western world is a relatively recent and rapidly growing phenomenon in emerging countries, especially Asian emerging countries. Venture capital financing is extremely important to support economic development in both developed and emerging economies (Ahlstrom and Bruton 2003). Unfortunately, VC is woefully under researched and, not surprisingly, misunderstood in the emerging market context (Scheela and Jittrapanun 2012). Emerging Asian countries, especially East and Southeast Asia, have shown some of the fastest GDP growth rates globally throughout the past decade (Asian Development Outlook 2013). More specifically, VC financing in Asia is playing an increasing role in supporting the development of high-potential entrepreneurial ventures (Scheela et al. 2012b). Ben Hur Gomez and Emiliano are but two examples of how VC can have a major impact on a rapidly-growing business;

in one situation to start a promising business and in another situation to sell a successful and still very promising business. But these two examples are only anecdotal and provide a small insight to understanding how VC can have a positive impact on the economic development of an emerging country. Unfortunately, the impact of VC investing on the development of highly potential ventures in emerging Asian countries has not been significantly addressed, but it should be and is the focus of this book.

Private Equity: Formal and Informal Venture Capital

Private equity (PE) investors raise and manage a pool of capital that is invested in primarily private ventures (but sometimes publicly-listed companies) at various stages of their development. PE investors are active investors; they are often referred to as hands-on investors, which is further explained in this chapter. PE is comprised of both the large multibillion dollar leveraged buy-out funds (to include both debt and equity) and the smaller VC funds, which are primarily equity and the focus of this book. There are two types of VC: formal and informal. Formal VCs invest institutional equity (funds raised from institutional investors such as pension funds and university endowments) and provide management assistance to high-growth potential, unlisted small- and medium-sized enterprises (SMEs). Their overriding goal is to generate significant financial returns for both the institutional investors (also called limited partners) and themselves (also called general partners). Informal VCs are frequently referred to as BAs and are mostly high net-worth individuals, typically with considerable business experience, who invest both their personal funds and managerial experiences into early-stage ventures. Similar to VCs, business angels (BAs) invest for financial gain via equity investments, but many BAs also invest in early-stage companies as a way to give back by providing entrepreneurs both equity and ongoing advice in developing their ventures. Many BAs, in our face-to-face interviews in the Philippines, Vietnam, Thailand, and Indonesia talk about how they are also motived to invest just by the "thrill of doing the deal."

While VCs have played a significant role in funding high-technology SMEs in the United States during the last four decades, BAs are playing an increasingly significant role in the United States by providing equity investments for seed- (prerevenue) and early-stage ventures, which are

increasingly perceived by VCs as being too risky and too small for profitable investing (Sohl 2003). Subsequently, there are now VC investment gaps in the United States whereby significant VC funding is lacking for both seed-stage companies requiring funding of less than $250K and growth-stage companies requiring funding of $1 to $2 million. BAs have been able to only effectively address the first gap, but not the second, by investing primarily in seed- and early-stage companies. Fortunately, in the last decade BAs have been able to address the second gap by developing BA networks (BANs) to raise angel funds resulting in larger investment deals in growth-stage companies. BANs are now a significant part of the PE landscape in the United States, United Kingdom, and Western Europe, but not yet in emerging countries (Sohl 2007).

What Do Venture Capitalists Do?

Michael Gorman of the U.S. consulting firm McKinsey & Company and Professor William Sahlman of the Harvard Business School in 1989 published a soon-to-become very frequently cited research article on what VCs actually do. In fact, the title of their article was "What Do Venture Capitalists Do?" (Gorman and Sahlman 1989). Based on their survey, they explained that VCs do many things besides investing equity in early- and growth-stage companies. Their research launched many studies that shows that VCs are involved in raising institutional funds, finding deals, monitoring their investments, providing additional financing, assisting in strategic planning, replacing and recruiting top management (Sahlman 1990; Gorman and Sahlman 1989). Later research showed that BAs are also involved in similar value-adding activities besides simply providing equity financing (Van Osnabrugge and Robinson 2000). Venture capitalists and BAs aggressively attempt to add value to their investments (typically called portfolio or investee companies) after their equity injections in order to increase returns, both, to their institutional investors (VCs only) and themselves (VCs and BAs). Venture capitalists and BAs can add value by playing an active postinvestment role in both strategic and operations management. So it is extremely important for VCs and BAs to be able to attract good deals, negotiate favorable investment terms, and effectively manage postmanagement value-adding activities before being able to successfully exit their investments.

Decision-Making Process

Venture capitalist in developed countries, and to some degree BAs, have been shown by researchers to use a fairly standard process when making investments in a company. Table 1.1 shows the investment decision-making stages for both VCs and BAs. Venture capitalists' decision making has been analyzed far longer than BAs and this process was first published in 1984 by academics Tyzoon Tybjee and Albert Bruno in a seminal article that focused on VC's investment decision making (Klonowski 2007; Paul et al. 2007). Much later in 2007, Professors Stuart Paul, Geoff Whittman, and Janette Wyper, all from the University of Paisley in Scotland, proposed a BA investment process using Tybjee and Bruno's research as benchmark. Interestingly, both processes are comprised of five steps, with many of the steps very similar if not identical. VCs and BAs must find deals, screen and analyze each deal, and, for deals that pass due diligence,

Table 1.1 Developed country investing stages

Venture capital investing*	Business angel investing‡
1. Deal origination • Finding high-quality deals • Professional referrals	1. Familiarization • Learning about the entrepreneur and opportunity
2. Screening • Fit with investing criteria	2. Screening • Hard and soft data about the entrepreneur and opportunity • Due diligence
3. Evaluation • In depth due diligence	3. Bargaining • Deal structuring • How much money for how much equity
4. Deal structuring • Agree on terms • How much money for how much ownership	4. Managing • Hands-on investor
5. Postinvestment activities • Adding management value by VCs • Exit the investment ○ IPO, trade sale, management buy-back	5. Harvesting • Exit the investment ○ Primarily trade sale

*Tyebjee and Bruno (1984).

‡Paul et al. (2007).

come to an investment structure agreement with the entrepreneur. Once there is an agreement, VCs and BAs must manage their investment so as to maximize their return when they attempt to exit an investment (hopefully at 3 to 10 times the value of their investment) in a timely manner (typically 3 to 5 years after investing).

There are differences between VCs and BAs. As mentioned previously, BAs do smaller deals, focus more on seed- and early-stage ventures, and are also interested to give back, to help entrepreneurs in starting a business. BAs also tend to be more informal in their decision making, by being able to move quickly to make a decision, conducting less rigorous due diligence, requiring less conditions from the entrepreneur (such as a board seat), and focusing more on the entrepreneur than the actual venture or proposed venture (Van Osnabrugge and Robinson 2000). As shown in Table 1.1, BAs primarily exit their investment via a trade sell (portfolio companies purchased by another company). While VCs prefer to exit via an initial public listing (initial public offering–IPO) in the stock market, this exit is seldom an option for BAs (Van Osnabrugge 2000).

Deal Syndication and Returns

Both VCs and BAs prefer to co-invest with other PE investors. With increasing uncertainty, VCs tend to invest with other VCs as part of a syndicate by investing jointly in portfolio companies; especially, VCs investing in highly-innovative technology companies. As Professor William Bygrave of Babson College has shown, when there is more uncertainty, there is more co-investing among VCs in the United States (Bygrave 1988). More specifically, syndication networks can facilitate information sharing, deal flow, value-added potential, contacts, and resources among PE investors. BAs also co-invest for some of the same reasons motivating VCs to form syndicates, but the level of communications between BAs compares poorly to the effectiveness of VC syndicates in doing deals (Murray 2007). More recently, to improve communications among investors, increase deal flow, and enhance due diligence, BAs have begun to syndicate in doing deals by forming formal networks (BA clubs), which is a trend in the United States and Western Europe, but not in emerging economies (Van Osnabrugge and Robinson 2000). Basically BA clubs

or networks are formal organizations that bring together BAs seeking to invest and entrepreneurs who are in need of capital. The primary goal of BA networks is to improve the efficiency of the deal flow of early-stage ventures for BAs and to provide entrepreneurs increased access to angel financing (Sohl 2007).

Investment returns can be challenging to analyze because of the lack of public data about PE returns, especially for BA investing. In fact, experts who track VC financial returns refer to measuring performance as a *tricky problem* (Lerner et al. 2012, 274) because of the volatile valuations of the investee companies during the time of the investment and is beyond the context of this chapter. However, it can be concluded that VC returns during 1989 to 2009 in the United States were 22.1 percent for early-stage investment and 14.7 percent for later-stage investments, respectively, which is significantly higher than VC returns in Europe for both asset classes (–1.1 percent and 6.9 percent) (Lerner et al. 2012, 278). BA returns are much more difficult to assess because their returns are even less publicized than VC returns, which has resulted in far fewer studies focusing on BA returns. One significant study on U.S. BAs found that investments were primarily in seed or early-stage companies and resulted in failures in two-thirds of BA investments, but 20 percent of the exits resulted in rates of returns of over 100 percent (Wiltbank 2005). These findings compared favorably to a U.K. study of BAs, which also showed a 47 percent partial failure or total failure rate for investments, but 23 percent of investments resulting in a rate of return exceeding 50 percent (Mason and Harrison 2002). Returns for BAs clearly fit the often used cliché about high risk–high returns as BAs invest primarily in risky seed- and early-stage ventures where most companies fail but a minority of the investments can generate spectacular returns for early investors.

Research Setting

In spite of increasing PE investments in emerging Asia, there has been minimal research analyzing this phenomenon. We have conducted field studies of both VCs and BAs in multiple emerging Southeast Asian countries (Scheela et al. 2012a, 2013): Vietnam (Scheela and Nguyen 2001, 2004), the Philippines (Scheela and Isidro 2008, 2009; Scheela 2006),

Thailand (Scheela and Jittrapanun 2008, 2012), and Indonesia (Gunawan et al. 2011). All four countries represent an interesting dichotomy as they are simultaneously characterized as exhibiting strong economic growth potential (The World Bank 2010) that attracted significant PE investments (*2008 Asian Private Equity 300* 2007), in spite of the lack of fully-developed institutions that are necessary to support PE investing. In addition, VC and BA investors tend to be minority shareholders unlike the larger leveraged buyout investors who generally take a majority position (Schwab 2012). In this book we will present a synthesized analysis of our research publications combined with the latest research on these four countries , and China where researchers have analyzed both VCs and BAs.

We identified VC firms in Vietnam, the Philippines, and Thailand from various published PE listings. We identified key individuals or VC associations who provided guidance about which VC firms were the most significant investors and should be included in our study. Once identified, we contacted them to arrange an interview. We also requested each interviewed VC to recommend appropriate VC firms to be in our study. In Indonesia we focused on published data and one focused interview with a VC as part of a pilot study.

A major challenge in studying BAs is to find them because BAs tend to prefer a low profile almost to the point of being invisible (Harrison and Mason 2008). Because of the lack of BA public data bases, collecting primary data from individuals who wish to remain anonymous is an arduous task. Therefore, developing a representative random sample of BAs from an *invisible* population is extremely problematic especially in a developing country. Academic field researchers recommend using a judgment sample when it is difficult to identify firms or individuals in the population of interest. More specifically to BA research, Colin Mason and Richard Harrison, two highly-respected BA researchers in the United Kingdom identify formal BA networks as "the only visible part of the informal VC market," which could be a potential source to collect data (Mason and Harrison 2008, 322). Of course, using such networks increases bias as the sample would not be representative of the population.

Using these recommendations we developed a judgment samples for both the Philippines and Thailand. For the Philippines, we developed a

judgment sample in two steps. First, we selected potential BAs from a list of members who attended a monthly investment forum, meeting of investors and entrepreneurs, in the Philippines. From this list, we identified individuals who had a history of actively investing in SMEs. Face-to-face interviews were conducted with 29 BAs in the Philippines in English and lasted 60 to 75 minutes.

In Thailand we used a similar two-stage technique to identify and interview twenty BAs who are all members of a Bangkok-based Thai Chinese business association. Thai-Chinese most likely represent the overwhelming majority of BAs investing in Thailand as Sino-Thai family business groups have dominated business in Thailand since 1932 when the monarchy became less powerful (Phongpaichit and Baker 2002). All interviews were conducted in Thai, lasted approximately two hours and were translated into English for data analysis.

Formal BA networks do not exist in Vietnam and Indonesia where we have completed pilot studies, which makes finding BAs even more challenging. Finding the first BA is crucial because we can then use a technique called *snowballing,* where we ask interviewed BAs to recommend other BAs for our study and so on until we can build a useful sample of 20 to 30 BAs. We interviewed five Indonesian BAs and eight in Vietnam. We did not conduct BA or VC research in China, but instead focused on published research to form the basis of Chapter 6.

The Role of Theory

Theory is based on scientific research and explains the relationship between variables such as the role of legal and financial institutions and economic development. We use institutional theory as our theoretical framework to guide our research in trying to understand how VCs and BAs can survive in emerging economies that lack the necessary institutions needed to support effective PE investing. Nobel Laureate Douglas North defines institutions as “the rules of the game in a society... that shape human behavior” (North 1990). Institutions are posited as being necessary in guiding economic development. Key institutions for PE investors are legal (protect minority shareholders) and financial (existence of efficient stock markets and banks) institutions. Daron Acemoglu and

James Robinson, in a recent book explaining why nations succeed and fail, state that, "Institutional differences play the critical role in explaining economic growth throughout the ages" (Acemoglu and Robinson 2012, 124). That is, those countries with better institutions do better economically than those with undeveloped institutions. Dambisa Moyo, from Zambia, posits that effective political and legal institutions could be more effective than Western aid in providing a better economic future for Africa (Moyo 2009). Relatedly, the World Bank has shown that the role of institutions is very profound in supporting market transactions, growth, and poverty reduction (The World Bank 2002). More specifically, political, legal, and financial institutions, which are crucial to support PE investing, tend to be more effective in developed countries compared to emerging countries. Legal institutions can provide crucial private property protection to VC and BA minority shareholders while financial institutions can provide banking and equity support to both entrepreneurs and investors.

As I will explain in the next chapter, emerging Asian countries lack fully-developed institutions, which makes VC and BA investing both more challenging and unique compared to the United States and Western Europe. So the key question is: How do emerging Asian VC and BA investors survive, let alone make money, in countries that do not adequately support or even protect equity investors? In short, why are they even there?

CHAPTER 2

Emerging Asia

Philippine Venture Capital Investment Group[1]

In April 1987, when Philippines' economy was starting to recover from the replacement of President Marcos by President Aquino, a group of six people in Manila got together to talk about deals, funding, financing, and different types of projects including businesses that needed different types of resources. They quickly realized this type of forum was very helpful, so the group started to hold regular monthly meetings; usually, they planned for the third Wednesday or third Thursday of the month. As the group got bigger, they started to meet at the Bayanihan Room in the SyCip Gorres Velayo & Company (SGV) building, courtesy of one of the SGV business partners, and they formally called it the Philippine Venture Capital Investment Group (PVCIG), which is now registered as a foundation and is referred to simply as the Philvencap Forum. It is the oldest business investment forum in the Philippines.

In 1993, as attendance continued to grow, the Asian Institute of Management (AIM), through its then president (Felipe Alfonso), invited the group to work closely with AIM and hold the forum at AIM for free since the group does not charge its attendees any fees. This joint effort was geared to the activities of AIM toward making people more aware of entrepreneurship and developing more entrepreneurs in the Philippines.

The PVCIG is now on its 27th year and has just finished its 294th meeting in November 2013; impressively, the Forum has never cancelled a meeting in spite of the Philippines being the recipient of 15 to 20 hurricanes annually. The PVCIG meets monthly except in December when the Christmas holiday pre-empts the monthly meeting. From

[1] Written by Edmundo Isidro, Chairman, Philippine Venture Capital Investment Group (2013).

the initial meeting of six businessmen, the Forum now has an average of about 120 people attending their monthly meetings. The Forum has evolved into a meeting of entrepreneurs, business angels, private funders, venture capitalists (VCs), and consultants or facilitators interested in business opportunities and disseminating information to the attendees. The Forum's objectives are:

- to discuss business opportunities;
- to propagate the concept of business angel financing or private equity (PE) investment, or both;
- identify trends to build business opportunities;
- to enhance personal and business networks.

The Forum attempts to match entrepreneurs looking for funds with potential investors, such as business angels, institutions, or private individuals, who are interested in funding projects. A third category of attendees are consultants or facilitators who can help both investors and investees to effectively identify and complete deals. The VCs are also invited to attend to learn more about potential deals and to meet entrepreneurs.

A formal presentation of 4 to 6 business opportunities are usually presented in the Forum during each meeting. These are formal presentations by entrepreneurs after being screened by the chairman of the PVCIG. Each presenter has 4.5 minutes to present his or her business opportunity and must specifically identify the desired investment required from potential investors.

Another feature of the Forum requires attendees to verbally give their names, affiliations, and any possible business opportunities or services they may have. Most importantly, each speaker must tell the Forum what they want from the group. If not, the chairman will request such information.

The minutes of the monthly Forum meeting, along with an attendee database, are produced and distributed to the core members and their guests. A person can become a core member if he or she attends four consecutive meetings. Guests can attend by invitation only from a core member. There are no fees collected for attending the Forum as all costs are covered by the PVCIG. Besides Forum attendees, the minutes are

distributed to VC associations throughout the world and to parties interested in investing in the Philippines.

The PVCIG has developed a system to track each business opportunity presented in the monthly forum. The tracking results in matching interested parties to specific opportunities or projects presented in the Forum. The PVCIG summarizes the interested parties' names, contact numbers, and particular interest in the project. This information is forwarded to the entrepreneurs who presented their business opportunities. This is done to ensure that potential investors can contact the relevant entrepreneurs after the meeting, in a more comfortable and confidential atmosphere.

The monthly forum is scheduled for 2 hours, but time is not allotted for investor-entrepreneur meetings during the Forum. Consequently, a tracking sheet was developed to facilitate follow-up meetings between interested investors and entrepreneurs. The tracking sheet also gives PVCIG the opportunity to evaluate how many projects are successful in attracting capital and other required resources.

What Is an Emerging Country and Why Are They Important?

Emerging countries are defined as low- or middle-income markets with increasing economic liberalization but still having significant institutional voids, which are caused by absent or underdeveloped institutions (Khanna and Palepu 2005). Increasing economic liberalization has resulted in recent strong economic growth, in spite of high transaction costs caused by institutional voids (Khanna and Palepu 2010). According to The World Bank, "Two-thirds of the growth in global investment over the last 10 years has originated in developing countries" (The World Bank 2013, 9). Within emerging countries, both East and Southeast Asia represent two of the fastest growing regions. By 2030, emerging Asia is projected to collectively hold 55 percent of the world's capital stock (inventory), compared to the developed world's current holding of 70 percent (The World Bank 2013, 17). More specifically, the countries, which are the focus of this book (China, Indonesia, Philippines, Thailand, and Vietnam, which I will refer to as emerging Asia) have

shown impressive GDP growth during the past decade in spite of the recent global recession. The Asian Development Bank reports that for 2012 these five countries experienced annual GDP growth rates ranging from 5.0 percent for Vietnam to 7.8 percent for China, and they are forecasted to grow through 2014 from 5.0 percent for Thailand to 8.0 percent for China (Asian Development Bank 2013). As shown in Table 2.1, GDP per capita growth rates for emerging Asia and Singapore from 2009 to 2011 are even more impressive for emerging Asia, especially compared to Japan and the United States.

Emerging Asia's financial markets have also been expanding at a relatively rapid rate over the past decade. More specifically, according to a World Bank study (Ghosh 2006), in comparison to other emerging markets, emerging Asian financial markets are developing at a more rapid pace. While many of Asia's emerging economies' nascent equity markets still rank relatively low, Vietnam, Thailand, the Philippines, and Indonesia have successfully reduced some significant challenges facing entrepreneurs when attempting to start and grow new ventures in their respective

Table 2.1 Economic indicators

Country	GDP per capita U.S. current dollars 2009*	GDP per capita U.S. current dollars 2011‡	Percent change	Ease of doing business rank 2010§ (n=183)	Ease of doing business rank 2013# (n=185)
China	3,678	5,414	19.1	89	91
Indonesia	2,329	3,509	50.7	122	128
Philippines	1,746	2,223	27.3	144	138
Thailand	3,940	5,394	36.9	12	18
Vietnam	1,060	1,374	29.6	93	99
Singapore	37,293	49,271	32.1	1	1
Japan	39,731	45,920	15.6	15	24
USA	46,381	48,387	4.3	4	4

*Schwab (2010).

‡Schwab (2012).

§Doing Business 2010 (2009).

#Doing Business 2013 (2013).

countries (Doing Business 2013). However, emerging Asia is still a difficult place to do business as is shown in the last two columns of Table 2.1. In comparison to developed Asia (Japan and Singapore) and the United States, four of the five countries of emerging Asia rank considerably lower on the World Bank's Doing Business rankings for both 2010 and 2013. Only the Philippines showed improvement in their ranking during the three-year period.

Private Equity

Venture capital researchers have, so far, focused their efforts primarily on VC investing in developed countries of North America and Western Europe, where developed financial and legal institutions play a crucial role in supporting private equity (PE) investing. Because of increasing economic growth along with the development of Asian equity markets, researchers have been calling for increased research on PE investing in emerging Asia (Bruton et al. 2008).

The development of PE in emerging markets has been extremely robust as shown by the increasing share of global PE investing, focusing on emerging markets. From 2002 to 2011, PE fund raising for emerging markets grew from $3.2 billion to $45.2 billion with about 61 percent of the PE funds raised directed to emerging Asia (Klonowski 2012, 16). Generally, PE investing in Asia has continued its recovery from the 2008 global financial recession. While global PE fund raising has not yet recovered to its prerecession level and showed a slight increase in 2011, the Asia-Pacific region witnessed a 23 percent increase in capital raised to approximately $30 billion with China leading the way (Asia-Pacific Private Equity Review 2012a). During the first half of 2013, both the value and volume of PE deals plateaued in Asia, but Southeast Asia generated an increase in the value of PE investments (Private Equity International 2013).

Since 2009, the IESE Business School at the University of Navarra in Barcelona, Spain has published *The Venture Capital and Private Equity Country Attractiveness Index* that ranks both regions and countries in terms of attracting and supporting PE investing. This index provides a composite measure that determines the attractiveness of eight geographic

regions and 118 countries to receive VC and PE (leveraged buyout funds—LBOs) funding. This index is comprised of six main criteria or key drivers of country attractiveness for VC or PE investing. Table 2.2 shows the ranking of the eight regions for 2009, 2011, and 2013 with one being the highest rank and indicating highest attractiveness for VC or PE investors. The regional rankings have not changed in 5 years of analysis with North American being the most attractive region and Asia ranking consistently as fourth. The first three regions represent developed countries, while Asia is primarily comprised of emerging countries or economies with the exception of Japan, Singapore, and Hong Kong. Thus Asia would rank as the most attractive emerging region for VC and PE investing for the past 5 years.

As is shown in Table 2.3, China is the clear leader in PE (LBO and VC) investments from 2005 to 2011 with average annual investments of U.S. $17.6 billion followed by Japan and Singapore. For emerging Southeast Asia, Indonesia is the leader in PE investments followed by Thailand, the Philippines, and Vietnam. Clearly emerging Asia has been an active participant in PE financing in spite of the recent global financial recession. As shown in Table 2.4, PE investors in Southeast Asia are predominately foreign but there are a significant number of local institutional investors. Investment stage analysis shows that out of the total PE investments, VC comprises about 16 percent of the total investments represented by Early- and Expansion-stage investments. There are no data representing BA investing in either developed or emerging Asia.

Table 2.2 Regional VC or PE attractiveness

Regions	Rank 2009	Rank 2011	Rank 2013
North America	1	1	1
Australasia	2	2	2
Western Europe	3	3	3
Asia	4	4	4
Middle East	5	5	5
Eastern Europe	6	6	6
Latin America	7	7	7
Africa	8	8	8

Source: Groh et al. (2013).

Table 2.3 Private equity investments in emerging Asia

Country	Annual Investment Range[*]	Average investment per year (2005–2011)
Thailand	<U.S. $150M–3.9B	U.S. $657M
Indonesia	$520M–2.4B	$1.14B
Vietnam	< $150M–844M	$343M
Philippines	<$150M–1.5B	$371M
China[‡]	$9.5–28B	$17.6B
Japan	$4.6–17.5B	$10.6B
Singapore	$1.4B–7.2B	$3.8B

Source: Bhagat et al. (2012).

[*]Total investments were less than $150M in Thailand for 2004, 2008, 2009, 2010, and 2011; Vietnam for 2005, 2008, and 2009; the Philippines for 2005, 2006, and 2009.

[‡]Data is for Greater China (PRC, Hong Kong, Taiwan and Macau).

Table 2.4 Private equity investor composition[*] and stage[‡] (1H 2011)

Southeast Asia PE investor composition	Asia-Pacific PE investment by stage
Foreign PE: 44% Local PE: 34% Mixed PE: 22%	Seed: 0% Early: 5% Expansion: 11% Public Markets: 11% Later Stage: 20% Acquisition: 52%

*Bhagat et al. (2012).

[‡]Thomson Reuters (2011).

Institutional Voids and Venture Capital

Emerging countries, in spite of increasing economic liberalization, still lack fully-developed institutions that are necessary to support VC investing. This “lack of institutions” has been labeled as an institutional void, which is defined as when, “institutions are either absent or under developed in an economy” (Khanna and Palepu 2005, 1). This void represents a lack of legal and financial intermediaries needed to effectively support market efficiencies, which minimize transaction costs, such as the costs of doing business deals in emerging Asia. Therefore, institutional voids can

increase transaction costs for PE investors in emerging countries and have a negative impact on generating investment returns.

While Asia is receiving increased PE funding, there are significant institutional differences between emerging Asia and developed Asia. I have previously identified emerging Asia, for analytical purposes in this book, to include China, Indonesia, Philippines, Thailand, and Vietnam. Developed Asia includes Singapore and Japan, which have developed institutions more similar to the United States and Western Europe than to emerging Asia. To more specifically analyze the significance of the institutional voids for emerging Asia and the impact on VC and BA investing, we have computed an institutional score and applied a VC index for both emerging Asia and developed Asia and also, for comparison purposes, the United States.

As previously shown in Table 2.1, in four of the five countries of emerging Asia, doing business is difficult in spite of rapid economic growth. In Table 2.5, we provide more details about the institutional voids facing VC and BA investors. We selected key institutional rankings for each country from the "Global Competitiveness Report 2012–2013," which is published annually by the World Economic Forum located in Geneva, Switzerland. We computed an institutional score for each country by analyzing six institutional rankings (corruption, property rights, minority shareholder rights, political trust, stock markets, and bank soundness) from the competitiveness report. We then computed the mean rank for each country from the six institutional variables to get an institutional score for each country (shown in part a, the last column). Collectively, emerging Asian countries exhibited lower scores (65.2 to 94.2) than developed Asia (4.8 and 41.7) and the United States (47.2). Interestingly, since we lasted computed these scores for 2006, the United States has shown a significant decrease in institutional ranking (Scheela et al. 2012a).

Institutional differences exist between emerging and developed Asia. While the United States appears to be struggling with maintaining effective institutions based on Table 2.5, part a, it is highly ranked in ease of doing business, as seen in Table 2.1. Combining the two tables (Table 2.1 and 2.5, part a), for analytical purposes, shows there are clearly two institutional clusters: A developed institutional cluster and an emerging

Table 2.5 Institutional analysis

a. Institutional ranking[*] (n = 144 countries; 1 = highest rank)

Country	Business corruption[‡]	Protect property rights[§]	Protect minority shareholders[#]	Trust of politicians[**]	Stock market[‡‡]	Bank soundness[§§]	Institutional score (mean rank)
China	67	47	134	26	46	71	**65.2**
Indonesia	111	81	87	60	30	99	**78.0**
Philippines	108	74	137	95	36	41	**81.8**
Thailand	80	103	29	107	27	45	**65.2**
Vietnam	118	113	97	42	70	125	**94.2**
Singapore	3	3	8	1	6	8	**4.8**
Japan	11	15	87	57	17	63	**41.7**
USA	42	42	47	54	18	80	**47.2**

[*]Schwab (2012).

[‡]Higher rank indicates a low incidence of paying bribes or undocumented extra payments.

[§]Higher rank indicates property rights are clearly delineated and protected by law.

[#]Higher rank indicates minority shareholders are protected by law.

[**]Higher rank indicates higher trust of politicians.

[‡‡]Higher rank indicates companies can easily raise money by issuing shares.

[§§]Higher rank indicates that banks are healthy with sound balance sheets.

b. Venture capital attractiveness index [*] ***(n = 118 countries; 1 = highest rank)***

Country (rankings)	Economic activity[‡]	Depth of capital market[§]	Taxation[#]	Investor protection and corporate governance[**]	Human and social environment[‡‡]	Entrepreneur culture and deal opportunities[§§]	Rank 2013
China	1	8	16	55	60	25	**24**
Indonesia	2	25	97	95	82	79	**47**
Philippines	18	38	93	88	88	86	**56**
Thailand	10	23	51	43	56	45	**32**
Vietnam	26	40	112	106	76	81	**64**
Singapore	40	14	25	2	1	11	**5**
Japan	6	4	45	12	17	2	**4**
USA	3	1	37	8	11	1	**1**

[*] Groh et al. (2013).

[‡] Size of economy, expected real GDP growth, and unemployment.

[§] Size of stock market, stock market trading volume, IPOs and public issuing activity, M&A market activity, bank nonperforming loans to total gross loans and financial market sophistication.

[#] Entrepreneurial tax incentives and administrative burdens.

[**] Quality of corporate governance, security of property rights and quality of legal enforcement.

[‡‡] Education and human capital, labor market rigidities and bribing, and corruption.

[§§] Innovation, scientific and technical journal articles, ease of starting and running a business, simplicity of closing a business and corporate R&D.

institutional cluster, where emerging Asian countries face similar problems of corruption, weak property and shareholder rights, lack of trust in politicians, ineffective stock markets, and weak banks.

What is the impact of weak institutions or institutional voids on BAs and VCs when attempting to do deals in emerging Asia? To answer this question, we again use *The Venture Capital and Private Equity Country Attractiveness Index* as we did for regional ranking in Table 2.2 but this time for country ranking in 2013 for the eight countries shown in Table 2.5, part b. The results are interesting in that there are three clusters: cluster one for the United States, Singapore, and Japan; cluster two for China and Thailand; and cluster three for Indonesia, Philippines, and Vietnam. Although, clusters two and three rank more closely together with cluster one being more of an outlier with rankings in the top five of the most attractive countries for both formal VC and informal VC or BA investors. It appears that BAs and VCs investing in emerging Asia face more obstacles and higher costs to do deals than do American and developed Asia PE investors.

So how do BAs and VCs survive when investing in emerging Asia in the face of significant and challenging institutional voids? For the past two decades we have attempted to answer this question by analyzing the investment strategies of VCs operating in three of the emerging Asian countries (Vietnam, Philippines, and Thailand). For the past decade, we have conducted field research focusing on BAs in the Philippines and Thailand. In 2010 we expanded our BA research to Vietnam, and in 2011 we expanded both our VC and BA research to Indonesia, where we have completed pilot studies for both countries. For the past decade ongoing VC research about investing in China has been published and, since 2011, preliminary research focusing on BA investing in China has also been published. Collectively, for all five countries, our research question is: How do VCs and BAs survive in emerging Asia, a region that lacks the necessary fully-developed institutions to support VC and BA investing? In the next four chapters, I will explain how this question is addressed in each country.

CHAPTER 3

Vietnam

Saigon Hub: Where Everyone Knows Your Name

In August 2012, Chris Quang Zobrist and 10 investors and entrepreneurs started Saigon Hub in Ho Chi Minh City, Vietnam (formerly called Saigon, but changed after the Vietnam War[1] ended in 1975, to honor revolutionary hero Ho Chi Minh). Soon after start-up, two friends Roy Hai Nguyen and Anh-Minh Do joined Chris to be actively involved in developing this unique start-up. All three friends share a passion of helping to develop the entrepreneurial ecosystem in Vietnam and strongly believe that Saigon Hub can make a significant contribution toward developing entrepreneurs. On the website (www.saigonhub.vn), Saigon Hub is described as "A world-class, coworking community and event space… that provides a great environment for free-lancers, entrepreneurs, small business owners, digital nomads and early-stage investors to connect and cocreate successful new ventures."

Basically, Saigon Hub is a high-impact incubator (provide space) and accelerator (space and training or mentoring) that provides opportunities for entrepreneurs to work and network with other entrepreneurs, in order to help each other develop start-ups. Entrepreneurs can participate in events (for example, a three-hour "Start-up Competition 2013 Workshop") organized by Saigon Hub and engage in hands-on training provided by Chris and a hand-selected group of experienced entrepreneurs and mentors.

The three friends have tried to develop an environment that supports creativity and collaboration as a way to inspire entrepreneurs to develop and successfully start innovative and scalable new ventures. Membership is $5 per day or $90 per month, which includes a quiet cospace working

[1] In Vietnam this war is referred to as the American War

area; eight meeting-room hours per month; high-speed Wi-Fi; free coffee and snacks; printer, scanner, and fax access; mentorship programs; and investor matching. Saigon Hub also provides additional benefits for a wide range of fees, from hourly rates for meeting space ($4 to $6 per hour for a meeting room) to monthly rates for a variety of services (from $5 per month for a huge locker to $30 per month for a dedicated seat). After 4 months, there are 40 members with only 20 members short to break even, which Chris hopes to realize in two months.

So who are these three young guys, ranging in age from mid-20s to mid-30s—Chris (35), Roy (28), and Anh-Minh (27)? Chris is an American-Vietnamese U.S. citizen, also called an overseas Vietnamese (*Viet Kieu* in Vietnamese), who returned to Vietnam in 2005 to pursue his passion for creating and funding start-ups and educating young entrepreneurs, to help develop the entrepreneurial ecosystem in Vietnam. Chris has U.S. degrees from the University of California system (Berkley and Davis) and has been both a successful entrepreneur in the United States and Vietnam and an active angel investor, including, investing in four sustainable new ventures in Vietnam. Roy Hai Nguyen is a local Vietnamese who had studied in the United States (California State University, Long Beach) and shares Chris' passion for developing an entrepreneurial ecosystem. Roy has founded or cofounded six businesses: three for-profit and three social organizations that help develop entrepreneurs, including Saigon Hub. Anh-Minh (University of California, Santa Cruz) is editor of *Tech in Asia* where he writes about the start-up scene in Vietnam and helps organize events that promote entrepreneurship and start-ups. Similar to Chris, Minh is also an American-Vietnamese, Viet Kieu, and relocated to Vietnam more than eight years ago. All three friends have also worked together in a previous venture called StartUp.vn or Start-Up Vietnam, which is a technology-focused online media platform (http://startup.vn/) with a mission to "connect, educate and inspire entrepreneurs in Vietnam through events like workshops, trainings and conferences."

When you walk into the Saigon Hub's third floor 300 square meter workspace, you will typically see 15 to 20, mainly young Vietnamese, aspiring entrepreneurs quietly working on their computers attempting to create their start-ups. Over on the wall next to the support-staff desk are

the prominently displayed signed photos of all the current Saigon Hub members, so that everybody knows their name.

Doi Moi

Vietnam is a communist country but has been moving toward a market economy since 1986. More specifically, this transition from a command economy to a market economy has been labeled by the Vietnamese as Doi Moi or *renovation*. The outcome of doi moi has been impressive politically and economically. U.S. President Bill Clinton eliminated the U.S. embargo on Vietnam in 1994 (installed because of the Vietnam War), diplomatic relations between the United States and Vietnam were restored in 1995 and, along with other significant events discussed as follows, the culmination of this transition was Vietnam's accession to the World Trade Organization (WTO) in 2007. Economically, Vietnam has shown fairly consistent growth since the 1997 Asian financial crisis and commensurate with increasing economic vitality has been an increased optimism about Vietnam's venture capital (VC) potential because of its strengthening entrepreneurial ecosystem (Taussig et al. 2012).

Two Waves of Venture Capital

Venture capital is a relatively recent phenomenon in Vietnam with the first VC firm being introduced to Vietnam in 1991 because Western investors became increasingly enamored with the unsubstantiated view that Vietnam could be the next economic tiger. Until 1995, this first phase of private equity (PE) investment showed a gradual but consistent annual increase in the number of firms to a grand total of eight VC firms operating in Vietnam. Since 1996, VC activity plateaued and the number of active VC firms declined to only five by 1998 (Scheela and Nguyen 2004). The major reasons for this decline were the 1997 Asian financial crisis having a significant negative impact on Asian institutional investors; the difficulty of both, finding quality deals and providing effective postinvestment monitoring of VC's portfolio companies; and the delay in developing a stock market in Vietnam (Scheela and Nguyen 2001). Not surprisingly,

all of the funds, operating in Vietnam, reported disappointing results and many closed their funds and left (Scheela and Nguyen 2001).

A second wave of PE interest commenced at the beginning of the 21st century. In 2000, new regulations were implemented supporting private enterprise and entrepreneurship as a priority to provide sustainable economic growth, followed by a bilateral trade agreement in 2001 with the United States and, in 2002, the much-delayed opening of the stock market in Ho Chi Minh City (Taussig et al. 2012). Subsequently, foreign PE firms, many under the direction of overseas Vietnamese (Viet Kieu), set up operations, which were both, more knowledgeable about Vietnam in general and Vietnamese culture, more specifically. Also, the new VCs were much more experienced business executives than their PE predecessors who were primarily foreign lawyers and investment bankers with minimal knowledge about Vietnam and limited business operations and management skills (Scheela et al. 2012a).

While as many as 15 PE firms were listed by the Asian VC Association as having an office in Vietnam in 2007, our most-recent field research in 2012 and 2013 identified a much smaller number of active VC firms. Basically, only three VC firms (Mekong Capital, IDG Vietnam Venture, and Vina Capital) have developed a credible reputation among entrepreneurs and PE pundits for making significant equity investments in early- and growth-stage companies and providing hands-on monitoring to their portfolio companies. Table 3.1 shows the evolution of the VC industry from 1998 to 2013 in terms of industry characteristics, investing challenges, and fund performance, based on our interviews of VCs.

While VCs report that it is still difficult to do business in Vietnam because the concept of VC is not fully understood ("VC is still in its infancy," said by one VC investor in 2007; another compared VC investing to "spring training" in professional baseball, in 2012), fund performance has significantly improved. In 2007, VCs reported that 75 percent of their VC funds are meeting or exceeding expectations compared to 0 percent in 1999. Yet institutions are still perceived as being challenging, quality deal flow is limited, exits are continuing to be difficult, and working with overseas Vietnamese is problematic in terms of getting them to return to Vietnam and sometimes being difficult to work with because of cultural differences in spite of Viet Kieu's Vietnamese ethnicity.

Table 3.1 Venture capital characteristics, challenges, and performance

1998–1999 (5 firms, 11 VCs interviewed)	2004 and 2007 (4 firms, 6 VCs interviewed)	2012 and 2013 (3 firms, 3 VCs interviewed)
Characteristics		
Misunderstood VCs	VC in infancy	Lack of good managers
Investment management	Small deals	Low PE ratios; good time to invest
	Poor returns	Only 3 VC funds
	Generalist investors	More expensive deals
	Foreigners focus on state-owned firms	VCs and entrepreneurs getting smarter
	Exit is difficult	Government understands PE
	VC in infancy	
Challenges		
VC's survival	Deal flow/Limited larger deals	Finding top and functional managers
Deal flow	No transparency	Instilling best-practices and discipline
Exit execution	Weak legal infrastructure	Government regulations and corruption
Limited transparency	Too many VCs	
Poor investment climate	Challenging due diligence	
	Reimmigration of Vietnamese	
Fund performance		
Below expectations: 100%	Below expectations: 25%	Below expectations: 20%
Meeting expectations: 0%	Meeting expectations: 25%	Meeting expectations: 60%
Above expectations: 0%	Above expectations: 50%	Above expectations: 20%

Source: Scheela et al. (2012a).

By 2012, many of the PE firms were focusing on larger investments in later-stage firms that were close to listing on the stock market. Only three PE firms had at least one fund that was a true VC fund. VCs indicate an improvement in the PE investment climate with a growing number of both smarter entrepreneurs and VCs, along with the government being more knowledgeable about PE. But finding good managers is the major

challenge along with the difficulty in applying Western best-practices management to portfolio companies. Even though government is still a major problem, VCs report 80 percent of their funds are meeting or exceeding performance expectations.

Business Angel Investing

Table 3.2 shows the profile and investing performance of business angels (BAs) investing in Vietnam, based on eight interviews conducted from 2007 to 2012, with seven of the interviews conducted in 2011 to 2012. These BAs are both highly educated and experienced investors. All eight are college graduates and six have earned advanced degrees. On average, these BAs have been investing for almost 6 years ranging from 2 to 13 years.

We asked each BA to tell us how much money they can access when investing in companies and how much they have invested so far. This

Table 3.2 Business angel profile and fund performance

Profile (n = 8)	Investing performance
Fund size • Range: $250K–1.5M • Mean: $800K • Median: $750K	Number of years investing • Range: 2–13 • Mean: 5.9 • Median: 5
Investment size • Range: $5K–200K • Mean: $72K • Median: $53K	Number of years for exit • Median: 4 years
Number of deals • Total: 61 • Range: 3–30 • Mean: 7.6 • Median: 4	Investment stage • Seed: 51% • Early: 33 • Growth: 16 • Late: 0 • Other: 0
Number of co-investors/deal • Range: 1–12 • Mean: 5.5 • Median: 5	Fund performance versus expectations • Below: 13% • Average: 38 • Above: 50 • Too early: 0
Level of education • Baccalaureate: 2 • Masters: 5 • Law: 1	

Source: Scheela et al. (2012a).

combined amount would be comparable to a formal VC fund where some funds have been invested and some are remaining to be invested, either as follow-on investments in a portfolio company or invested in new deals. BAs have access to significant VC funds' ranging from $250,000 to $1.5 million. On average these BAs invest $72,000 per deal in primarily seed and early-stage companies (84 percent of deals). Only one BA invests alone, while the remaining BAs always co-invest with typically four to five other BAs. These BAs are very active investors generating investments in 61 companies (median of four investments per BA) with fairly positive results as 88 percent of BAs report their respective funds are meeting or exceeding expectations at the time of their investments.

BAs aggressively network to find deals, and they source their funds for investments primarily from savings. Fifty percent of the BAs prefer to invest "close to home" in Vietnam or the United States, but four BAs have a global view when investing. All eight BAs have developed a specific investment strategy when doing deals ranging from investing in a growth business to businesses that "are exciting with positive cash flows." All eight BAs indicate they are active, hands-on investors who each average 4.5 board seats. Six BAs report spending at least 25 percent of their time, on a weekly basis, working actively with their portfolio company management teams.

Investments are held for a median of four years, one BA has liquidated two failed investments, another BA has no plans to exit ("I will give the shares to the employees"), four will sell via a trade sale, and three BAs anticipate exiting through an initial public offering (IPO) in the future. None of the BAs is yet to make a successful exit.

We asked each BA to identify his or her preferred industry for investing and to also identify the key characteristics that make the industry(s) attractive. BAs tend to invest in industries that are very diverse ranging from high tech (e-commerce and software) to low tech (forest products and mining). What they know is what they primarily invest in. Although, two BAs were more interested in industries that potentially offered high returns and good ideas, regardless of their business experience.

Table 3.3 shows the challenges reported by BA investors and their recommendations about how to improve PE investing in Vietnam. Not surprisingly, BAs' investing challenges are very similar to VC challenges in Vietnam. Weak institutions, especially ones with a lack of protection

Table 3.3 Business angel challenges and recommendations

Challenges	Recommendations
Private investing is challenging • No legal protection in general • Minority shareholders not protected • Risk of entrepreneurs cheating • Unprofessional board members • Lack of long-term investors • Lack of business planning • BA co-investing responsibilities not equally shared • Lack of trust • Weak corporate governance and transparency • Difficult to develop personal relationships Dealing with the government • Developing the correct legal structure • Takes time to restructure a business • Dealing with government corruption • Difficult exits • Government policies change constantly • Excessive red tape • Unhealthy competition	Government leadership • Need more mergers and acquisitions • Better legal and financial institutions ○ Easier liquidation of SME • Tax incentives for private investors • Better investment climate • Corruption must be punished • Better government transparency • Government stability Education • Educate future BA investors • Current BAs must learn more about investing • Better understanding about VC and equity financing • Better high school and university education about entrepreneurship • Use Silicon Valley (United States) as an investment model Increase BA investing • There is need and capacity for more BAs • Need Vietnamese-Americans to invest in Vietnam • Form a business angel club • Better access to bank financing for BAs and entrepreneurs

for minority shareholders, is very problematic for BAs. Weak institutions are further portrayed by weak corporate governance and both corrupt entrepreneurs and government officials. Unfortunately, government is perceived by BAs as part of the problem instead of representing the solution to enhance the PE investing process. Transactions costs for doing business are further increased due to excessive government red tape and continually changing policies, which increase the time to start or restructure a business and exit an investment.

BAs don't lack for recommendations when asked specifically, "What would you like to see in the future for the informal investing industry in Vietnam?" In spite of BAs' distrust of government, they strongly support "government leadership" as the most important factor in providing institutional support to improve the investment climate. More specifically, the

government needs to improve political, legal, and financial institutions to enhance and increase PE investing, in general, and BA investing, in particular. Education also needs to play a role as BAs believe education about PE is needed at the high school and university levels, along with training BAs about the investing process. Improving political and educational institutions will result in the third recommendation of significantly increasing BA investing by developing more professional investors, encouraging overseas Vietnamese to invest in early-stage companies, and developing BA networks, so better deals can be found and bigger deals can be funded.

Collectively, both BAs and VCs (more recently) report positive investment returns in spite of investing in a business climate that does not adequately support PE investing. Even though these investors have survived in a country correctly identified as possessing a very significant institutional void, they have developed investment strategies generating quality returns. Is Vietnam unique in emerging Asia in terms of generating solid returns for PE investors? We shall find out as we now analyze Filipino PE investors in the next chapter.

CHAPTER 4

Philippines

Investment and Capital Corporation of the Philippines Venture Partners[1]

Investment and Capital Corporation of the Philippines Venture Partners (IVP), a Manila-based venture capital (VC) firm, is part of the Investment and Capital Corporation of the Philippines (ICCP) Group, which started in 1988 as a licensed investment bank. The ICCP Group's major shareholders represented a cross section of some of the most prominent foreign and domestic financial institutions operating in the Philippines. ICCP comprises four major divisions: property development, management services, investment banking, and VC.

Investment and Capital Corporation of the Philippines Venture Partners was founded in 1997 and quickly became one of the most significant VC firms in the Philippines. IVP's management team is fairly lean, consisting of only four senior managers and seven professional staff. IVP immediately developed a global focus and opened an office in Menlo Park, California in the United States to complement its Manila office. While each team member had particular areas of expertise, they were primarily generalists with good people skills, a combination highly valued by IVP. Senior Managing Director William (Billy) Valtos (American) believes one of the competitive advantages of IVP is the team's ability to conduct exhaustive due diligence when analyzing potential deals. Billy uses an American football analogy to explain the relationship between IVP and its portfolio companies, where IVP's team are coaches who help develop a game plan, the portfolio company is the team, and the entrepreneur or CEO is the quarterback who has to execute the game plan in order to win (and keep the coaches happy).

IVP has raised five relatively small funds ($10M to 20M) from 1998 to 2012. Based on the performance of IVP's first three funds, Cambridge

[1] Case study primarily based on Scheela (2009).

Associates ranked IVP in the top quartile of Asian VC funds. As of June 2013, IVP has made 49 investments in 34 portfolio companies with 23 U.S.-based companies and 11 located in Asia (ICCP Ventures Partners 2013). Exits were primarily via trade sales (14 companies), but there were also five initial public offerings (IPOs) with three write-offs.

IVP has a unique global "Trans-Pacific" investment strategy as they invest in both Asian and non-Asian companies, where IVP can provide an Asian linkage to increase competitive advantage, primarily in manufacturing and distribution. For IVP's U.S.-based portfolio companies, the VCs provide linkages to potential customers, contract manufacturers, outsourcing, and other service providers in Asia. For Asia-based investments, IVP provides its portfolio companies introductions to potential customers and technology providers in the United States. These U.S.-Asia cross linkages are the foundation of IVP's Trans-Pacific investment strategy. More specifically, IVP's strategy is to combine U.S. technological innovation with Asian cost-effective contract manufacturing and business process outsourcing. IVP will invest in early- to growth-stage ventures in both Asia and the United States and facilitate cross-border linkages between Asia and the United States, through its offices in Manila and Menlo Park, California. IVP believes its competitive advantage is its proven ability to link its U.S. portfolio companies with Asian partners, primarily in the Philippines.

IVP also believes that the Philippines has a competitive advantage over China because the Philippines is the only former U.S. colony in Asia, where English is widely spoken, and Filipinos have a better understanding of the American culture. In terms of developing a positive environment for private equity (PE) investing, IVP senior management believes that the Philippines provides legal and financial institutions that are more consistent with U.S. standards.

Deal flow is primarily from the United States (56 percent) and the Philippines (35 percent). But IVP is not totally U.S.-centric as shown by their investment in DirectWithHotels (DWH), which I introduced as part of the introductory case studies in Chapter 1. Entrepreneur and DirectWithHotels CEO Emiliano Zulberti located in the Philippines because of its impressive supply of low-cost software developers and impressive quality of life. But Emiliano's strategy is to avoid the U.S.

market and develop websites for primarily non-U.S. hotels that typically are not as technologically sophisticated as U.S. lodging chains, thus providing a larger market and need for a sophisticated website developed by a service provider such as DWH.

Venture Capital[2]

The Philippines has the second smallest PE market of the five emerging countries, (see Table 2.2 in Chapter 2) yet it has one of the oldest VC presence in emerging Asia. VC was formally introduced to the Philippines in the 1980s when relatively small bank-related VC funds ($250K) were established by Philippines' government. The first independent VC fund was introduced in 1987 by Hambrecht and Quist, a major American VC firm, which set up a $20 million fund. The first domestic VC fund was established in 1989 under the sponsorship of the Asian Development Bank, International Finance Corporation, Commonwealth Development Bank (United Kingdom), and Germany's Deutsche Entwicklung Gesellschaft. While the *Asian Private Equity 300* report lists 21 private equity firms that are operating in the Philippines, our research has identified only 3 to 5 VC firms that are actively investing in unlisted small- and medium-sized enterprises (SMEs) during the past 10 years.

Similar to our research in Vietnam, we asked each VCs to describe PE investing in unlisted SMEs in the Philippines in terms of both the key characteristics and challenges and investment performance. A summary of their responses for 2003 and 2004 (five most active firms) and 2010 (two most active firms) are shown in Table 4.1.

Venture capitalists describe PE investing in the Philippines as "still… immature"; that is, still being undeveloped compared to developed Western countries, where there are a large number of significant funds raised and managed by experienced VCs. The developing Philippines' VC industry exhibits a small number of active key investors (the number of active VC firms decreased significantly from 2004 to 2010 and the "limited number of VCs" is cited as critical weakness by a VC) managing small investment funds (about $20–30 million per fund) and doing small deals.

[2] The analysis in this section comes primarily from Scheela et al. (2012a).

Table 4.1 Venture capital characteristics, challenges, and performance

2003–2004 (n = 5)	2010 (n = 2)
Characteristics • Entrepreneurs open to VCs • Small funds and deal size • No financial transparency • Syndication among top VCs	*Characteristics:* • *Immature VCs* • *Low technology focus* • *Risk-averse institutional investors* • *Limited number of VCs* • *Small deal size*
Challenges • Maintaining VC presence • Limited IPOs • No funding from institutional investors • Few global investors; only focus on domestic market • High entry valuation from entrepreneurs	*Challenges:* • Deal flow • Misunderstand VC • Hands-on investors; active/close monitoring of investees • Difficult to find LPs/institutional investors • No experienced VCs
Fund performance • Below expectations: 80% • Meeting expectations: 20% • Above expectation: 0%	*Fund performance*: • Below expectations: 0% • Meeting expectations: 25% • Above expectations: 75%

Source: Scheela et al. (2012a).

Because of the limited number of VCs and small deal size, VCs work together syndicating deals for larger investments.

While entrepreneurs have become familiar with VCs ("less wary"), they are still perceived by VCs as not fully understanding the concept of VC and also the process of VC investing. The VCs express concerns about a lack of portfolio company transparency, which makes due diligence more important but time consuming and expensive, thereby increasing transaction costs. The lack of transparency is an issue with both VCs and their institutional investors or limited partners. VCs perceive institutional investors as being "risk averse"; especially, foreign institutional investors who are hesitant to invest in the Philippines. Some VCs are critical of local entrepreneur's lack of focus on starting and developing high-tech companies. As explained in the introductory case study for this chapter, IVP has developed the strategy of investing into high-tech U.S. investee companies that are founded by ethnic Filipino-Americans (typically in Silicon Valley) who will, as part of the investment deal, transfer or outsource some operations to the Philippines to create significant competitive advantage.

The challenges facing VCs are many. Finding good deals is increasingly frustrating along with the challenges of finding experienced VCs for both deal networking and syndication It is difficult to convince limited partners to invest into a Philippine country fund versus investing into a China fund or a more regional Southeast Asian fund because the Philippines as a market is considered to be too small. VCs also face serious problems of government corruption and bureaucracy. It is also very problematic to exit via an IPO in the Philippines because of the small size of the stock market and the bureaucratic process for SMEs to list. Collectively, these challenges have made maintaining an investment presence in the Philippines very difficult for VCs. Because of the immature stage of PE investing in the Philippines due to the lack of developed legal and financial institutions, VCs must be hands-on, active investors, and network with other VCs to find quality deals.

As shown in Table 4.1 under *Fund performance*, VCs report increasing satisfaction with their investments from 2003/2004 to 2010. Initially, they reported 80 percent of their investment funds performing below expectations, which is in stark contrast to 0 percent performing below expectations and 100 percent of their funds meeting or exceeding expectations more recently. Because of the lack of fully-developed institutions, VCs in the Philippines have developed an effective investment strategy based on networking with other private investors, conducting in-depth due diligence, and being very active, hands-on investors that has resulted in improving financial returns (Scheela 2006). Yet, maintaining a vibrant VC industry continues to be challenging.

Business Angel Investing[3]

We interviewed 29 BAs who were active investors in primarily seed- and early-stage companies. All of the interviews took place in the Philippines (24 in Manila and 5 in Cebu), and averaged about 90 minutes. Twenty-eight of the BAs are from the Philippines and one is a foreigner who is living in Manila and has significant business experience in the Philippines. Twenty-six investors are men and three are women. These BAs are highly

[3] Much of this section is summarized from Scheela and Isidro (2009).

educated as they all have university degrees and 21 have advanced degrees (Scheela and Isidro 2009).

Table 4.2 shows the descriptive statistics (mean, median, and range) for the 29 investors. All 29 investors have previous work experience and they have been investing in companies or deals for an average of 18 years.

The average or mean amount of investment funds managed per investor is not applicable because one investor is a significant outlier with a $300 million investment fund. This results in a distorted average investment fund of $13.77 million per investor for the 29 BAs. However, only one BA has developed an investment fund that is larger than the average and 28 investors have funds that are significantly less than the average amount. In this situation using the median amount invested per investor provides a more accurate description. The median (the middle amount with 50 percent above the median and 50 percent below) total amount already invested or available for investments per BA is $1.8 million In terms of how much each business angel invests per investment deal, the median investment range per investment for each investor is $100,000 to $250,000.

Table 4.2 Business angel profile and fund performance

Profile	Investing performance
Fund size • Range: $40K–300M • Mean: not applicable • Median: $1.8M Investment size/deal • Range: $1K–3M • Mean: $133K–1.7M • Median: $100K–250K Number of deals • Total: 238 • Range: 2–30 • Mean: 8.2 • Median: 6 Number of co-investors/deal • Range: 0–10 • Mean: 3.7 • Median: 3.0	Number of years investing • Range: 1–35 • Mean: 18 • Median: 19 Number of years for exit • Median: 5.0 Investment stage: • Seed/Early: 85% • Growth: 8% • Late: 7% • Other: Fund performance • Below: 14% • Average: 38% • Above: 41% • Too early: 7%

Source: Scheela et al. (2012b).

Note: K = thousand; M = million.

Most of the BAs invest with partners, resulting in an average of 3.7 co-investors for each investment. In total, the 29 Business Angels have invested in 238 companies, which are comprised of 203 early-stage companies and 19 growth-stage companies. To date, each investor has made, on average, a cumulative total of over eight investments with a median number of six investments per BA. Because of the wide range of investments per investor (2 to 30), the median is probably a more realistic descriptor of the number of total investments per business angel.

BAs overwhelmingly source their investment funds from personal savings and tend to focus their investments on investee companies operating in the Philippines and preferably in Manila. However, seven BAs are open to investing in companies operating outside of the Philippines. In terms of using an investment strategy, 25 BAs acknowledged that they have formulated a strategy, which they use to identify and invest in companies, while four investors are simply open to a broad range of investment opportunities.

Twenty-four of the BAs are active, hands-on investors, who average five board seats per investor, while five investors consider themselves to be passive investors. The latter investors do not fully fit the definition of a BA because of their lack of involvement with their investee companies. This is surprising considering all 29 BAs are both highly-educated in business and have significant business experience.

Investments are typically held for five (median) years with the exit strategy being primarily a trade sale to a third party. IPOs, while technically possible, are not perceived as a viable exit, especially in the Philippines, because of the lack of a fully-developed securities market.

Similar to our interviews of Vietnamese BAs, we asked each BA to identify his or her preferred industry for investing and to also identify the key characteristics that made the industry(s) attractive. There is a wide range of preferred industries for investing, real estate and business services being the most preferred followed closely by technology services, agribusiness, and trading or retail. Combining all service industry preferences (technology, financial, and business) strongly supports a significant interest in investing in early-stage service businesses. Industry attractiveness criteria are even more dispersed than industry preferences. It appears that BAs have a very clear understanding of the most significant criteria that make an industry attractive within their preferred industries.

Table 4.3 Business angel challenges and recommendations

Challenges	Recommendations

Convince foreigners to invest
• Fund raising is difficult
• Declining disposable income
• Small market size
	Form a BA club/network
	• Develop a deal database
	  ○ Identify success and failures
	  ○ Website listing deals

Finding the right people • Investment partners • Entrepreneurs • Managers	Education • Entrepreneur's understanding of BAs • "How to do a deal" • International deals via U.S. dollar • Large company mentoring • Fund student business plans
Finding opportunities • Need to educate about private equity • Be patient in doing deals • Accurately estimate market size	Further institutional development • Protect foreign investors • Improve peace and order • Decrease corruption • More aggressive banks
Poor economic performance • Weak currency • Political and social risk • Focus on survival	Develop over-the-counter SME trading • Improve SME transparency • Minimal restrictions to buy and sell • Provide access to funding
Dealing with red tape/bureaucracy and corruption • Lack government programs for entrepreneurs • Improve tax collections	Improve the investment climate • Public and private funds for start-ups • More VCs doing smaller deals • Form a VC association • Change the mentality of family businesses

Source: Scheela et al. (2012b).

Investment performance as reported by the BAs is very positive as almost 80 percent (79 percent) of the business angels evaluate their overall investment performance as meeting expectations (average) or performing above expectations.

The challenges of angel investing in the Philippines are shown in Table 4.3, reflecting a poor investment climate. BAs have difficulties in finding the right people (entrepreneurs, co-investors, and managers) in order to do deals. This challenge is further increased because it is also difficult to convince foreign investors to enter the Philippines because of the small country market, currency risk of the peso, political instability, and government red tape and corruption. Consequently, it is important for

BAs to be patient investors and conduct in-depth due diligence for each potential investment.

Each BA was asked to make recommendations on how to improve PE investing in small companies in the Philippines. Table 4.3 shows the major recommendations; basically, there are two sets of recommendation.

First, BAs strongly supported the creation of a BA club or formal network to improve both the effectiveness (being able to do a deal) and the efficiency (reduce transaction cost of a deal) for investing purposes. This was the dominant recommendation; specifically, to form an organization in order to enhance and streamline the investment process and to educate entrepreneurs about PE investing. According to many of these BAs, this club should provide a forum for entrepreneurs to present business plans to potential investors and, more specifically, for the club or network to provide specific services to enhance the investment process for club members. Services could include, screening the entrepreneurs or business plans before they are presented, publishing the minutes of club meetings, developing a database of deal making activities, creating a website that lists possible investments, and educating both entrepreneurs and investors about the investment process.

The second major recommendation is to support the government in developing more effective institutions to enhance the investment climate in the Philippines. This includes reducing political and legal risks, which should result in both more investments in SMEs and foreign direct investment (FDI) in the Philippines, in general. Also, financial institutions need to be improved in order to increase bank support for SMEs and to improve IPO exit strategies in the Philippines, by reducing the current listing requirements for SMEs. According to the BAs, this second set of recommendations could also be a significant responsibility of a BA club, whereby recommendations on institutional development and listing requirements are generated and formally proposed to the government.

Similar to Vietnamese PE investors, both VCs and BAs in the Philippines agree there are significant institutional challenges facing PE investors, which has resulted in investing in a country typified as an institutional void. To rectify this challenge, Philippine PE investors agree with their Vietnamese counter parts that the government must play a leading role in aggressively reducing the institutional void by developing more

effective legal and financial institutions. Also, BAs in both the Philippines and Vietnam strongly support creating business angel networks, which should decrease investment risk and transactions costs and increase the number of quality deals for BAs and commensurately increase PE investment opportunities for entrepreneurs.

In Vietnam and the Philippines formal PE networks are not developed and only Filipino and Vietnamese BA investors actively support the development of BA clubs. Neither country has developed a VC association or a business angel club. In the next chapter, we will analyze an emerging Asian country that has both a VC association and a BA network: the Kingdom of Thailand.

CHAPTER 5

Thailand

Thai-Chinese Investment Association[1]

Many Chinese have migrated to Thailand since the 18th century for various reasons, most notably to escape from poverty, politics, and wars. Compared with people from other Southeast Asian countries, Chinese in Thailand have been more successful in being assimilated into the host country. Typical new-generation Thai Chinese speak fluent Thai, understand, and practice Thai culture but still keep some traits of their Chinese identity, not as a national identity, but more as cultural and class identities. Although originating from humble beginnings, the second and third generations of Thai-Chinese descendants eventually controlled much of Thailand's trade, manufacturing, and services industries, and have now become the most powerful ethnic group in Thailand's business community.

Because of the lack of fully developed institutions needed to effectively do business in Thailand, most Thai-Chinese small- and medium-sized enterprises (SMEs) developed ways of operating outside the standard legal framework with minimum contacts with the government. Many Thai-Chinese entrepreneurs perceive the government and legal community as causing more problems than offering solutions. Thai-Chinese business men and women formed associations, which provided its members a sense of belonging and security; an informal institution one can trust and rely on when doing business.

Currently, there are nine Thai-Chinese associations in Thailand, with each association congregated by its unique dialect group, namely, Chaozhou, Hakka, Hainanese, Cantonese, Fujianese, and other small dialect groups. In practice, there are negligible cultural differences

[1] Unpublished paper written with Jittrapanun (2009).

between each association, and they collectively promote Mandarin as the only language. The Hainan Association of Thailand was originally founded by Hainanese traders. The Association currently consists of 150 committee members and 7,000 regular members. The committee members are elected every two years and are expected to donate a monthly fee (plus larger donations for special projects) that is used to pay for the association's monthly activities' expenses. In total, each committee member is expected to contribute about $10,000 annually.

Hainanese businessmen initially focused on investing in hotels, lumber, restaurants, and retail businesses. Subsequent generations have expanded into manufacturing, which traditionally was dominated by the Chaozhou business group. Thai Chinese entrepreneurs and investors are continually investing and building their businesses (empires, in some cases) and then passing them on to the next generations. There is rarely a formal plan for succession and exiting the business; instead, businesses are bought and sold among friends and business partners as needs arise. Forming partnerships is a common business practice typically through an informal form of financing called *Share Ring*, which is an alternative or supplement to bank loans, especially for those entrepreneurs unable to get financing.

With increasing financial business success, many association members invest in projects and new ventures using debt or equity, or both, to foster new businesses. This investment process is totally based on networking among trusted friends, associates, and family members. These interactions help minimize transaction costs and act as an informal institution for efficient investing. Networking is essential for the survival and success of Thai-Chinese businessmen and investors operating in an environment characterized as lacking adequate institutional support. Thai-Chinese associations, besides providing social benefits, also provide services similar to a business angel (BA) network.

Today, one of the largest shopping centers and hotel and resort chains in Thailand, the Central Group, is controlled by a Hainanese family clan, and according to *Forbes'* rankings, nine out of the ten wealthiest individuals in Thailand are Thai Chinese. Beyond these very successful business families are thousands of Thai-Chinese SME entrepreneurs and investors whose investments spawn countless new ventures across the Kingdom.

The Hainan Association of Thailand is the primary provider of BAs to our BA field research sample in Thailand.

Venture Capital

The venture capital (VC) industry in Thailand developed in three phases starting in 1987 (Pinvanichkul and Wonglimpiyarat 2011). Similar to the Philippines, the first phase involved the introduction of foreign VC firms, which were instrumental in creating a domestic interest in raising VC funds. The second phase began in 1997 with the Asian financial crises and, not surprisingly, resulted in the closing of some domestic and foreign VC firms. The third and current phase commenced in 2002 commensurate with Thailand's significant economic recovery from the crisis because of the introduction of government policies strongly supporting SMEs to lead economic development. The increased government focus on SMEs resulted in the return of many domestic and foreign VC firms, along with the creation of new investment funds. A major organization that provided economic leadership for SMEs is the Thai government Office of Small and Medium Enterprise Promotion (OSMEP), which also initiated funding along with the Thai VC Association for our research on both VC and BA financing in Thailand.

Similar to Vietnam and the Philippines, very little research has focused on VC in Thailand. Not only was the Asian financial crisis a significant economic event for the region, Thailand was actually ground zero, and its impact on institutional development, besides VC investing, was extremely problematic., As explained previously, Thailand has rebounded and is now home to foreign and domestic VC firms;yet, it is still in the developing phase and clearly fits the developing status when compared to Singapore and the United States (Table 2.5b in Chapter 2).

Thailand's investment climate and private equity (PE) and VC industry have much more in common with the Philippines, Indonesia, and Vietnam in terms of the amount of average annual PE investments. While Thailand's VC industry is significantly smaller than that of Singapore, it is the second largest of the five emerging countries in this study. Similar to Vietnam and the Philippines, not all of the Thai VC firms that are listed in various country VC directories are, in fact, active PE investors. Based

on guidance from the Thai VC Association, we interviewed 10 venture capitalists (VCs) from the most active investment firms in Thailand.

As shown in Table 5.1, Thailand shares some of the same industry characteristics with Vietnam and the Philippines in terms of a transitioning and restructuring VC industry: most of the deals are relatively small, government corruption is problematic, and the lack of experienced professional VCs. The major challenge, finding good deals, is similar to Vietnam and the Philippines as is the need to conduct in-depth due diligence because of the lack of legal institutions to protect equity investors and the lack of access to public industry data. Exits are also difficult as is closing the deal because of the formative stage of the VC industry, which makes initial public offerings (IPOs) for relatively young companies unfeasible. VCs report 60 percent of their investment funds are meeting or exceeding expectations, which is more in line with the Philippines' assessment in 2010, yet 40 percent of the funds are not meeting expectations.

An investment strategy pattern may be emerging from these three emerging economies that of VCs being very keen to invest in promising

Table 5.1 Venture capital characteristics, challenges, and performance, 2007

Characteristics	*Challenges*	*Fund performance*

• VC industry is in transition and restructuring
• Small deal size
• Decreased corruption since 1997
• Inexperienced VCs
  ○ Lack of operating experience
• Most Thai companies are too highly leveraged
• Thailand lacks a significant competitive advantage
	• Finding good deals
	• Closing a deal is difficult
	• Doing in-depth due diligence is difficult
	  ○ Lack of public industry data
	  ○ Many investee companies maintain three sets of financial statements
	• The VC industry is young and undeveloped
	• Exit strategy is increasingly difficult
	  ○ IPOs are very limited due to low PE ratios
	  ○ Entrepreneurs resist trade sales
		• Below expectations: 40%
		• Meeting expectations: 20%
		• Above expectations: 40%

Source: Scheela and Jittrapanun (2008).

SMEs operating in an emerging economy but struggling to do deals in institutional voids. So to do a deal in this type of challenging business environment, VCs must conduct time-consuming (and therefore expensive) in-depth due diligence and practice a very hands-on postinvestment strategy with each portfolio company. In spite of these institutional challenges, VCs report fairly positive investment returns.

Business Angel Investing

We interviewed 20 BAs in Bangkok: 5 female and 14 male Thai-Chinese investors (one BA requested not to divulge his or her gender) who are all members of the Hainan Association of Thailand. We identified association members who were active equity investors in private SMEs. Similar to our BA research in other emerging Asian countries, BAs were asked to provide descriptive data about their respective investment strategy, fund performance, and investment environment. All 20 BAs are high school graduates, 18 have earned a bachelor's degree, and 11 have also earned a master's degree. The high education level is partially explained by the fact that most of the BAs in this study are second and third generation family members who have the resources and family support to pursue higher education. Table 5.2 shows the average profile of a BA in this study. All BAs have significant business experience in a wide variety of industries. The average length of investing in companies for each BA is 16.1 years within a range of 2 to 50 years. Each BA, on average, serves on 2.4 boards.

The emerging Asian BAs in our three-country samples compare favorably to the developed-country Asian BAs in Japan (Kutsuna and Harada 2004; Tashiro 1999) and Singapore (Hindle and Lee 2002; Wong and Ho 2007) in terms of being highly educated and possessing significant business experience. More specifically to Thailand, the Thai BAs were more experienced angel investors (16.1 years vs. 3 years) than the Japanese BAs.

The average investment fund size for each BA is $3.33 million and the median is $2.25 million. Similar to the Philippines' BA sample, the average (mean) is skewed because two BAs' funds are significantly larger than the other 16 BA funds (two BAs did not specify a fund size). So the median size fund of $2.25 million is a better descriptor than is the average. Emerging Asian BAs do not actually create a separate investment

Table 5.2 Business angel profile and fund performance

Profile	Investing performance
Fund size • Range: $90K–15M • Mean: $3.33M • Median: $2.25	Number of years investing • Range: 2–50 • Mean: 16.1 • Median: 10
Investment size • Mean range: $2.7M–4.6M • Median range: $1.0M–1.25	Number of years to exit • Median: 7.5
Number of deals • Total: 74 • Range: 1–7 • Mean: 3.4 • Median: 3.0	Investment stage • Seed/Early: 47% • Growth: 22% • Late: 19% • Other: 12%
Number of co-investors/deal • Range: 0–10 • Mean: 3.6 • Median: 3.0	Fund performance versus expectations • Below: 25% • Average: 40% • Above: 35% • Too early: 0%

Source: Personal interviews by author (2006 to 2007)

Note: K = thousand; M = million.

fund, but primarily source their investments from personal savings or from fairly liquid assets such as selling a company; so, the investment fund represents the amount of accessible and already invested capital. BAs in all three developing countries in our study have access to significant invest funds to do deals. Vietnamese BAs report a median fund size of $750K, Filipino BAs have access to a much larger amount of $1.8 million,, which is still smaller than Thai BA's investment funds of $2.25 million.

The median initial investment range for Thai's BA in a portfolio company is relatively small at $10K to $12.5K, which increases significantly to a median of $1.0 million to $1.25 million for a follow-on investment. This follow-on investment strategy is unique in that both Vietnamese and Filipino BAs are not active follow-on investors. An explanation for this difference is that the Thai BAs invest primarily in family businesses and, as explained in the introductory case study for this chapter, continually invest in their companies.

Each BA, on average, invests with 3.6 partners, but 6 BAs prefer to invest alone. Cumulatively, the BAs, in this study, have invested in 59 companies, which is an average of approximately 3 investee companies

per BA. These portfolio companies were mainly in the seed- and early-stages at the time of investment. Collectively, seed- and early-stage companies comprise 47 percent of the total BA investee companies while growth- and mature-stage companies attract 41 percent of BA investee companies in Thailand. BAs typically hold their investments for 6.1 years and spend almost 70 percent of their time monitoring and assisting their portfolio companies. This indicates that BAs in Thailand are very active, hands-on investors, and, more specifically, 16 of the 20 BAs actually categorized themselves as active, hands-on investors. BAs have initiated the removal of 11 CEOs and 58 functional managers, which indicates that many of the 59 portfolio companies in this study have felt the impact of hands-on BA investors.

Unlike Vietnamese and Filipino BAs in our field studies, Thai BAs use multiple sources to fund their investments including personal savings (55 percent), debt (31 percent), and cash flow from existing businesses (10 percent). Most of the BAs prefer to invest in Thailand with 43 percent focusing primarily on companies in Bangkok. Only four BAs were open to investing outside of Thailand.

All of the BAs articulated an investment strategy ranging from very general ("stay ahead of the competition") to more precise ("invest in companies with few competitors that have meet a market need and have growth potential"), yet none of them had an exit strategy, which is different from the majority of Vietnamese and Filipino BAs. Relatedly, the median time frame to hold an investment for Thai BAs is 7.5 years, but the range was from 2 years to open-ended, that is, no time frame.

In terms of preferred industries for investing, Thai BA's preferences were more low tech (construction, import-export trading, and lodging as the top three preferred industries) compared to the Vietnamese and Filipinos. Why these industries? Similar to the Vietnamese and Filipinos, industry experience is the most important factor when investing, but industry growth and profit potential are also very important. Unique to Thai BAs is the importance of the family business, in that investments must also fit or be related to the family business for 7 of the 20 BAs.

Overall, the 20 BAs reported their fund performances were positive, with only 25 percent of the funds performing below average, 40 percent performing as expected, and 35 percent performing above expectations. Generally, BAs reported positive returns on their investments with

75 percent of BA's funds meeting or exceeding expectations, which compares favorably to Thai VCs reporting 60 percent of their funds meeting or exceeding expectations.

Each BA was asked to identify and explain the major challenges relevant to investing in SMEs in Thailand. We categorized their responses in terms of the frequency that each specific challenge was cited by the BAs and, in Table 5.3 we show the top five most significant challenges.

It is a challenge to operate a business in a highly uncertain and competitive environment where there is high political uncertainty, weak legal support for investors, and inefficient government support for SMEs. The challenge of political uncertainty is not surprising given that all the interviews took place fairly soon after a government coup, which occurred on September 19, 2006. More specifically, the business landscape in Thailand is a challenge because it is perceived by BAs to be extremely competitive

Table 5.3 Business angel challenges and recommendations

Challenges	Recommendations

Very competitive business environment
• Results in low profitability
• Difficult to obtain reliable data
• High personnel turnover
• Volatile market environment
Unstable political environment
• Corruption
High financial risks increase costs
• High funding costs
• Foreign investors don't understand Thailand
• Shortage of key personnel
Weak legal framework
• Political connections of big business
• Lack of government transparency
Inefficient government
• Complicated tax system
• Economic development only focuses on big cities
	Public investment for SME/VC promotion
	• SMEs to globalize
	• Emphasize successful start-ups
	• More professional entrepreneurs
	• Educate entrepreneurs
	  ○ How to do start-ups
	  ○ Understand strategy
	• Public support for banks to finance SMEs
	Improve the investment climate
	• Support from financial institutions
	• Public investment in basic industries and tourism
	• Invest in education and technology
	• More bio-tech specialists
	Better political stability and governance
	• Eliminate corruption/red tape
	• Government support for exporting
	More equitable legal system
	• Control large MNCs
	More reliable public information for deals
	• Reduce bureaucracy for small deals

Source: Scheela et al. (2012b).

and volatile for both domestic and foreign companies. BAs agree with each other and with their VCs counterparts about the lack of reliable data needed for necessary due diligence to make investments. Other factors that increase the level of competitive rivalry include difficulty in retaining employees, bad work habits, low barriers to entry, limited distribution channels, and the lack of a global vision for many SMEs. The outcome of these factors is, on average, high financial risk because of low profitability for both domestic and foreign companies.

Political, financial, and legal institutions are perceived to be obstacles for Thai-Chinese BAs operating in Thailand. These characteristics and challenges collectively indicate a lack of fully-developed institutions, which are needed to support an effective informal VC industry in Thailand. Similar to our findings in Vietnam and the Philippines, BAs in our Thai sample develop informal institutions in order to network to enhance deal making because of the many challenges of investing in an emerging economy, which we categorized as an institutional void economy.

In Table 5.3 we also show the top five recommendations from the Thai-Chinese BAs to better support BA investing in Thailand. Collectively, these recommendations strongly support the need for developing more effective government, legal, educational, and financial institutions necessary to protect investors and develop better entrepreneurs. More specifically, the government needs to aggressively reduce corruption, in general, and red tape, in particular, for SMEs and to also provide better public data to improve the due diligence process for equity investors. That is, the business environment needs to be improved for both entrepreneurs and angel investing to generate better deals. Relatedly, educational institutions need to increase the level of professionalism by educating entrepreneurs about developing global strategies and how to do start-ups. Banks need to more aggressively support SMEs, which is always a concern of SME investors. Without effective banks, SMEs are constrained to implement their aggressive growth strategies. Clearly, the government can play a major leadership role in enhancing PE investing for both VCs and BAs.

The Thai BAs did not recommend any type of formal networking system such as a BA club so deal making can be improved. Both Vietnamese and Filipino BAs strongly supported developing BA clubs to improve deal flow, due diligence, and postinvestment monitoring of portfolio

companies. This is not a surprising dichotomy because, in fact, the Thai BAs already have their BA club as all 20 BAs belong to an ethnic association that provides significant networking opportunities, plus many of the BAs focus on family businesses, which provides another layer of networking to do deals. An interesting difference, which is in need of further research, is in terms of ethnic Chinese angel financing in other countries.

The two largest emerging Asian economies in East Asia are the focus of the next chapter, which can be categorized as the paradox of the giants. China and Indonesia are the largest and fourth largest populated countries, respectively, in the world, with impressive economic growth rates and increasingly liberalized investment opportunities, yet, at least in terms of PE investing, significantly under researched, especially Indonesia.

CHAPTER 6

Emerging Asian Giants

Shenzhen Capital Group: A Government-Supported Venture Capital Firm[1]

Shenzhen Capital Group (SCGC) was established in 1999 in the southeastern Chinese city of Shenzhen, which is just across the "border" from Hong Kong. The local Shenzhen government was the primary sponsor of SCGC and invested RMB 500 million (approximately $70 million in 1999) along with RMB 200 million invested by corporate investors for an RMB 700 million initial investment fund. Although the government was the largest shareholder, the investment fund managers were given significant autonomy to professionally manage the fund and make investments based on market-economy fundamentals.

The goal was to develop an alternative support system, besides providing subsidies to local businesses, in order to significantly increase economic development. Therefore, SCGC's investment strategy was both economic and political: to provide equity financing for SMEs that were unable to get financing to effectively grow their businesses and also to become a successful investment fund management model for China's emerging private equity (PE) industry.

Until 2005, the growth of SCGC was unimpressive and highly volatile, but for the next 5 years, SCGC experienced a period of sustained high growth and by 2010 had developed a national network of investment funds in 29 provinces with funds totaling RMB 20 billion. SCGC basically manages four different types of funds: government-backed funds in cooperation with different levels of governments; commercial funds, which are VC funds; joint-venture funds, which are also VC funds, but with foreign investors; and an internal SCGC venture fund sourced from using its own capital.

[1] Information taken primarily from Harvard Business School case study 9-211-029 Shenzhen Capital Group (2012).

The Giants

As of 2010, SCGC funds have invested RMB 6 billion in 287 portfolio companies in a wide variety of industries and different investment stages. Two-thirds of SCGC's investments were relatively close to home in Southeastern China; especially in Shenzhen. SCGC has been able to successfully exit a significant number of investments through initial public offering (IPO) and trade sales. Initially, exits were primarily via trade sales or management buy-backs, but since 2006 exits have been increasingly by IPOs. SCGC was able to list its portfolio companies, both domestically and globally, to include NYSE, NASDAQ, Korea KOSDAQ, and Euronext. SCGC is now considered to be a pioneer of successful government-backed PE funding in China.

China and Indonesia are the two largest countries in our emerging Asia sample with populations of 1.3 billion and 245 million, respectively. Unfortunately, scientific private equity (PE) research is weak in China and almost totally lacking in Indonesia. Published research about PE investing in China focused initially on formal VC investing, but recently three studies have been published examining business angel (BA) investing in China. Published information about VC investing in Indonesia is exclusively industry reports from Private Equity International based in Singapore, not academic research. Unfortunately, published information about BA investing in Indonesia is almost nonexistent, except for two unpublished papers we wrote and presented at conferences, to include preliminary data for VC or BA investing based on our pilot study in 2011. While the lack of PE research in Indonesia represents a tremendous opportunity, I believe the existing published industry data along with our pilot study is very appropriate to present an introduction to VC and BA investing in Indonesia.

The Largest of Them All: China

Venture Capital

China represents one of the fastest growing markets for PE in the world, but this growth has been rather recent compared to Japan and Singapore. The first international VC firms didn't enter China until the 1990s and

the PE market developed in three waves. In the first wave foreign VCs set up operations outside of China via offshore holding companies and only transferred money to China when a deal was finalized. The Chinese government ultimately restricted the use of offshore investing vehicles by requiring a stronger in-country VC presence for foreign VC firms, which then became the second wave. Also, the government began to encourage the development of local VC funds by allowing Chinese VCs to raise funds (in U.S. currency) from foreign institutional investors. The Third wave began in 2006 when the government allowed local currency funds (RMB funds) to operate (Alexander and Casey 2012), which resulted in Chinese VCs being able to raise both foreign and local currency funds. Finally, the Chinese government allowed foreign VCs access to RMB VC funds via strategic alliances with local municipality governments and corporations. The third wave has resulted in an explosion of PE investing as China has become "… the destination of choice for investors in emerging markets" (Alexander and Casey 2012, 184). The development of RMB funds for both domestic and foreign VC firms has jettisoned China to become the second largest market globally for PE funds (Fannin 2012). As reported by Rebecca Fannin in her recent book *Startup Asia*, RMB funds (in U.S. $) have surpassed U.S. dollar funds in China increasing from $219M for RMB funds and $3.8B for USD funds in 2005 to $6.9B for RMB funds, but only $4.3B for USD funds in 2010; a very dramatic reprioritization in only 5 years (Fannin 2012).

Subsequently, the Chinese PE industry is becoming an insider's market in that China does not need foreigner's money as much as it did during the first two PE waves (McNulty 2012). Increasingly, domestic VCs are gaining a competitive advantage over their foreign competitors. Corruption and money laundering in potential portfolio companies continues to be a challenge for investors and the PE market in China has been described as "something of a minefield for foreign investors" (McNulty 2012, 101).

Since 2010, the Chinese Venture Capital and Private Equity Association has been surveying its members (general partners, limited partners, and service providers) about their perspectives on investing in China (2012–2013 China venture capital/private equity industry survey report

Table 6.1 Venture capital industry overview and characteristics

Industry overview

- The industry has witnessed a slower development and entered into the readjustment period.
- Evaluation on the policy environment tends to be negative, concerns are escalating.
- The difficulties in fundraising and exit are the greatest concerns of the industry.
- Industry talent development and intermediary services have experienced the greatest improvement, enhancing the overall industry environment.

Industry limited partners'/ general partners' characteristics

- Development status of limited partners (LPs):
  - LP's investment is generally stable with a downward trend in 2012 compared with 2011.
  - Over 80% of LP's internal rate of return (IRR) of portfolio investment is less than 25%.
  - Demand for secondary market financing is emerging.
  - Over 70% of LPs enjoy special preferential terms beyond the Limited Partnership Agreement (LPA).
- Development status of general partners (GPs):
  - Fund investment has plunged year-on-year.
  - P/E ratio of investments is trending downwards, but risks still exist.
  - LP's default on capital contribution is at a relatively low level.
  - Nearly 20% of LPs in the funds managed by GPs have transferred their shares.
  - Number of exits has dropped by 30% while exits through M&A hit a high record.
  - Expansion of GP teams has slowed down.
  - Compensation remains relatively stable.

Source: 2012–2013 China venture capital/private equity industry survey report (2012).

2012). Table 6.1 shows the level of satisfaction that respondents have with the current performance of the industry. Investors believe the VC industry has cooled off considerably from the previous two years and that government policy has not continued to improve PE investing. Both, raising PE funds and exiting their investments are becoming increasingly difficult. On the positive side, the development of industry professionals has shown significant improvement to include more quality VCs and service providers (lawyers and accountants).

Table 6.1 also shows the responses from both general partners (GPs) and limited partners (LPs). The LPs or institutional investors believe that their investments have plateaued from previous years because their returns are less than the returns in the previous year, but the demand to easily offload their investments on the secondary market, while emerging, is still not a viable option for exit. LPs are powerful negotiators because they are

major domestic or foreign investors with access to significant funds. They agree this level of power allows them to get special privileges over those negotiated in the LP agreement document with the general partners.

General partners strongly agree that both the number of deals and amount of capital invested in 2012 has decreased significantly, but that the price-earnings ratio (P/E) of prospective portfolio companies has also declined, which means the price for a deal has also decreased. Encouragingly the rate of LP default remains low and less than 20 percent of LPs have transferred their shares in the fund to secondary markets where LPs can sell their shares, which further supports a small but emerging secondary market that can provide an exit for LPs. As China's PE and VC market expands, it is expected that the secondary market will also grow in importance to provide more liquidity to LPs. Declining IPO exits (along with increasing trade sales-M&A), expansion of VC teams, and stable compensation for VCs all indicate a plateau in the growth of the PE and VC market.

Table 6.2 shows the overall outlook for 2013, which is generally positive in spite of the many negative or moderating factors identified in the previous table. All of the "outlooks" listed in Table 6.2 support a bullish outlook for PE and VC investing in China. To support further localization of PE, 80 percent of the GPs plan to focus on raising RMB investment funds. There will be a higher priority of VC investing in that 51.3 percent of the respondents believe that early-stage investments will return the highest value compared to larger, PE (leveraged buyouts) deals.

Table 6.2 Venture capital outlook

- Generally optimistic despite slight decrease in confidence index.
- More prudent toward the economic outlook of China next year.
- The investment trend of LPs for 2013 is basically the same as 2012.
- Strong enthusiasm in fund raising with limited partnership RMB funds as the primary choice.
- Investment opportunities in mainland China are still highly regarded.
- Early- and mature-stage projects present the highest investment value.
- The biomedical industry replaced the consumption industry to become the most popular investment target.
- Domestic Main Board becomes the primary choice for IPOs.
- Nearly 30% of the Red-Chip Companies have returned or plan to return
- Demand for professional talents remains strong.

Source: 2012–2013 China venture capital/private equity industry survey report (2012).

Red-Chip companies are Chinese companies listed outside of mainland China (to include Hong Kong) and only 30 percent plan to "return" (list on the Chinese bourse) because many foreign investors lack confidence in the Chinese stock markets. Finally, in spite of the slowdown in the expansion of VC or PE management team identified by the GPs in Table 6.1, there is still a strong demand to recruit professional staff.

China's Institutional Environment

We have been analyzing how both VC and BA investing are shaped in part by its institutional context; more specifically, the lack of formal institutions necessary to fully support PE investing. While China is an emerging economy with undeveloped institutions and its VC industry may have some of the characteristics of other emerging Asian countries, it will also have its own characteristics unique to its institutional environment. But clearly, even at the end of the last century, China's VC industry was still described as being in the infant stage in terms of its weak legal institution along with the central government playing a strong and complicated role in developing the investment climate. Professors Bat Batjargal of Harvard and Mannie Liu of Renmin University in Beijing categorize the government as playing the roles of shareholder, investor, fund manager, and auditor of VC firms, simultaneously (Batjargal and Liu 2004). The role of government as an active PE participant, such as in China, is very controversial in the VC literature and is the subject of a widely-quoted book written by Harvard Professor Josh Lerner. The book's title, *Boulevard of Broken Dreams,* is not a positive metaphor to support an active investment role for governments whereby they actually create and manage a PE fund (Lerner 2009).

Initial research on VCs in China showed differences between foreign VCs investing in China and domestic Chinese VCs. First, Chinese VCs were much more passive investors compared to Foreign VCs and were not involved in monitoring their investing; second, Chinese VCs had much less influence over their portfolio companies' management and were less likely to offer follow-on investments; third, Chinese VCs were less likely to participate in providing value-added activities such as strategic planning and management recruiting; and, fourth, Chinese VCs were much

less experienced than foreign VCs and thus, less likely to be able to be active investors with significant influence based on their expertise and experience (White et al. 2005).

Similar to our field studies in Vietnam, Philippines, and Thailand, networking is critical for Chinese VCs to do deals. In a study of 158 VCs, their ability to develop social capital had significant effects on investment selection decisions of Chinese VCs based on effective interactions with prospective portfolio companies (Batjargal and Liu 2004). Social capital consists of building networks of relationships and developing resources within these networks, which is similar to the Chinese concept of guanxi. Because of the lack of developed institutions in China, it is critical for VCs to build social capital to do deals, especially between the VCs and entrepreneurs, before consummating a deal. Strong social capital in a deal has a positive impact on not needing significant restrictive covenants placed on the entrepreneur in doing a deal because there is a high level of trust as part of social capital. Because of the importance of guanxi in Chinese culture, networking to build social capital is probably more critical than in other emerging Asian countries (Ahlstrom et al. 2007). According to Lucy McNulty, Asia editor for *International Financial Law Review* who is based in Hong Kong and studies VC across Asia, the importance of guanxi in China gives competitive advantage to domestic VCs because Chinese fund managers are more likely to "know how the system works and, perhaps more importantly, how to work the system" (McNulty 2012, 103). Not surprisingly, McNulty points out that sophisticated foreign LPs and government-level investors have begun to favor domestic VC firms over foreign VCs because of the importance of social capital and the many restrictions placed on foreign investors attempting to do deals in China.

Business Angel Investing

Until 2011, there was no published scholarly research about Chinese BAs. Fortunately, three empirical papers have been published recently about BA financing in China and are very helpful in understanding the types of BAs that are active investors in China. All three papers acknowledge the challenges facing BAs investing in an environment lacking fully-developed financial and legal institutions. Similar to most BA field studies, researchers

in China also report on the challenges of identifying and interviewing low-profile BAs resulting in the development of nonrandom, convenience samples.

The earliest study, published in 2011 by Li Xiao and Bob Ritchie, analyzed Chinese BA's investment strategies in a longitudinal study carried out mainly in the first decade of this century. They describe this time period as a business investment environment where institutions were still very weak but finally beginning to improve (Xiao and Ritchie 2011). The authors interviewed 11 BAs who were active investors from 1999 to 2010. They completed 30 interviews with these 11 BAs during 2005 to 2010 when these BAs completed 70 deals. Li Xiao, with a different coauthor, David North, expanded their focus beyond just BAs by conducting interviews with 74 SME managers in 2004 and again in 2009 (71 managers) to measure the impact of institutional change on BA financing of high-tech SMEs in China. In 2012, a team of five Chinese academics from Heifi University of Technology in Anhui, China surveyed 78 BAs in an exploratory study of the investment behavior of Chinese BAs. Table 6.3 provides a composite BA profile and fund performance based on these three studies.

Chinese BAs are similar to emerging Asian BAs in that they also invest significantly in seed- and early-stage companies, but unlike other BAs they also invest in growth- and later-stage companies. Chinese BAs make fairly large investments ranging from median of $46K in one sample to over $155K for 44 percent of BAs in another sample. Chinese BAs, also similar to emerging Asian BAs, tend to be highly educated and relatively affluent. They invest in 2 to 6 deals, are relatively young (primarily between 30 and 40 years old), and seem to be satisfied with their investments.

Because of weak institutions, and similar to other studies on emerging Asian BAs, Xiao and Ritchie found that Chinese BAs were actively involved in building social capital through networking in order to build personal trust with entrepreneurs as part of the investment process. More specifically, Li and his colleagues report that BAs source deals primarily through personal networks (friends, business partners, clients, classmates, family members, and relatives) and invest in "strangers" in only 3.9 percent of their deals, which fits well with the role of *quanxi* in Chinese culture. Xiao and North refer to social capital as "informal institutional

Table 6.3 Business angel composite profile and fund performance of Chinese business angels

Profile[*]	Investment performance
Investment size (total investments) • Range: <$15K–>154K[*] • Median: $46.2K • $8K–155K: 52% of BAs[‡] • >$155K: 44% of BAs Investment structure • Loan: 61% • Equity: 39% • Short-term: 74% • Long-term: 26% Number of deals • Total: 70[*]/130[‡] • Range: 1–20/NA • Mean: 6.4/1.7 • Median: 3 Education[‡] • Bachelor's degree: 39.7% • Master's degree: 50.0% • Doctoral degree: 7.7% • Other: 2.6% Personal data • Median age range: 30–40 yrs. • Annual income: 2/3s<$155K • Net worth: 61%>$310K	Investment stage (2012)[§] • Seed: 12% • Early: 35% • Later: 53% Investment stage (2013, can be multiple)[‡] • Seed: 27.3% • Early: 58.4% • Growth: 42.9% • Mature: 10.4 • Expansion: 7.8% Fund performance[*] • All payments received: 66% • (to include agreed upon returns) • Partial loss: 15% • Total loss: 6% • Still trading: 7% Investment returns[‡] • Extremely satisfied: 10% • Satisfied: 70% • Extremely dissatisfied: 20%

[*]*Xiao* and Ritchie (2011); [‡]Li et al. (2013); [§]Xiao and North (2012).

Note: K = thousand; M = million.

arrangements," which, they found, plays a critical role in providing PE to SMEs and that the role of BAs has increased as a source of VC.

Xiao and Ritchie discovered a unique investment strategy in their sample. They found that in order to minimize investment risk due to weak institutions, Chinese BAs were much more short-term focused than BAs in emerging Asia. This short-term investment strategy resulted primarily in debt investing instead of longer-term equity investing. Xiao and North posit that Chinese BAs actually develop a two-stage investment strategy by initially making short-term debt investments. As the BAs built up personal trust with the entrepreneur and as the State improved the investment climate, then BAs became more confident to

make longer-term equity investments. Therefore, Xiao and Ritchie offer a different version of BA financing in that they define BAs as informal investors who provide both equity and loans in the form of noncollateral finance on a short-term basis and equity on a long-term basis. It is also apparent, based on these three samples that Chinese BAs only invest when there is a high level of social capital based on personal trust between the investor and the investee. And this investment process is evolving as both trust and institutions improve. This relationship is called coevolution whereby BAs modify their investment strategy as the State improves the financial and legal institutions. To analyze this relationship requires more longitudinal studies of the BA investment process similar to both Xiao and Ritchie and Xiao and North.

Business Angel Clubs

Since 2001, the Zero2IPO Research Center in Beijing has conducted research on the PE industry in China including reports on BAs and BA clubs. According to Zero2IPO, the government was instrumental in setting up angel investment clubs, which was soon followed by private BA clubs or independent angel groups comprised of successful entrepreneurs in China and also ethnic Chinese not living in China (also called Overseas Chinese). The first angel investment fund in China, Tianjin Binhai Angel VC Fund, was established in 2006 and "focused on investments in biopharmaceutical, new materials, fine chemicals, new energy, and other fields" (Zero2IPO Research 2011, 15). China's BA networks are still in its infancy and the government continues to play a role in their development by supporting innovation and venture funds set up by ministries and local governments that can be a source of angel investments. The early BA networks in China include some successful groups such as Z-Park Enterpriser Angel Investment Alliance, Shenzhen Angel Investor Club, Super Angel Investment Management, and K4 Forum Beijing Branch, which has offices in 20 international cities including Silicon Valley near San Francisco, and is one of the largest angel investment networks in the world. Since its inception in 2000 outside of China, K (Keiretsu) 4 Forum has invested $200M in 260 companies around the world (Zero2IPO Research 2011, 36).

Challenges and Recommendations for Business Angel Investing

The Zero2IPO Research Center has identified the major challenges facing BAs in China and has also generated recommendations to address these challenges in order to improve BA investing. Table 6.4 provides an overview of the major challenges and recommendations. Most of the problems are similar to those facing BAs in emerging Asia: lack of institutions to support BA investing, lack of professional BAs, and inability to communicate and network when doing deals. A new challenge, not identified in our previous research, is the problem of developing incubators in China. Even though the Chinese government in its *Eleventh Five-Year Plan* implemented a series of policies to develop incubators to support the development of high-technology entrepreneurship, which resulted in over 800 incubators by 2010, there are concerns about the quality of these incubators (Zero2IPO Research 2011, 61). These incubators have not been effective in developing innovative companies that have been capable to significantly impact economic development. Relatedly, the lack of

Table 6.4 Challenges and recommendations for business angel investing in China

Challenges	Recommendations

• Absence of BA investment laws
  ○ Investment regulations don't include BA investors
  ○ BA investing is still in the infancy stage versus VCs/PEs
• Lack of professional BAs
  ○ Lack of knowledge about BA investing
• Lack of communication between BAs and projects
  ○ Lack of Internet websites to match BAs with investment projects
• Lack of development of incubators
  ○ Many incubators exits, but quality is low
  ○ Unable to develop innovative projects to provide economic development
	• Improve institutions and policies for BA investing
	  ○ Tax breaks for BAs
	• Government to play a leading role in BA development
	  ○ Support early-stage funds
	  ○ Develop policies to compensate for the high risk of BAs
	• Provide more support for incubators
	  ○ Create incubator industry standards
	  ○ Provide training for staff
	  ○ Develop an incubator network system to promote cooperation

Source: Zero2IPO Research (2011).

highly-skilled professional service staff to develop the resources required by these high-tech focused incubators has been a major problem.

Recommendations have been proposed by the Zero2IPO Research Center to directly address these challenges. Once again, there is a call for improving institutions necessary to effectively support BA investing. The State has been proactive in supporting VC and PE financing, but not BA financing; especially in *not* offering the same tax incentives to BAs to invest in early-stage companies that are available to VCs. Relatedly, the State needs to play a stronger role in supporting angel funds, which compensate for the high risk of investing in early-stage companies. Finally, the quality of incubators needs to be improved by setting industry-wide standards, providing training to develop high-tech professional staff services and enhance the formal networking capabilities of incubators so they can share and cooperate on research projects.

In summary there is a vibrant PE industry presence in China that is growing because of the rapid development of domestic VCs. This in part is due to the supportive government policies and the return of ethnic Chinese to set up VC funds in China. The BA climate is also improving, but lacking the government legal and taxation support given to VCs. The two-stage BA investment strategy appears to be unique in emerging Asia and definitely requiring more longitudinal research. Most impressively for BA financing is the recent but significant development of BA clubs some of which have an impressive global presence.

Indonesia: A Giant Unknown

Strong Economic Growth

As shown in Table 2.1 in Chapter 2, Indonesia has exhibited strong economic growth recently as GDP per capita grew by almost 51 percent from 2009 to 2011 in spite of a downward trend in its "Ease of Doing Business Rank" from 2010 to 2013

According to Henry McVey, of U.S.-based, PE firm Kohlberg Kravis Roberts (KKR), Indonesia's economic potential is still very positive for PE investors focusing on emerging markets. More specifically he summarizes, "The long-term outlook for the country makes it a highly attractive destination for emerging market-oriented growth capital" (McVey 2013, 10).

McVey, head of KKR's Global Macro & Asset Allocation Team, writes frequently in KKR's *Insights*, a monthly investment series about emerging markets in terms of PE investment opportunities. McVey cites recent economic data that strongly support his bullish view of Indonesia. Short-to-medium-term, GDP per capital in Indonesia should grow by 7.4 percent annually over the next 5 years; long term, by 2050 Indonesia will have the third largest consumer economy in the world, trailing only China and India.

Indonesia is shifting its focus from small business development to entrepreneurship development. More specifically, SMEs have been promoted since 2007 through Indonesia's President Instruction number 06/2007, while youth policy, which stresses youth entrepreneurship, was introduced in 2009 (law number 41/2009) to respond to the high level of Indonesian youth unemployment. Promoting entrepreneurship is seen as a potential solution to youth unemployment, but a major challenge for entrepreneurs, especially young entrepreneurs, is to secure financing for early-stage ventures. Similar to both developed- and emerging-countries, besides personal savings, family and friends' investments, a significant source of financing for early-stage ventures could be VC and BA financing.

Venture Capital

According to the *Asia-Pacific Private Review*, Indonesia is on target to become one of the most significant PE markets in the next 10 years; primarily because of strong economic fundamentals, favorable demographics, and an increasing demand for VC (Asia-Pacific Private Equity Review 2012b). As shown in Table 2.3, Chapter 2, PE investments in Indonesia averaged $1.14 billion annually from 2005 to 2011. PE investors generated a total of 48 investments during this time period for a grand total of $8.0 billion PE investments, with the highest annual investment of $2.4 billion occurring in 2008 (Bhagat et al. 2012).

In the VC portion of our pilot study (Gunawan et al. 2011) we conducted a focus interview with an Indonesian VC firm in Surabaya to test our interview format and get a general introduction to VC financing in Indonesia. This VC firm is semiprivate in that it was established in 1994 through a government initiative and support. The VC firm is classified as

public-private partnership (PPP) because it is part of a government holding company, which controls 27 VC firms, that is, one firm in each of the 27 provinces of Indonesia. There are 17 founders or shareholders of this VC firm including the government, a bank, and many large conglomerates. The general mission of this VC firm is to support the development of SMEs, which show potential but are unable to secure bank financing. The founders are not active shareholders, but they perceive their investment as part of their respective corporate social responsibility investing, which means they are less concerned with financial returns than social returns such as generating jobs. The lack of active private shareholders results in the VC firm being primarily operated by the government. Surprisingly, even though this firm calls itself a VC company, it primarily lends to SMEs. A major reason for only doing debt financing is that the VC firm does not have the staff to conduct the necessary due diligence before investing and to also provide hands-on monitoring after the deal is finalized. However, the Director of the VC firm has made equity investments as an angel investor in one of the portfolio companies that secured a loan. We conclude that in spite of 25 years of operating as a VC firm, this firm is an example of an unsuccessful VC firm without a clear vision of the role of PE investing in an emerging country. On the positive side, this case study does show that the government is supportive of VC as a force for economic development.

Business Angel Financing

We interviewed five BAs and found that the time spent by BAs to help develop their portfolio company is minimal, while the amount of investments vary significantly between the BA investors. In general, we found there are two types of BAs. First, is the BA with purely economic motives and, second, is the BA with broader ecosocial motives, which is similar to the VC firm we analyzed.

In Table 6.5, I provide a profile our BA investors. With the small sample, we do not generalize our findings as this is a pilot study to determine if we can find BA investors and, secondly, they meet the definition of a BA by investing their own money in seed- and early-stage companies. Our BAs invested a median of $11,000 in exclusively seed-stage companies so

Table 6.5 Business angel profile and fund performance

Profile	Investing performance
Fund size • Range: $7K–333K • Mean: $124.5K • Median: $75K Investment size • Range: $1.5K–11M • Mean: $224K • Median: $11K Number of deals • Total: 27 • Range: 2–12 • Mean: 5.4 • Median: 4 Number of co-investors/deal • Range: 2–4 • Mean: 2.6 • Median: 3	Number of years investing • Range: 1–36 • Mean: 9.3 • Median: 2 Investment stage • Seed: 100% • Early: 0 • Growth: 0 • Mature: 0 • Other: 0 Fund performance versus expectations • Below: 0% • Average: 40 • Above: 60 • Too early: 0

Source: Scheela et al. (2012b).

Note: K = 1000; M = million.

they clearly are BAs who are unafraid to invest in high-risk start-ups. The range of their fund size and investment per deal is somewhat confusing as one BA reports investing up to $11 million into an early-stage company, which is highly unusual, but certainly interesting. Obviously, a larger sample will allow us to be more confident in our findings. Yet, this profile is very useful in that it appears BAs exist in Indonesia, they tend to co-invest, have a deal portfolio of 4 to 5 seed-stage companies, and are generally meeting or exceeding their investment goals.

In Table 6.6, we show the major challenges facing BA investors in Indonesia along with their recommendations to improve BA investing. Three major challenges were identified: Lack of government leadership in PE investing, a difficult environment to do deals, and the lack of bank support to do deals. The lack of fully-developed institutions necessary for PE investing is clearly evident in all three challenges; especially, government corruption and the lack of ethics in government officials, investors, entrepreneurs, and bankers. Given the difficult investment climate reported by BAs in this small sample, it is surprising they report positive investment returns.

Table 6.6 Business angel challenges and recommendations

Challenges	Recommendations
Lack of government leadership • No clear legal regulations • Significant red tape • Unfair competition due to gov't. favoritism • Government corruption • Need political connections to do business • Lack of ethics in government	Government leadership • Reduce monopolies • Better protection for minority shareholders • Simplify government regulations for PE investing • Support the need for social entrepreneurs ○ Provide better food security for poor
Difficult to do a deal • Lack of trust between BA, entrepreneur and co-investors • Difficult to measure risk • Entrepreneurs learn by doing; no training • Difficult to duplicate/grow the business • Inconsistent planning due to short-term focus of entrepreneurs	Better investor networking to do deals • Create BA clubs for deal making • Encourage entrepreneurs to bring in partners to run the business • More focus on developing local resources • More investments outside of Jakarta and Java
Lack of support from banks • Difficult for SMEs to get bank financing • Banks are too conservative • Lack of ethics in banking	Bank leadership • Easier for SMEs to get bank financing

Source: Scheela et al. (2012b).

Not surprisingly, these five BAs' recommendations focus on the government, BAs, and bankers to lead the way in improving BA financial opportunities. The government needs to improve regulations for investors to include protecting minority shareholders and supporting the opportunities for social entrepreneurs to improve the quality of life for poor people. Networking is very important to these BAs in doing deals and they strongly support formal network such as a BA club to enhance deal making. Finally, it is important for banks to provide economic leadership by making it easier for SMEs to get financing.

In most of the BA or VC recommendations in the previous chapters, the government was identified as a key player in providing a leading role to improve institutions and support for PE investing and entrepreneurial development. In a positive sign, the Indonesian government is attempting to play a leadership role to address institutions, PE, and entrepreneur development. The government has recently begun to provide more

emphasis to improve the opportunities for struggling young entrepreneurs. Indonesian law number 40/2009, which focuses on young people, indicates that Indonesia is increasing the attention to youth enterprise development. Chapter 27 of this law states that youth enterprise development should be enhanced by focusing on the interest and potential of youth and combining them with local opportunities and national strategic direction. Government can support the development through training, apprenticeship, coaching, partnership facilitation, promoting, and access to finance. This law is relatively new, and so far, the Ministry of Home Affairs indicates that in the government-decentralization era of Indonesia political development, program coordination and alignment between national, provincial, and district government programs are very challenging. The structure of the offices, the budget policy, and the capacity of the people may differ. Thus, focusing the development purely on the institutional aspect may take time.

Universities can take an active role in the development of youth enterprise development in three areas. First, as a research institute, universities could use its alumni or institutional networks, domestic or international, or both, to support student's enterprise development. Considering university roles, university research may help to determine which sectors provide the best opportunity for Indonesia's youth. Research could also investigate how alumni may be interested to be angel investors for students with the proven technical competencies. Second, university teaching methods may include seminar and knowledge-sharing about how seed-stage entrepreneurs develop and how BAs contribute to or could contribute to the development of youth-led enterprises. Last, as is mentioned in the law, but not yet established, universities should establish student entrepreneurship support service centers, which include training, knowledge sharing, coaching, and networking facilitation. Such services are not currently available. A model for youth entrepreneurship support services that include students, lecturers, and alumni may be beneficial for all parties interested in the enterprise development.

Stating the obvious in summarizing our pilot-study research in Indonesia—much more research is needed to better understand PE investing in this large and promising country. The PE signals are there and PE investors are setting up funds and investing in Indonesia—we

know that. But for the seed- and early-stage companies and the young entrepreneurs, we know very little about the role of BA investing in terms of its impact, challenges, and how to make angel investing both more efficient (reducing transaction costs) and more effective (doing more deals by increasing deal flow). For researchers, not only is finding BAs a big challenge, as I have discussed earlier, but getting research funding to actually conduct the field research has been extremely difficult for our research team since we first expressed an interest to implement a field research project to include the completed pilot study in Jakarta and Surabaya. Yes, there's a lot of interest in our research, but unfortunately a lack of investment in our field work in spite of our ongoing efforts to get research funding. Hopefully, that will soon change for the better as more stakeholders begin to understand the economic significance of PE investment in emerging Asia.

CHAPTER 7

Venture Capital Investment Strategy for Emerging Asia

Many of the challenges identified by venture capitalist (VCs) and business angels (BAs) in emerging Asia are related to the developing status of the VC industry in both Southeast Asia and China, which, compared to the United States and Western Europe, as explained in Chapter 1 is young and undeveloped. By comparing the research on VC and BA investing challenges to the general characteristics of both developed country VCs and emerging country VCs listed in Table 7.1, similarities and differences are evident. Compared to developed country VCs, emerging Asian VCs and BAs focus more on low-tech deals, raise smaller funds, invest in more early-stage companies (especially BAs) requiring more intensive postinvestment monitoring, exit primarily through trade sales (not initial public offerings [IPOs]), and operate in much more challenging and opaque investment environments because of the lack of fully developed legal and financial institutions.

Both emerging Asian VCs or BAs and emerging country VCs suffer from a low number of attractive deals, problems of political risk, lack of transparency, and a lack of a credible stock market as a viable exit strategy. Both types of VCs are being forced to primarily use a non-IPO exit strategy. In many ways, emerging Asian VCs fit the model of VCs operating in emerging countries. However, the Thailand VCs also differ from emerging country VCs in that Thai VCs tend to invest in mature, later-stage companies, while emerging VCs are increasingly investing in early-stage companies.

As stated in Chapter 1, our central research question, which we use to guide both our field research and the focus of this book is: How do emerging Asian VCs and BAs effectively invest in and help develop entrepreneurial firms in emerging Asian economies lacking the

Table 7.1 Comparison of developed and emerging countries' venture capital firms

Activity	Emerging country VC firm	Developed country VC firm
Fund structure	Corporation and limited partnership	Limited partnership
Capital sources	Pension funds, corporations, insurance companies, high net worth individuals, government and nongovernmental organizations (USAID, IFC)	Pension funds, corporations, insurance companies, high net worth individuals
Types of investments: traditionally	Privatizations, corporate restructuring, strategic alliances, infrastructure funds	High-technology, early-stage, high growth firms
Types of investments: recently	• Services expanding from developed to developing • Labor-intensive industries • Indigenous technology in developing countries	Trend toward late-stage
Deal origination	Low number of attractive investments, focus on quality of management, problems of country risk, corruption, exchange rate risk	Focus on quality of management
Deal structuring	Common stock and debt	Common stock, several classes of preferred stock, debt and convertible preferred stock
Pricing the deal	Difficulty in assessing the value of an investee company: • Lack of transparency	Higher level of transparency
Exit strategy	Sale to third parties, co-investors, investee firm's management	Initial public offering (IPO)

Source: Aylward (1998); Pacanins (2001).

fully-developed institutions necessary to support private equity (PE) investors? We believe an emerging Asian PE investment strategy may be developing for VC and BA investors whereby successful PE investors actively network to build social capital, engage in intensive due diligence, and practice hands-on monitoring, all of which result in an investment strategy that has proven to be effective in relatively challenging investment environments.

Emerging Asian Venture Capital and Business Angel Investment Decision Making

We further believe, this emerging Asian PE investment strategy is mandatory because of the lack of effectively functioning formal financial and legal sectors, which are needed to provide the necessary market intermediaries to do deals. Related research by Professors David Ahlstrom of Chinese University Hong Kong and Garry Bruton of Texas Christian University found that VCs in East Asia "…generally used networks to substitute for formal institutions such as the rule of law" (Ahlstrom and Bruton 2006, 312). Similar to emerging Asian VCs, BAs in China, the Philippines, Vietnam, Thailand, and Indonesia also networked with other investors to find deals, conduct due diligence, and reduce investment risk because of the lack of legal protection for minority shareholders. While VCs in the United States also are engaged in networking to do deals and monitor investee companies, emerging Asian VCs and BAs also network with government officials in order to improve the investment climate.

Venture capitalists in the emerging markets of Central and Eastern Europe (CEE) also struggle with poor PE investment climates, which negatively affects deal flow and exits (Klonowski 2006). Because of the high level of perceived investment risk in CEE countries and the lack of significant local VC experience, Western institutional investors require Central and Eastern Europe VCs to conduct on-going, in-depth, and postinvestment monitoring of their investee companies at a much higher level compared to PE investing in developed economies (Klonowski 2007). Professor Darek Klonowski of the University of Brandon in Canada, based on both his VC experience and research in CEE has proposed a more complex nine-stage investment model for VCs investing in CEE emerging markets compared to the five-stage investment model utilized in developed economies (see Table 7.2 for both models). I introduced this five-stage VC model in Chapter 1 in Table 1.1 along with a similar five-stage BA model for developed country VC and BA investors. Table 7.3 shows both the developed BA investment model from Table 1.1 and our proposed emerging Asian BA model.

More investment stages are required by VCs operating in CEE emerging markets because of both the need for more information and intensive

Table 7.2 Investment model for Venture capital investing in CEE and Asian emerging markets*

Developed country VC investing process	Emerging country VC investing process
Venture capitalists 1. Deal origination 2. Screening 3. Evaluation 4. Deal structuring 5. Postinvestment activities	Venture capitalists 1. Deal origination/*building social capital* 2. Initial screening/*maintaining social capital* 3. Feedback from investment committee and due diligence (phase I) 4. Feedback from supervisory board (including limited partners' representatives and due diligence I) 5. Pre approval of completions a. Investment memorandum and term sheets 6. Formal approvals and due diligence (phase II) 7. Deal completion 8. Monitoring 9. Exit

Source: *Klonowski (2007).

Table 7.3 Investment model for BA investing in emerging Asian countries

Developed BA investing process	Emerging BA investing process
Business angels 1. Familiarization 2. Screening 3. Bargaining 4. Managing 5. Harvesting	Business angels 1. Familiarization/building social capital 2. Screening/maintaining social capital 3. Bargaining 4. Managing 5. Harvesting

monitoring due to higher levels of market risk, which have resulted in higher transactions costs. We also support a more complex, multistaged VC investment process for emerging Asian VCs. In both our field studies and published research in China, VCs practice an in-depth due diligence and hands-on investment strategy. For emerging Asian VCs, building social capital via extensive networking with entrepreneurs, co-investors, and government officials is a significant component in their investment strategy. However, the nine-stage model doesn't specifically include the impact of building social capital via developing networks to create informal institutions as part of the investment process in emerging Asia. We propose that building and maintaining social capital precedes doing a

deal in emerging Asia, and I have included it as part of the first two steps: "Deal origination" and "Initial screening" shown in italics in Table 7.2. That is, VCs must develop and maintain informal institutions or networks before a deal can be seriously undertaken and initial screening can be accomplished. Once there is sufficient trust between all parties (VC, entrepreneur, and co-investors) in a proposed deal, the next seven steps can proceed.

It's important to remember that BAs are also referred to as informal VC investors and, as explained in Chapter 1, are significantly less bureaucratic than VCs and can do deals much more quickly. We believe the developed country five-step model for BA investing also applies to emerging Asian BAs, but that social capital is an important part of this process and must be reflected in the first two stages of familiarization and screening, as shown in the second column of Table 7.3. BAs don't need more stages to do deals in emerging Asia, but the need to build social capital requires more time, which can have the same impact as adding more stages for VC investing in that both emerging models will require more time to do deals compared to developed VCs and BAs.

Informal Institutions

The emerging Asian VCs and BAs complained about the challenges of dealing with red tape, bureaucracy, and corruption, which may be a reason for some entrepreneurs and BAs to voluntarily exit the formal economy either totally or partially. This finding supports the Neo-Liberal perspective whereby the informal economy "… is a direct response to the overregulation of the market" (Williams and Nadin 2010, 369). The lack of fully-developed, efficient institutions along with weak government support for SMEs in all five countries have resulted in BA and VC investors working in both formal and informal economies using a combination of formal and informal institutions to do deals. Consequently, investment networking to build social capital is extremely important for PE to be able to effectively exploit investment opportunities in these emerging Asian economies. This observation further reinforces previous research supporting networking as a mandatory survival strategy in doing business in emerging economies lacking developed institutions (Xiao and Ritchie 2011).

Operating in an institutional void has forced BAs in these emerging countries to develop social capital institutions in order to do deals that have mainly generated quality (above-expectations or meeting-expectations) investments. Interestingly, it may be that the combination of the lack of formal institutions and a BA's ability to develop informal institutions via networking could be a competitive advantage for investing in an emerging economy, especially compared to VCs and foreign investors.

While many BAs and VCs in developed countries co-invest with other investors (primarily to reduce financial risk), a co-investing-networking strategy appears to be especially important for BAs and VCs in emerging Asia because of the high levels of financial, legal, currency, political, economic, and market risks. Networking to build social capital relates directly to our research question about how VCs or BAs can be effective investors. This investment strategy appears to be especially relevant for emerging Asian BAs to network in order to find deals, co-invest, and monitor their investments. Compared to foreign VCs, Chinese VCs can now more easily raise local currency funds, which combined with guanxi or social capital creates a significant competitive advantage for domestic funds. As institutional voids are minimized and foreign funds gain better knowledge and access to emerging Asia, it will be interesting to see if this indigenous competitive advantage can be surmounted.

Where to Go From Here

Generally, VCs or BAs in emerging Asia believe both investors and governments can significantly improve the investment process and climate. VCs or BAs are interested to form networks to both facilitate deal making and improve legal and financial institutions. VCs are interested to form or continue to form VC associations, while BAs recommend developing clubs or networks in order to develop a comprehensive database and website to improve deal making by being able to find better deals and then collaborate on due diligence and postinvestment monitoring. Both VCs and BAs believe governments can also greatly enhance the investment process in four areas. First, governments can provide more support to finance, educate, and promote entrepreneurship. Second, governments need to support the development of better legal and financial institutions

that are necessary to increase deal making and generally improve the investment climate. Third, governments must be more effective in providing reliable public information for investors to conduct in-depth due diligence more efficiently. Finally, governments need to improve public governance by reducing corruption or red tape for investors and entrepreneurs and also maintaining political stability.

Clearly, higher education can play a major role in improving the investment process for VCs, BAs, and entrepreneurs. Higher educational institutions in emerging economies can support research focusing on the unique characteristics and challenges facing VCs or BAs and entrepreneurs, operating in institutional voids, and they can develop appropriate curriculums, which should be markedly different than Western entrepreneurship curriculums. It is important that these new curriculums should be specifically based on emerging country PE research and the development of indigenous case studies of entrepreneurs or start-ups, BAs, and VCs.

Policy Recommendations

So what role should government play in supporting the development of PE in emerging Asia? Professor Josh Lerner of the Harvard Business School has written extensively about the opportunities, challenges, and pitfalls facing governments in attempting to support the development and financing of entrepreneurs. According to Lerner, based on his research, five consistent themes have emerged (Lerner 2009, 192):

- Governments around the world today seek to promote entrepreneurial and VC activity, employing a variety of "stage setting" (improving the entrepreneurial environment) and direct strategies.
- These steps are sensible, given the historical record and theoretical arguments regarding the importance of such interventions in the development of entrepreneurial regions and industries.
- But programs to promote entrepreneurship are challenging. Governments cannot dictate how a venture market will evolve, and top-down efforts are likely to be unsuccessful.

- The same common flaws doom far too many programs. These flaws reflect both poor design—indicating a lack of understanding of the entrepreneurial process—and poor implementation.
- Governments must do a careful balancing act, combining an understanding of the necessity of their catalytic role with an awareness of the limits of their ability to stimulate the entrepreneurial sector.

Entrepreneurship and PE are documented vehicles for both innovation and economic growth, worthy of public financial support yet extremely challenging for governments to develop and implement effective entrepreneurship programs. Professor Lerner makes many recommendations, one of which pertains directly to emerging Asian economies facing the challenges of institutional voids—"make education an important part of the mixture" (Lerner 2009, 187). Similar to the challenges facing VCs or BAs in Emerging Asia, Lerner posits that PE investors are hesitant to invest in countries where there is a lack of information about both local market potential and the level of entrepreneurial activity in local markets. Educators and governments can play a major role in researching and developing public databases about market potential and entrepreneurial activity. Lerner unapologetically states the obvious when he states "educating entrepreneurs is a critical process" (Lerner 2009, 188).

Based on our research and the recent published research in China, we believe educating entrepreneurs *and* public officials are *both* crucial to significantly improve both the investment process and entrepreneurial climate; one without the other will not be sufficient. A major component of this educational mandate is to introduce both stakeholders to formal and informal VC investing models in the local context. Both entrepreneurs and public officials need to be educated about the typically-inefficient investment process and challenges facing PE investors operating in institutional voids. In order for this education process to be effective it must be Transnational Education—*think global, teach local*. That is, include global knowledge about PE investing in general (primarily from Western universities), but develop significant local emerging Asian content based on academic research whereby indigenous databases and case studies can

be developed to make education germane to entrepreneurship students in emerging Asian countries who will be doing deals in spite of facing significant institutional voids. Hopefully, this book will be part of this education process.

Postscript: Ben and Emiliano

I started this book with two short case studies about Ben Hur Gomez at Omni Aviations and Emiliano Zulberti with Direct With Hotels (DWH); both companies located in the Philippines. Ben was unfamiliar with VC and Emiliano was very savvy about both BA and VC investing. In 2012, Ben did ultimately sell his entire company to a VC firm, but it was an arduous, hard-fought ,and stressful negotiation process and he's not happy with the outcome. Whereas, Emiliano aggressively pursued both BA and VC investments (and the VCs pursued him), which allowed him to rapidly develop capacity and globally grow the business. Emiliano is still CEO of DWH, which continues to be an investee company of VC firm, ICCP Venture Partners.

Final update. On April 4th, 2014, online newsletter *Tech in Asia* reported that incubator Saigon Hub, the focus of the introductory case study to chapter 3, has ceased operations temporarily with hopes of finding a less expensive location in order to resume operations on a smaller scale.

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