

**Summary of ADBI-IADB LAEBA Seminar  
Innovating and Increasing Venture Capital and Venture Business  
16 November 2007**

ADBI hosted a seminar on venture capital and venture business in Asia and Latin America on 16 November 2007.

**Mario Lamberte**, Director for Research, ADBI, firstly presented background information about venture capital in Asia. He concluded that venture capital is still relatively new in Asia both in terms of the number of venture capital funds and professionals and in terms of venture capital under management. Instead of insurance companies, major fund sources for venture capital are corporations and banks. For instance, in the People's Republic of China, 41% of funds are raised from corporations and 23% from banks, while only 8% of funds are from insurance companies.

Venture capital is mostly used domestically rather than in the rest of the region, except for venture capital in Hong Kong, China and Singapore. In terms of product distribution, venture capital in Asia bestows high priority to those existing companies capable of sustained effort and familiar with their markets instead of "high technology" companies and new entrants. He further identified several problems with venture capital business in Asia, such as, among others, the lack of professionals and specialists in the industry, difficulty in deal structuring, and poorly written business plans. Finally, Mr. Lamberte pointed out that there exists a large amount of government intervention (laws, regulations, and taxation) in the venture capital industry in Asia.

**Susana Garcia-Robles**, Senior Investment Officer, Multilateral Investment Fund, explained how the Inter-American Development Bank supports venture business in Latin America. A unique development instrument, the Multilateral Investment Fund (MIF), was established in 1993 as a major source of technical assistance grants for micro and small business development in Latin America. MIF utilizes both grant and loan financial instruments (occupying, respectively, 65%-75% and 25%-35% of its total funding) to take measured risks that the market is not yet taking and to finance innovative projects that will provide information to the market. In so doing, MIF can promote private sector development and entrepreneurship. MIF is also a leading investor in creating new forms of venture capital vehicles for small business in Latin America and seeks to transfer its know-how to other potential private and public sector investors, attracting them to the industry. To some extent, MIF has achieved its target as the venture capital industry is being shaped in the region. Finally, she pointed out some strategies for the future of MIF, such as working with the public and private sectors to improve legal platforms, accounting practices, tax incentives, governance standards, and fund oversight mechanisms.

**Nobuhiko Hibara**, Professor, Ritsumeikan University examined the question "can we create a venture capital industry?" by presenting relevant experiences in several countries. Citing Josh Lerner's words, he first pointed out that there seems no good solution to a government's failure in promoting entrepreneurship and venture capital investment due to issues such as adverse selection, moral hazard, crowding out effect, political influence, and scarce supply of risk capital. He presented three cases where governments helped to create the venture capital industry.

The first case is the Canadian experiment of so-called labor-sponsored venture capital, where the government provides tax benefits to individual private investors for investing venture capital. Quebec province introduced this model in 1983. The venture capital was raised from individuals with a maximum amount of \$5,000 per person per year, while the investment was encouraged by federal and provincial tax credits (15% each). The investment, however, must be in that province where the money was raised. This system was weak and did not generate many professional capitalists.

The second case was the Israeli experience. The Israeli government established a fund-of-funds “Yozma” (or initiative) in 1993, which in turn provided funds to several drop-down funds of up to \$8 million each. Each drop-down fund also needed to absorb funds from foreign and local private investors, in total at least \$12 million. Each fund must provide private investors with a five-year option to purchase the government shares. It seems that the incentive scheme was well established and this system worked quite successfully.

Contrary to the Israeli experience, the third case—the Chilean program—established a similar structure but it did not work as well. In this case, each drop-down fund must either have at least five unrelated investors, each holding at minimum 10%, or at least one institutional investor holding at minimum 20%. This system got the right structure with additional incentive mechanisms but unfortunately did not work out. It is difficult to give conclusive policy implications for successfully creating a venture capital industry, but one can not overemphasize the importance of human resources. The lack of professional fund managers will not make a venture capital industry successful even though there are plenty of funds.

**Osamu Hosokubo**, Executive Director, Japan Asia Investment Company presented on the status quo of the venture capital industry in Japan. Reviewing the history of venture capital in Japan, one may observe two turning points -1982 when JAFCO introduced the first investment fund in Japan and 1999-2000 when TSE-Mothers and Nasdaq Japan were formed. Recently venture capital investment in Japan has been increasing, reaching US\$3.6 billion in March 2007. The breakdown of new investments by industry shows that more than half of the investments were allocated to the “high technology” industry (around 34.8% for IT-related industry and 18.0% for biotechnology industry). Breaking down the investment by age of companies, one may observe that venture capital in Japan also actively supports new entrants. Although much progress has been achieved, venture capital size is still very small compared to the EU or the US. In 2004-2005, the size of venture capital in the US was more than 30 times the size of Japanese venture capital. Finally, he presented a case of venture capital in Japan, Japan Asia Investment Company (JAIC). It was established by Keizai Doyukai (Japan Association of Corporate Executives) in 1981 and started its venture capital investment in ASEAN in 1988 and in Japan in 1991. Currently, it conducts venture capital investments in various industries, and also expands to other private equity investments, such as buyouts and turnaround investments. JAIC has the largest number of domestic and overseas entities among the Japanese venture capital companies.

The seminar ended with a general discussion covering several important issues in the venture capital business.

First, the lack of human resources is one of the main constraints for the venture capital industry in Asia or Latin America. Professionals, such as engineers and risk analysts,

are in high demand in the field in these two regions. While professionals who hold both PhD in science or technology and an MBA are available in the labor market, they are very few in Japan and other Asian countries.

The second issue is about the cultural difference between venture capital in the US and Japan. As shown by Osamu Hosokubo, the amount of venture capital is still very small compared to that in the US. This may be explained by the cultural differences between the two countries. In Japan, share-holding in companies by venture capital is limited, as is the appointment of CEO or managers by venture capital. Once a company is established, the owner of the company usually wants to control the company and to pass the company as an asset to his or her children, so it is very difficult for a venture capitalist to be the major share-holder. In the US, however, venture capital usually helps establish new companies, makes them successful and eventually sells its stake in them. Cultural differences also exist in thinking about the role of government in the venture capital business. In Japan or other Asian countries, it is common to expect the government to create the venture capital industry or promote entrepreneurship, while the government is not expected to intervene in the venture capital business in the US.

Third, the investment philosophy and attitude of venture capital is also an important problem. Fund managers of venture capital both in Asia and Latin America are quite risk-averse. They are not really seeking ventures and incubating new companies; instead, they mostly look for investment opportunities in the existing manufacturing companies.

Finally, participants also addressed other important issues in the venture capital industry, such as marketing ideas, non-performing loans, and structural issues in Japan and Germany.