

CHAPTER 4

OVERVIEW OF THE VENTURE CAPITAL INDUSTRY IN TAIWAN

4.1 Background

It was back in 1983, when the government of the Republic of China officially established the grounds for the development of the venture capital industry. The Administrative Committee on Venture Capital Investment Enterprises was created as a government entity in charge of regulating and supervising the newborn industry. The Ministry of Finance issued the “Regulations Governing Venture Capital Investment Enterprises” in order to permit the official registration of venture capital funds in the country. The first government funneling of resources towards the venture capital industry was when in 1983, the Executive Yuan Development Fund allocated NT\$ 800 million in order to initiate several funds.

Experts in this field consider the period between 1983 and 1995 as the developing stage of the Taiwanese venture capital industry. During that time, the establishment process for venture funds was relatively slow, with no more than 7 funds created during one year.

Following the strong growth trend that venture capital industries experienced in other parts of the world such as the United States and Sweden, the Taiwanese industry also managed to climb up to its expansion phase. Set-up venture funds increased from 34 in 1995 to 114 in 1998.

Starting 1999, the number of new venture capital funds has shown a more stable behavior, signaling that the industry as a whole it's starting to mature. In table 1, some interesting statistics are shown regarding the growth of the industry.

Table 1. Venture Capital Funds in Taiwan.

	1996	1997	1998	1999	2000	2001	2002
Total No. of Venture	48	76	114	160	192	199	217

Capital Funds							
New Funds established	14	28	38	46	32	7	18
Discontinued funds (yearly)	1	3	3	0	0	4	1
Total Operating Funds	47	72	107	153	170	176	194

Source: Taiwan Venture Capital Association Annual Report, 2002.

In order to offer an incentive for investors to allocate resources into the nascent industry, the government of the Republic of China decided make available a 20% income tax deduction for individual and corporate shareholders of venture capital funds. Nevertheless, in 2000, the government decided to eliminate that tax incentive on the basis that it provided a “double” tax deduction for both the venture capital company and its shareholders. Yet, the shareholders of venture funds that were established before December 31st, 2000 can continue to receive that deduction until 2006.

The rapid and strong growth of the Taiwanese Venture Capital industry can be explained by the fact that several agents have participated aggressively since its inception in the island’s economy. Firstly, the government created two venture seed capital funds with an estimated of NT\$ 2.4 billion to strengthen the expansion of high-technology sectors and accelerate their importance in this knowledge-based society.

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Secondly, the impressive number of small and medium enterprises (SME) in Taiwan who are constantly in search of new technological advancements and resources to exploit those new scientific inventions have also pushed the demand curve of venture capital investments. In addition, the expansion of the capital markets in Taiwan and the accessible Over-the-Counter equity market have also lead to investors to pour more of their resources into high-tech enterprises.

Table 2. Capital under Management.

	1996	1997	1998	1999	2000	2001	2002
Total Fund Size (NT\$100 million)	254.60	426.31	729.32	1,034.25	1,280.76	1,341.07	1,512.88
New Funds raised (yearly)	67.57	171.71	303.01	304.93	246.51	60.31	171.81
Average Fund Size	5.42	5.92	6.82	6.76	7.53	7.62	7.80

Source : Taiwan Venture Capital Association Annual Report, 2002.

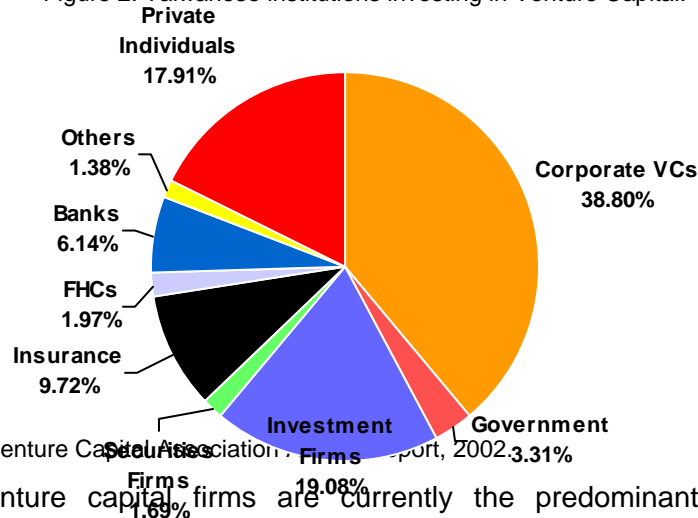
All those funds mentioned above, belong to several players in the venture capital industry in the likes of banks, insurance companies, securities firms, corporations and individuals. However, some government regulations have established particular restrictions to the participation of banks, insurance and securities firms in this business, mostly regarding on the amount that they can invest in this form of investment. It's rather important to mention that deposits from the Post Office and government pension funds are totally prohibited from investing in Venture Capital funds. An overview of these legal parameters established by the government will be done at the end of this chapter.

4.2 Industry Fundamentals

Fundamental aspects regarding the Taiwanese venture capital industry in Taiwan are explained below. The focus is on the institutions involved in this type of investment, their characteristics and environment.

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Figure 2. Taiwanese institutions investing in Venture Capital.



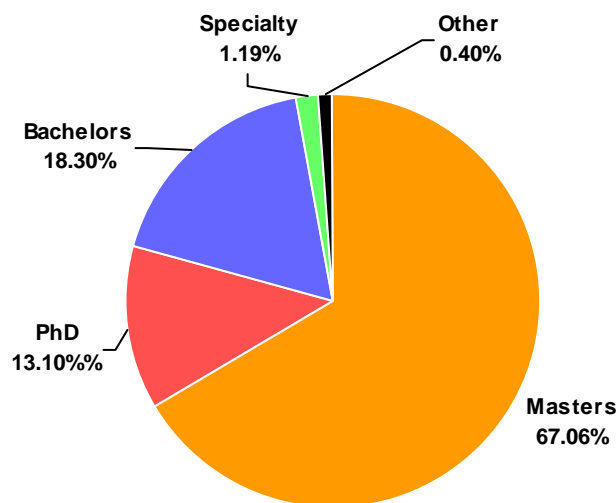
Source: Taiwan Venture Capital Association Annual Report, 2002.

Traditional venture capital firms are currently the predominant players in the marketplace, followed by investment consulting firms and private individuals.

Although other players such as insurance companies and financial holding companies also select a section of the funds to be directly invested in start-up firms, they also tend to “outsource” a section of those funds to traditional venture capital firms and to investment firms, therefore the dominant participation of those firms in the overall market.

One of the points that this research paper investigated, is the education level in different firms investing in the venture capital industry. Knowing the background of the investment team in charge of the venture funds will help determine the strategy that each firm pursues. In Figure 3 a display of the education levels of the fund managers shows a majority of Masters’ Degree graduates, followed by Bachelors’ Degree graduates. However, according to several experts in the area, an increasing number of more specialized professionals (with Ph.D. and Masters’ degrees) will be the trend in the near future.

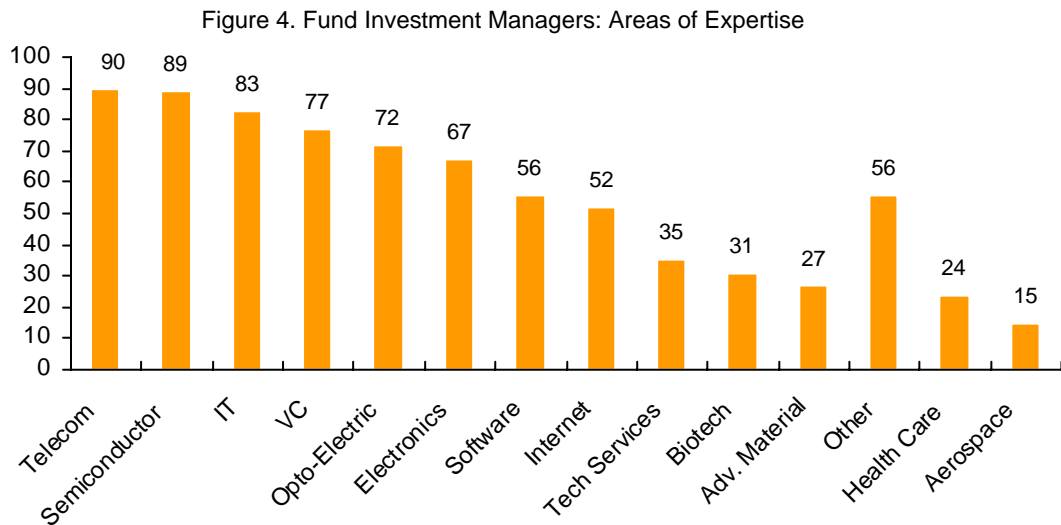
Figure 3. Fund Investment Managers: Education Level



Source: Taiwan Venture Capital Association Annual Report, 2002.

In figure 4, we can see some of the areas of expertise that fund managers of VC firms possess. Indeed there are several more areas but an overall picture like this one, shows us the high degree of professionalism and specialization that the Taiwanese venture capital industry currently holds. The category “other” includes experts in the financial arena which evidently it’s an area that many firms consider very important for their fund managers. Since this characteristic it’s also one of the determinants of the

firm's investment strategy, a further analysis will be done over the enterprises that this research paper includes.



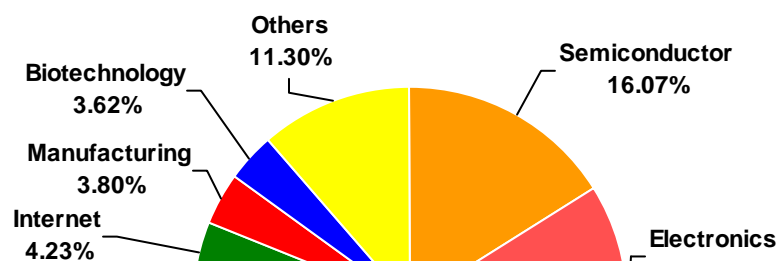
Source: Taiwan Venture Capital Association Annual Report, 2002.

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The information previously displayed is a key issue to examine. In Taiwan, several high-tech start-up firms are broadly managed by professionals with nothing else than a technology background. Regardless of the needs of capital that those start-ups require, they also seek added-value services such as strategic planning, access to a wider network of professionals, potential customers, suppliers, etc. Therefore, many Taiwanese Venture Capital players have strengthened their capabilities in order to attract those start-up firms by offering them professional services and skills that are hard to not have an access to. But the willingness and ability of those venture capitalists to provide those added-services to the start-up firms are part of their investment strategy. This paper is mostly focused in this situation.

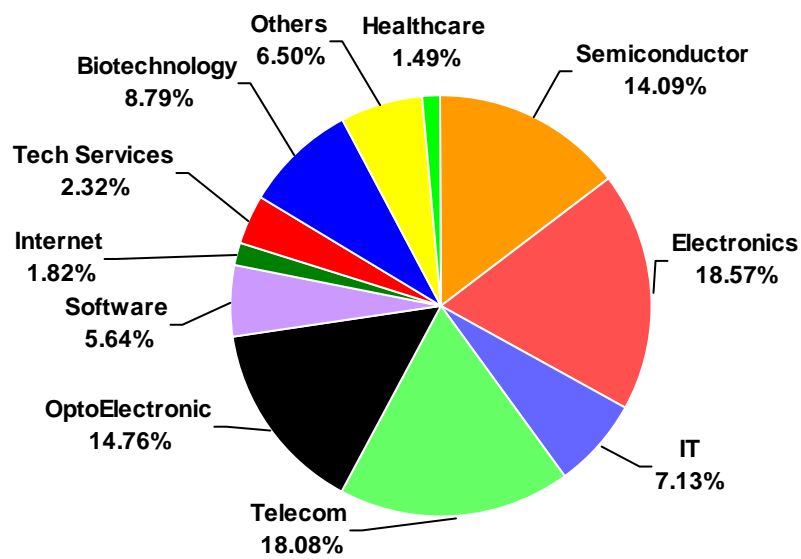
Since its birth, the Taiwanese venture capital industry has focused mainly in some high-tech sectors that obviously are linked one to another. In figure 5 we can see those industries as an accumulated investment from 1984 until the year 2002. Figure 6 shows the same allocation but only for the year 2002. When comparing these two sets of figures, it's important to note that the biotech industry has advanced significantly over the years, situation that explains its current boom not only in Taiwan but also worldwide.

Figure 5. Accumulated VC Investments by Industry and by Amount of Investments (1984 – 2000)



Source: Taiwan Venture Capital Association Annual Report, 2002.

Figure 6. VC Investments by Industry and by Amount of Investments, 2002.

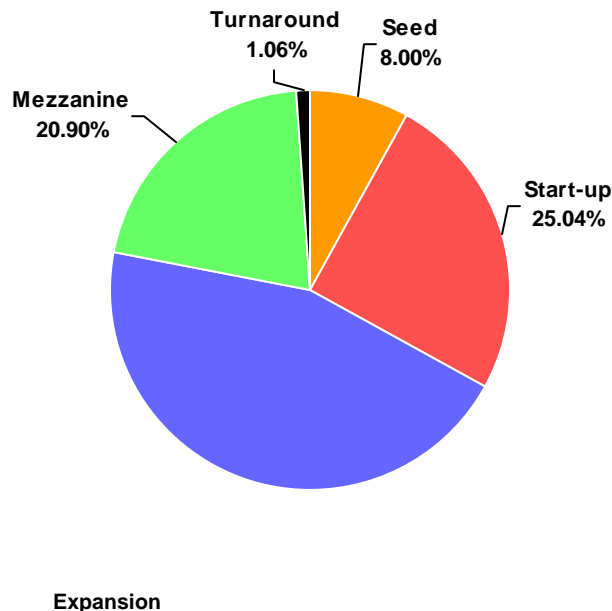


Source: Taiwan Venture Capital Association, 2002.

In Figure 7 a display shows the accumulated investment of venture capitalists into the five stages described in the previous chapter, according to the amount of investments

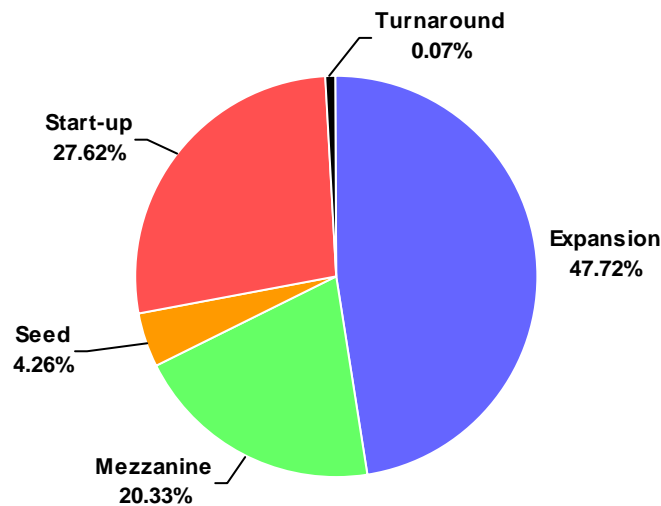
between 1984 and 2002. The preferred invested stage has been the expansion stage as it's typically the time when many companies proved to have the potential enough to attract investors with more tolerance towards risk. In Figure 8 the same graphic is presented but only for the year 2002 in which we can observe that the funding of expansion-stage enterprises become slightly more important and the seed investment decreases significantly. Let's remember that the year 2002 was the year after the beginning of a worldwide recession, which definitely made more investors adopt a higher degree of risk-aversion. Another proof of that theory is the fact that in the year 2002, the investment in turnaround companies practically disappeared.

Figure 7. Accumulated VC Investments by Stage and Amount of Investments, 1984-2002



Source: Taiwan Venture Capital Association Annual Report, 2002.

Figure 8. VC Investments by Stage and Amount of Investments, 2002.



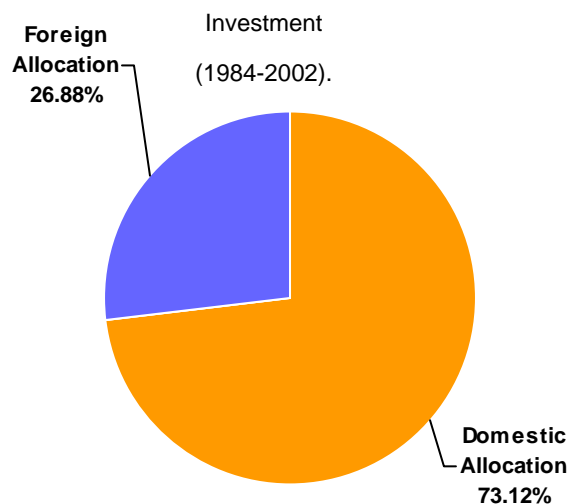
Source: Taiwan Venture Capital Association Annual Report, 2002.

Regarding the geographical investment allocation, venture capital has funded both domestic Taiwanese firms as well as foreign firms. Even though details about the weighting of each country are not provided, it's important to mention that the main regions invested are the United States (especially the Silicon Valley), Asia and Europe.

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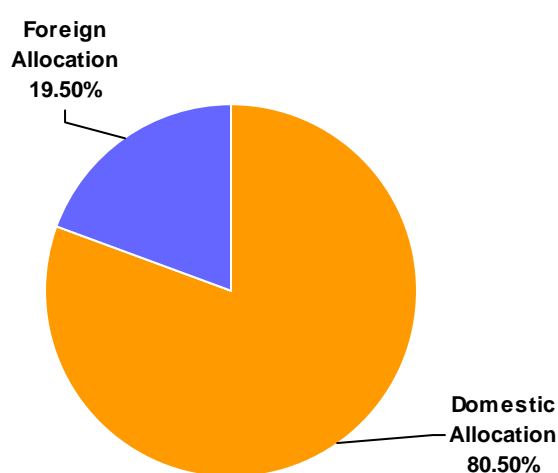
In Figure 9, the pie chart shows us a little more than a quarter of funds have been invested in foreign regions will almost three quarters have been invested in Taiwanese firms. However, Figure 10 tells us that in the year 2002, the geographical asset allocation didn't follow the historic behavior meaning that due to several economic and geopolitical uncertainties, the Taiwanese venture capitalists decided to overweight their domestic investments.

Figure 9. Accumulated VC Investments Allocated in Domestic and Foreign Regions by Amount of



Source: Taiwan Venture Capital Association Annual Report, 2002.

Figure 10. VC Investments Allocated in Domestic and Foreign Regions by Amount of Investment in 2002.



Source: Taiwan Venture Capital Association Annual Report, 2002.

4.3 Legal Issues governing the Taiwanese Venture Capital Industry

The legal framework governing the Taiwan venture capital industry is included in the the “Scope and Guidelines Governing Venture Capital Investment Enterprises” (創業投資事業範圍與輔導辦法). A copy of the official document can be found attached to the appendix of this paper (Mandarin Chinese Version). In the case of traditional venture capital firms, the legal restrictions are not as severe as they are for other entities such as commercial banks.

For commercial banks, the Banking Law in its 17th article limits their venture capital investments to a 5% of the total paid-in capital of the invested company. This is true for companies that are not included in the financial industry (such as high-tech companies, biotechnology, etc.). It's also important to remember that commercial banks in Taiwan can only invest until 40% of their own paid-in capital and that investments made in non-financial enterprises cannot exceed the 10% of the bank's total paid-in capital. A commercial bank it's not included in this research paper, therefore deeper analysis of this part will not be done.

For insurance companies, the Law governing their investment practices promulgates that investments made cannot exceed 25% of the investee's total paid-in capital in case that company is a venture capital company (fund). If the investee is a "limited" company, the investment amount cannot exceed 5% of that company's total paid-in capital. Another important factor is that the investee company must be included into the category of "venture capital" as defined by the "Scope and Guidelines Governing Venture Capital Investment Enterprises". Also, this kind of investments cannot exceed NT\$ 50 million or 2% of the insurance company's paid-in capital. One insurance company is included in this thesis.

In the case of securities firms, the venture capital investments are regulated by the Ministry of Finance – Securities and Futures Committee Document. This regulation limits these investments until a 10% of the total fund size or the investee's total paid-in capital. In addition, the investment in a venture fund cannot exceed 10% of the fund's issued shares as well as a 40% of the securities firm's paid-in capital.

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The Industrial Bank Establishment and Management Guidelines document stipulates that venture capital investments can be done until a 100% of a company's total paid-in capital. However, an approval must be received from the Ministry of Finance for the direct investment in a venture capital fund exceeding said fund's total issued shares or 20% of the fund's paid-in capital. In this category an industrial bank is analyzed in this research paper.

The Financial Holding Company Law, also permits these entities to invest in a 100% of the company's total paid-in capital.

