



**OECD/ADBI 7th Round Table on
Capital Market Reform in Asia**

**27-28 October 2005
ADB Institute, Tokyo, Japan**

**SESSION 4: DEVELOPMENTS IN VENTURE
CAPITAL AND PRIVATE EQUITY SINCE THE END
OF “TECH BUBBLE”**

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**Developments in Venture Capital and Private
Equity since
the end of “Tech Bubble”**

**Seventh Tokyo Round Table on Capital Markets
Reform in Asia.**

October 28, 2005

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Sources of SME Financing

	Positive cash flow	Collateral	High Return	High Risk
Banks	X	X		No
NBFIs	X			No
Govt. programmes	Usually	Usually		Sometimes
Equity			X	X
Internal Cash flow	X			

Hypothetical Life Cycle for New High-growth Companies

Phase 1: Pre-Venture Capital: Informal finance



Friends and Family
Business Angels

Precondition: overall entrepreneurial environment, flows of potential high-growth projects, links between research and commerce

Phase 2: Formal Venture Capital



Appropriate legal structures
Sources of funds (institutional investors, individuals, financial institutions, corporate sector, government)

Phase 3: Transition



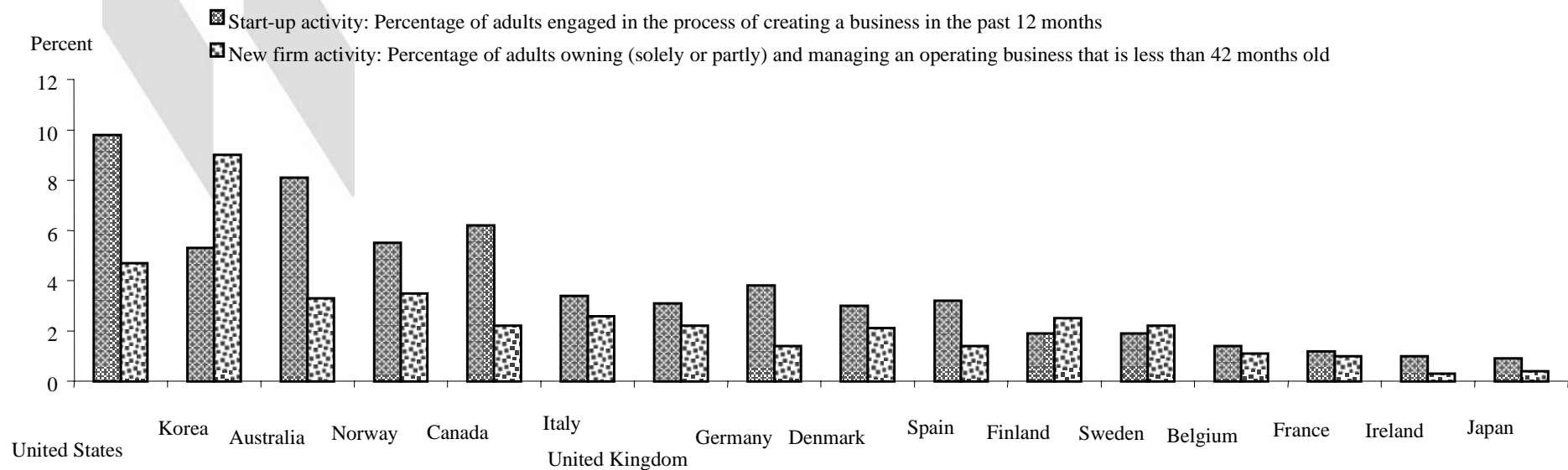
M & A
IPO Markets

Phase 4: Formal capital markets

Environment for Entrepreneurship

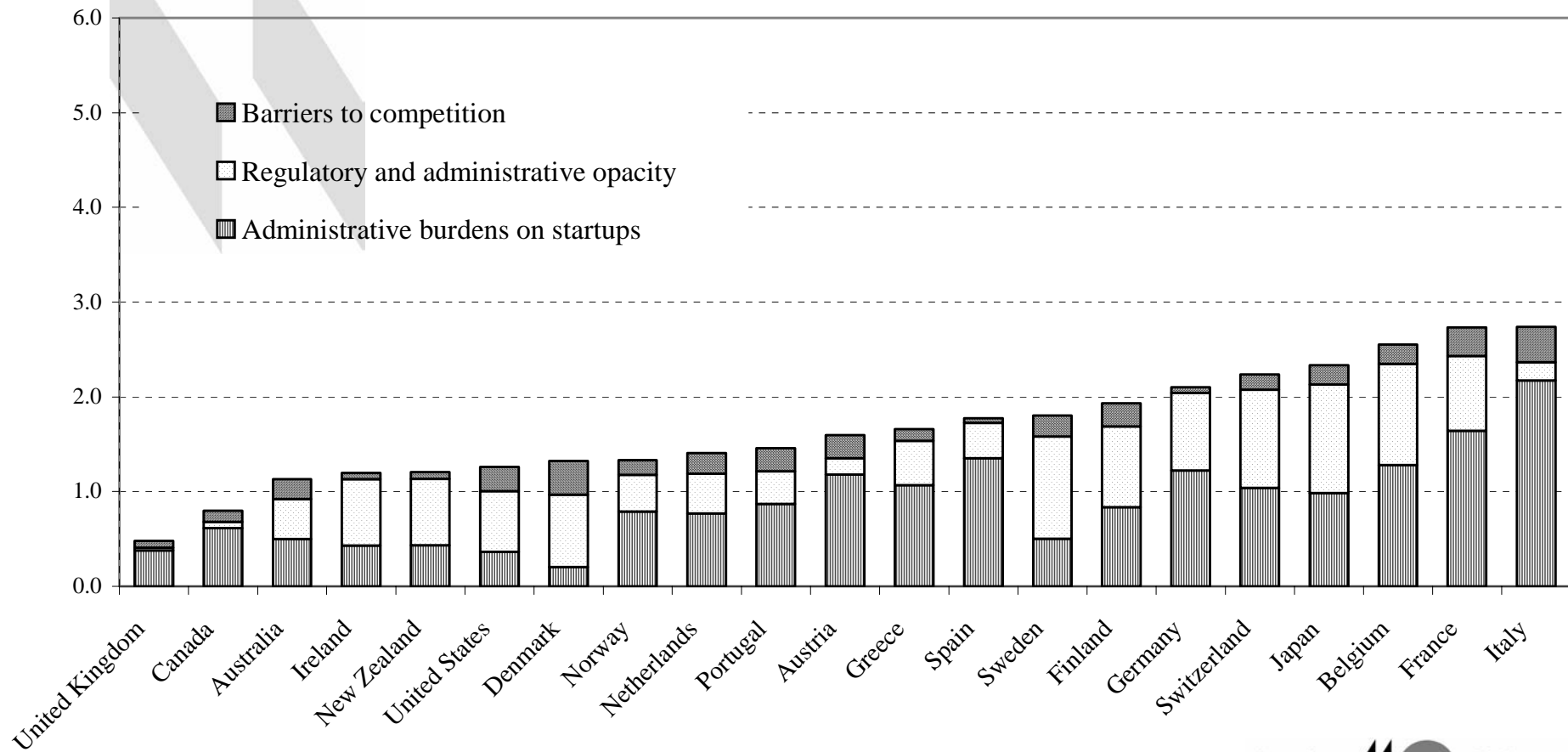
- Cultural values
- Education and training system
- Corporate and bankruptcy law
- Financial markets
- Taxation policy
- Social protection
- Science/industry linkages

Entrepreneurial Activity in Selected OECD Countries.



Barriers to Entrepreneurship Vary Across OECD Countries

Based on 1998 Data



Informal Equity Investment

- Former entrepreneurs
- Contribute capital and business skills
- “Hands on” participation, “coaching”
- Flexible participation
- Locally oriented
- Operate in both high growth companies and traditional SMEs
- “Business angels” and “business angel networks”
- An area for government support?

Venture Capital: Basic Characteristics

- Only suitable for high-growth companies
- Private equity (usually preferred shares)
- Players: entrepreneurs, venture capitals and investors
- Deal flow: screening of projects and high rate of rejection
- Intensive monitoring and coaching
- Asymmetric information, agency and monitoring problems
- Staging of investment
- Importance of exit

What kinds of firms are suitable for venture capital?

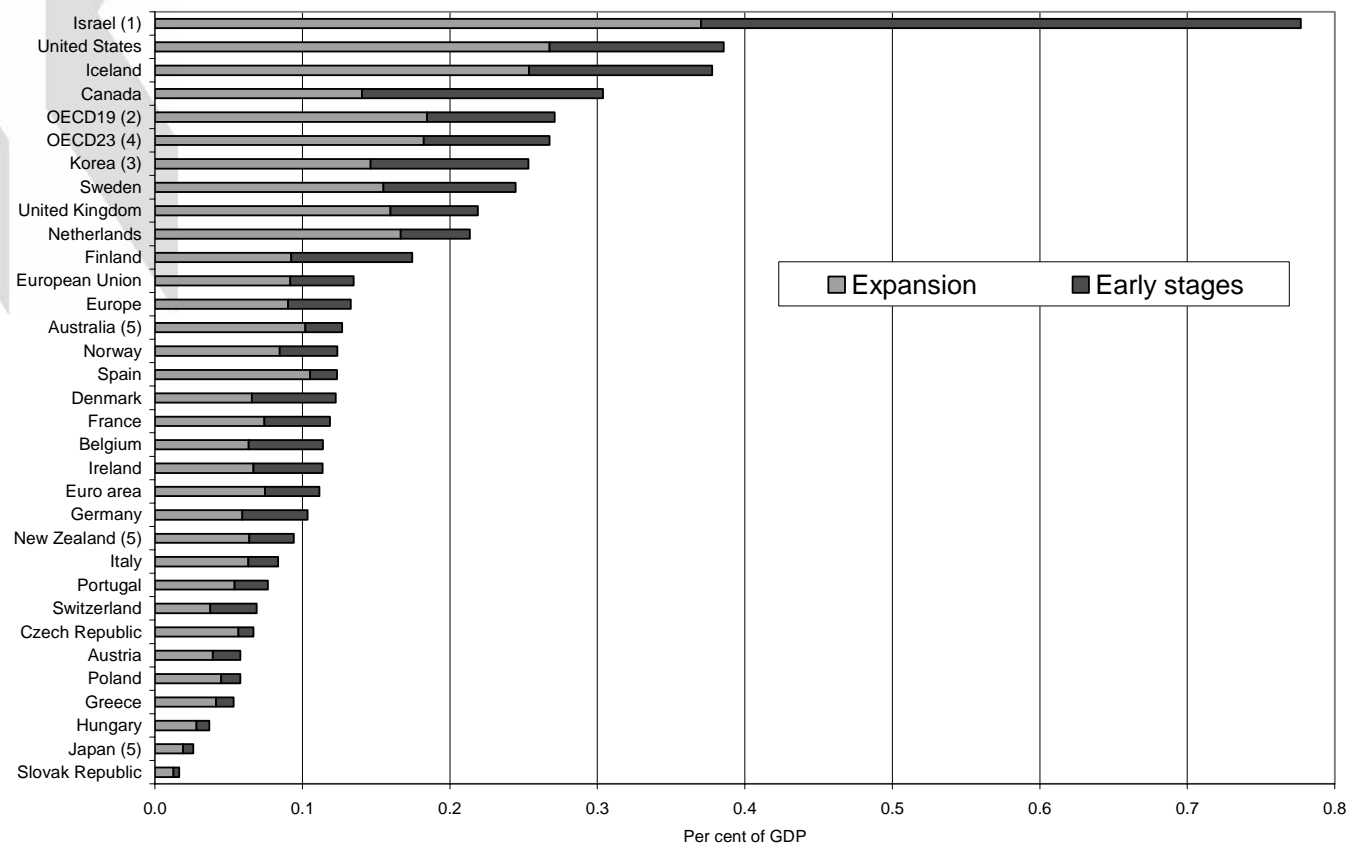
- High risk, high return
- Negative cash flow (burn ratio)
- Often technology related fields (ICT, biotech, etc.)
- Often in areas of concentration of technology related industry
- High share of tangible assets

Stages of Venture Capital Finance

- Preparatory phases: origination, screening, due diligence and deal evaluation
- Early stage
 - Seed
 - Start-up
- Expansion (one or more rounds)
- Mezzanine
- Exit
 - Buy-out
 - Trade sale
 - IPO

Venture Capital Investment

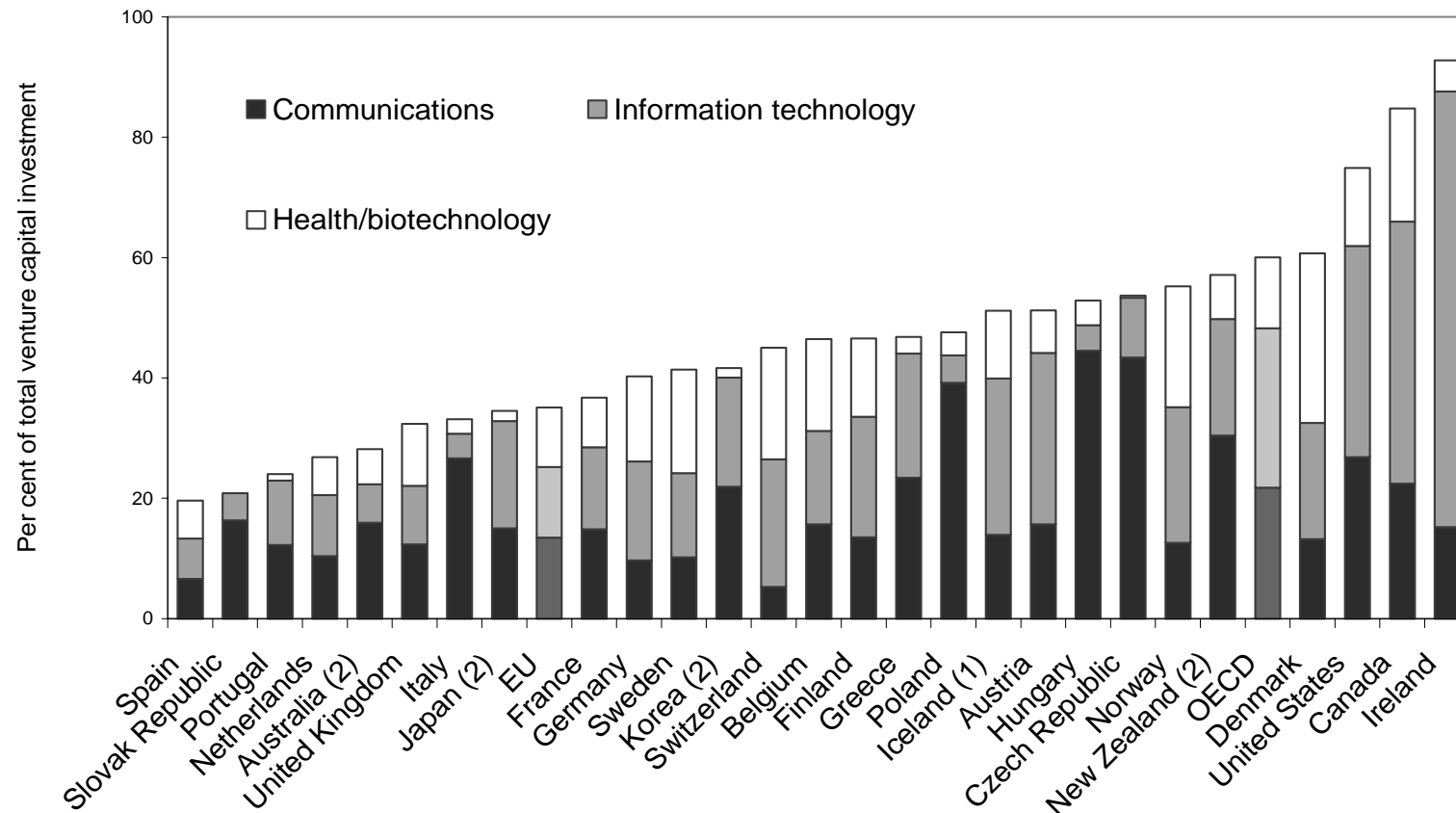
as a share of GDP, averages 2000-2003



(1) 2000-2002. (2) Europe, Canada and United States. (3) 1998-2001. (4) Europe, Czech Republic, Hungary, Poland, Slovak Republic, Canada, and United States. (5) 1998-2001.

Source: OECD, based on data from EVCA (Europe); NVCA (United States); CVCA (Canada); Asian Venture Capital Journal (The 2000 Guide to Venture Capital in Asia).

Venture Capital Investment in High-tech Industries in per cent of total venture capital investment, 2000-03.



(1) 2000-2002. (2) 1998-2001.

Source: OECD, based on data from EVCA (Europe); NVCA (United States); CVCA (Canada); Asian Venture Capital Journal (The 2000 Guide to Venture Capital in Asia).

Private Equity Fund Structures

Country (Structure)	Tax transparent for domestic investors	Ability to avoid permanent establishment for international investors from treaty or non treaty countries	Ability to incorporate a capital investment/incentive for fund managers.	Ability to avoid paying VAT on management charges	Ability to avoid paying VAT on carried interest	Freedom from undue restrictions on investments
Belgium	X	N/A		X		
Finland		X	X			
France				X		X
Germany				X		
Italy	X	N/A	X			
Netherlands		X				
Portugal	X	N/A			X	X
Spain	X	N/A				X
Sweden		X				
Switzerland	X	N/A	X	X	X	
United Kingdom						
United States						

Source: European Venture Capital Association

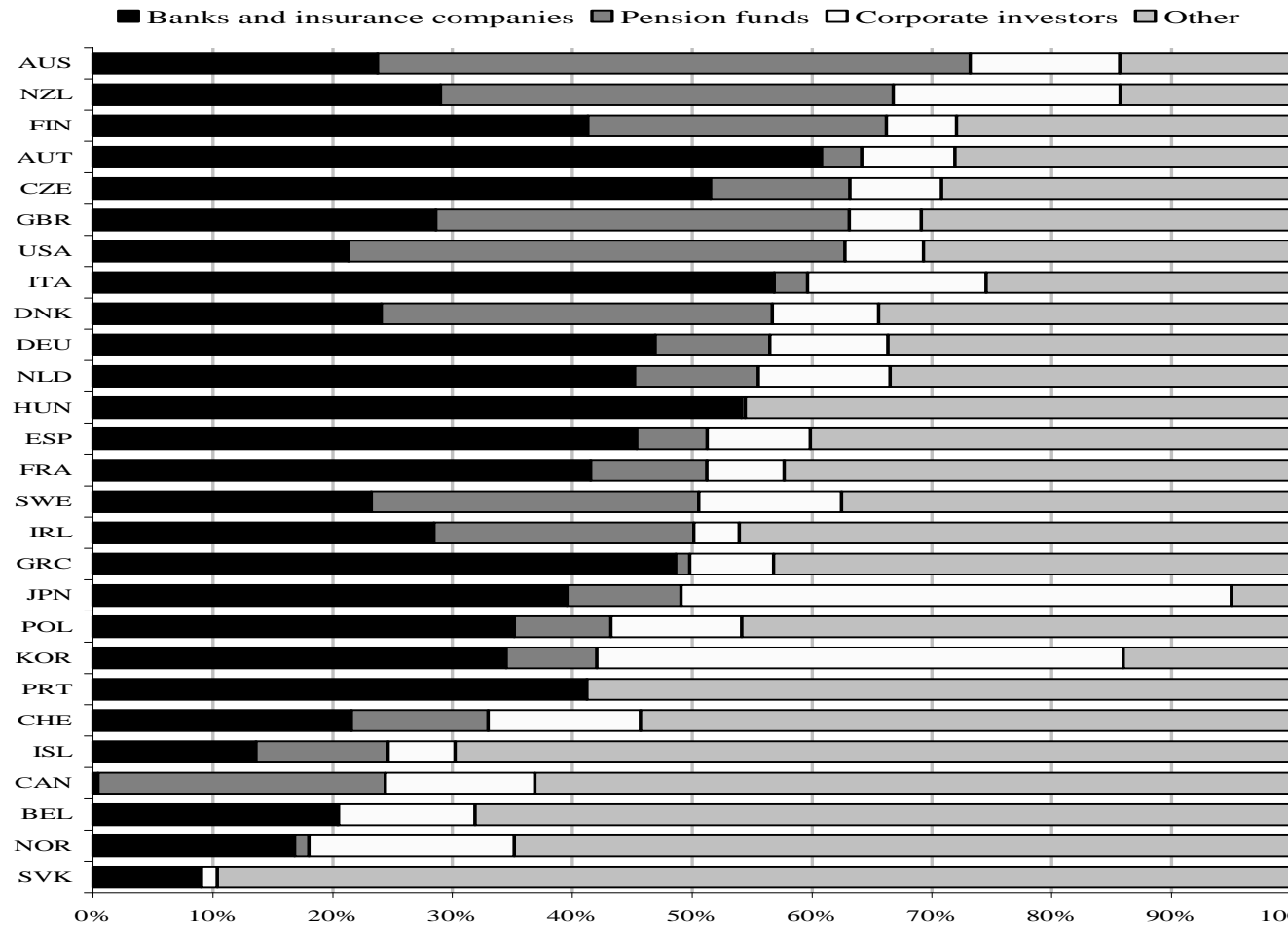
Note: An X indicates a problem in the area concerned.

Who supplies fund for Venture Capital?

- Banks
- Investment banks
- Pension funds
- Collective Investment Schemes
- Industry
- Foundations and Endowments
- High net worth individuals
- Foreign investors
- Government

Sources of Funds Raised for Venture Capital

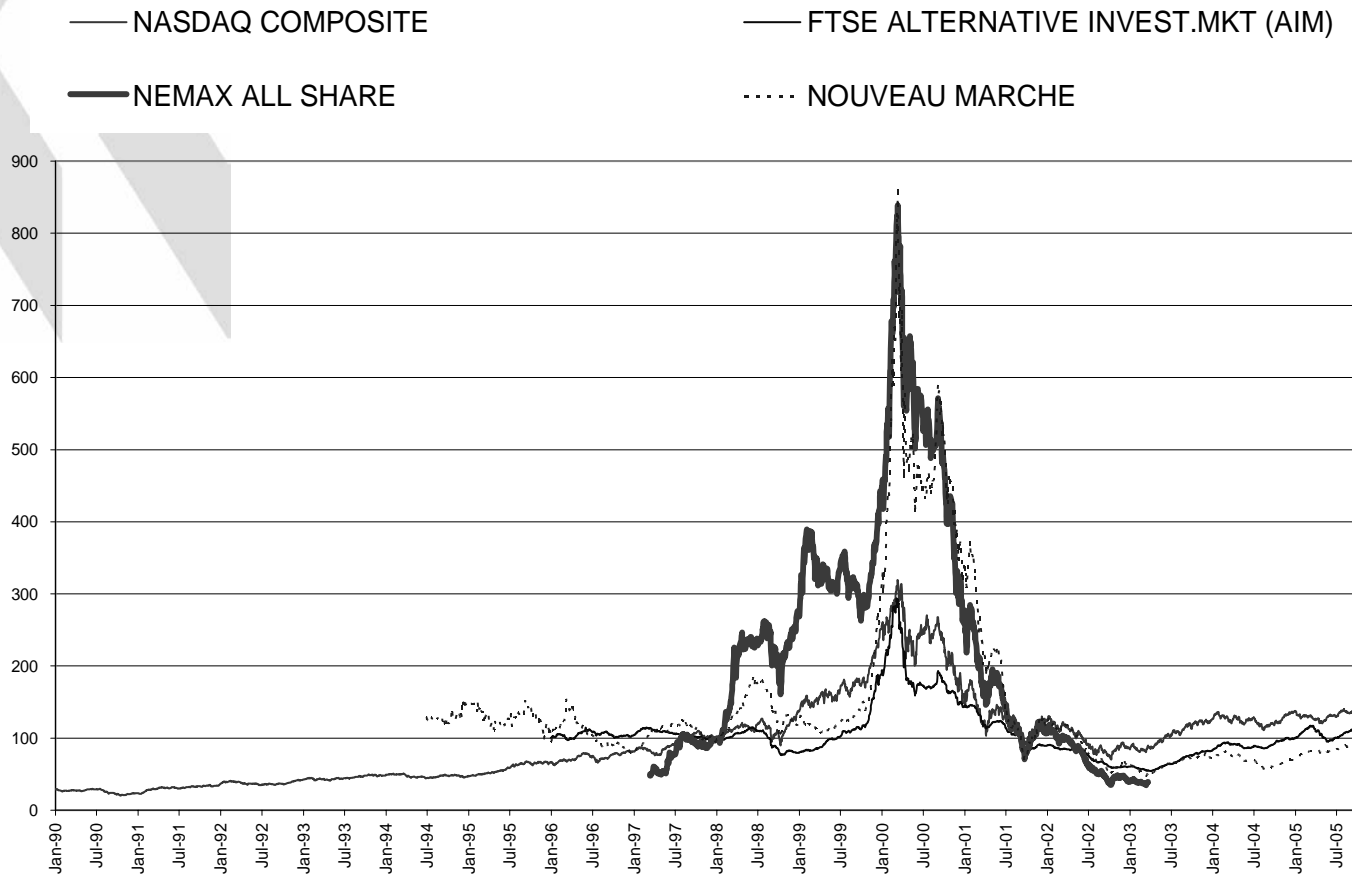
Averages over 1999-2000, per cent of total



Source: OECD, based on data from EVCA (Europe); NVCA (United States); CVCA (Canada); Asian Venture Capital Journal (The 2000 Guide to Venture Capital in Asia).

Performance of growth stock exchanges

Indices, 02/01/1998 = 100



Source: Thomson Financial DataStream.

Current Trends in Venture Capital

Highly cyclical sector

- Innovation
- Fund raising
- Inflows into sector
- Rising valuations
- Market peaks

Earlier cycles

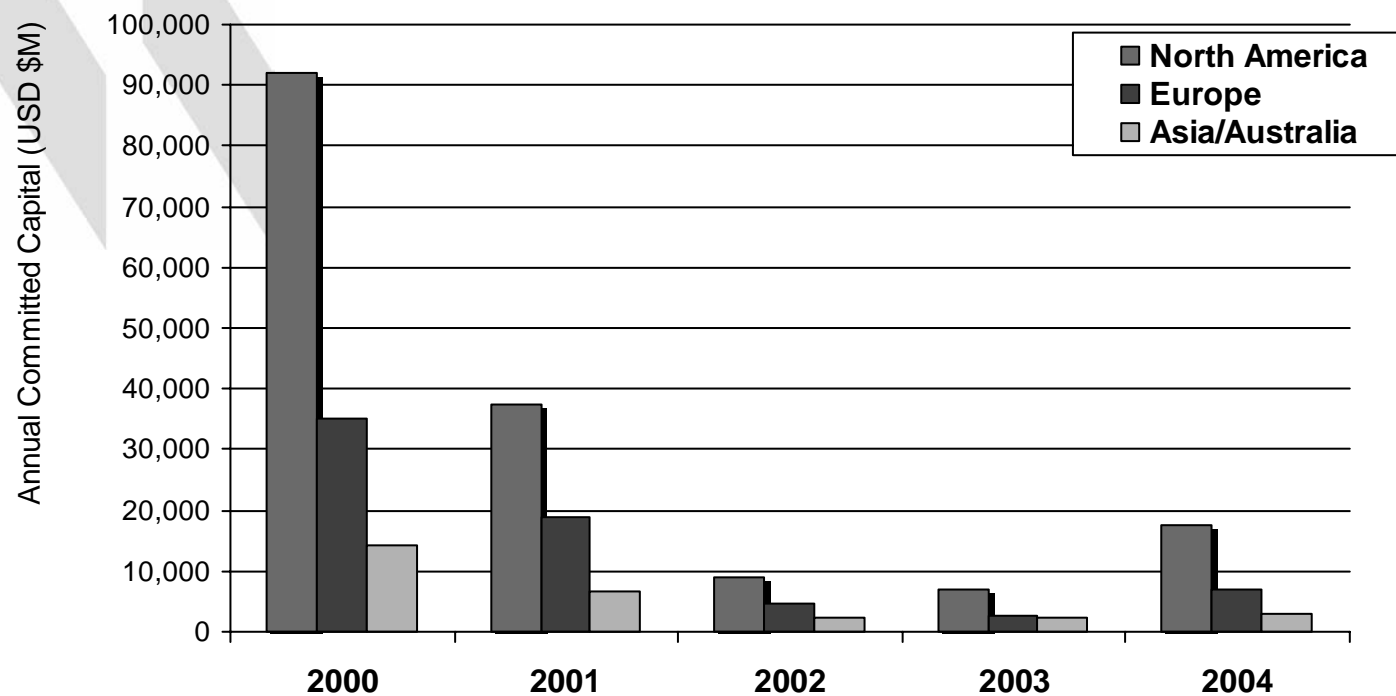
- 1980-84
- 1995-2000



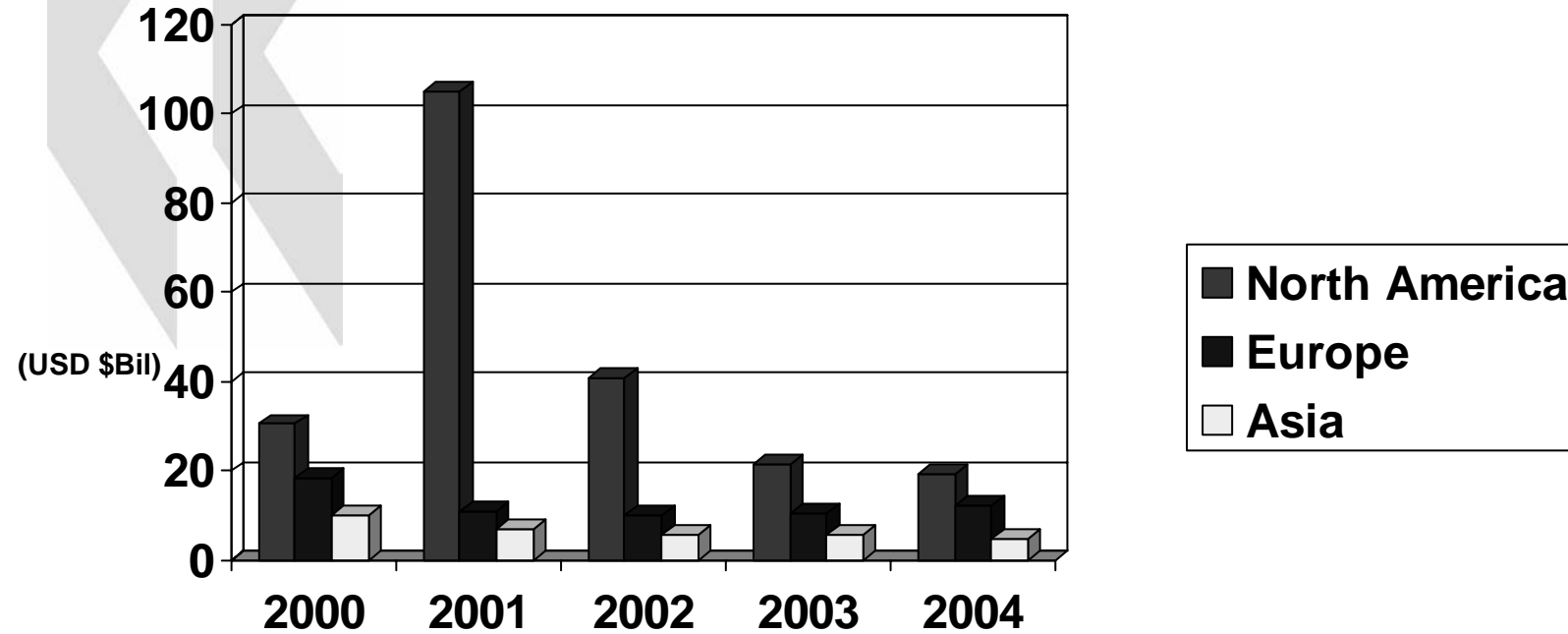
Is a New Cycle Beginning?

- Surge in activity in 2004 early 2005
- In US, both venture capital and buy-outs
- Globalization of the industry; India and China emerge
- In Europe, strong buy-out activity, **but** venture capital lags – especially early stages

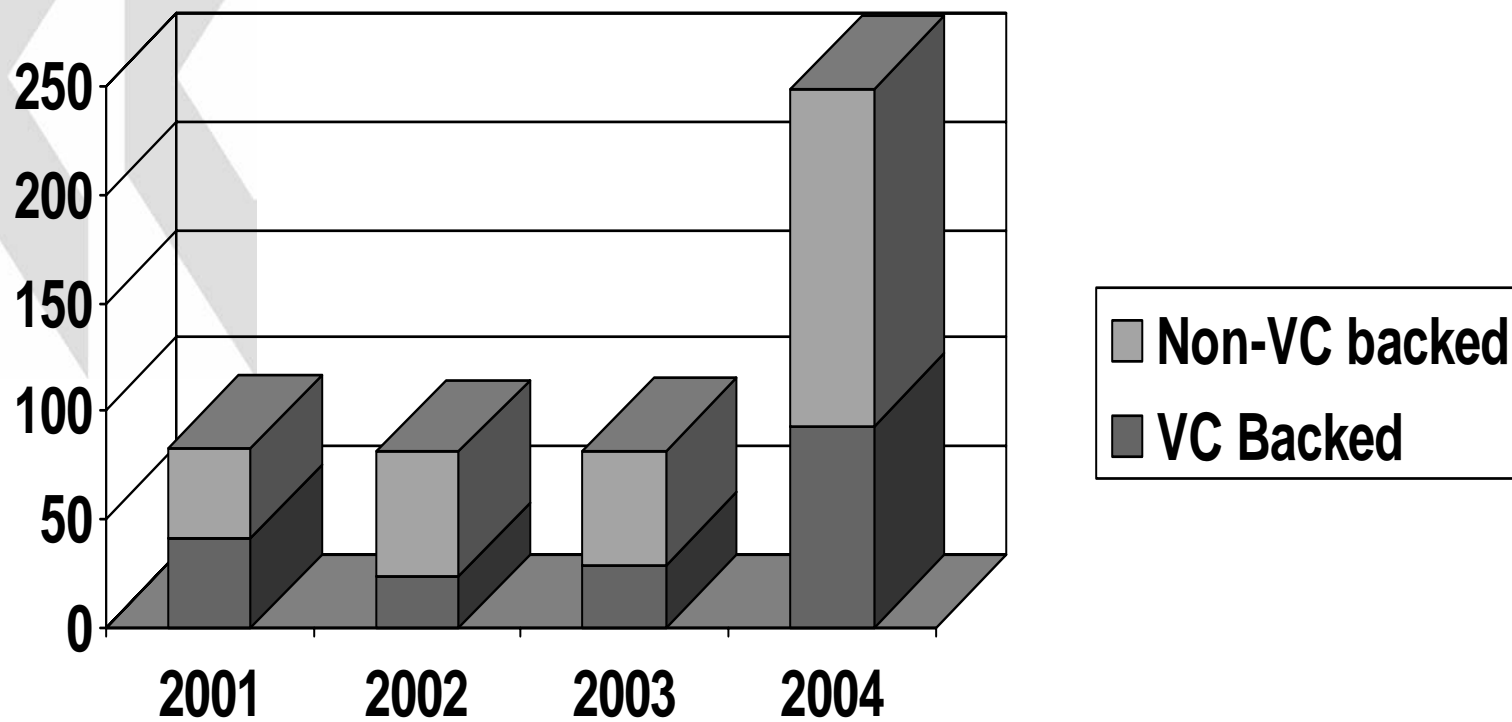
Global VC Fundraising Capital Raised by VC Funds; 2000-2004



Global Venture Investment Activity 2000-2004

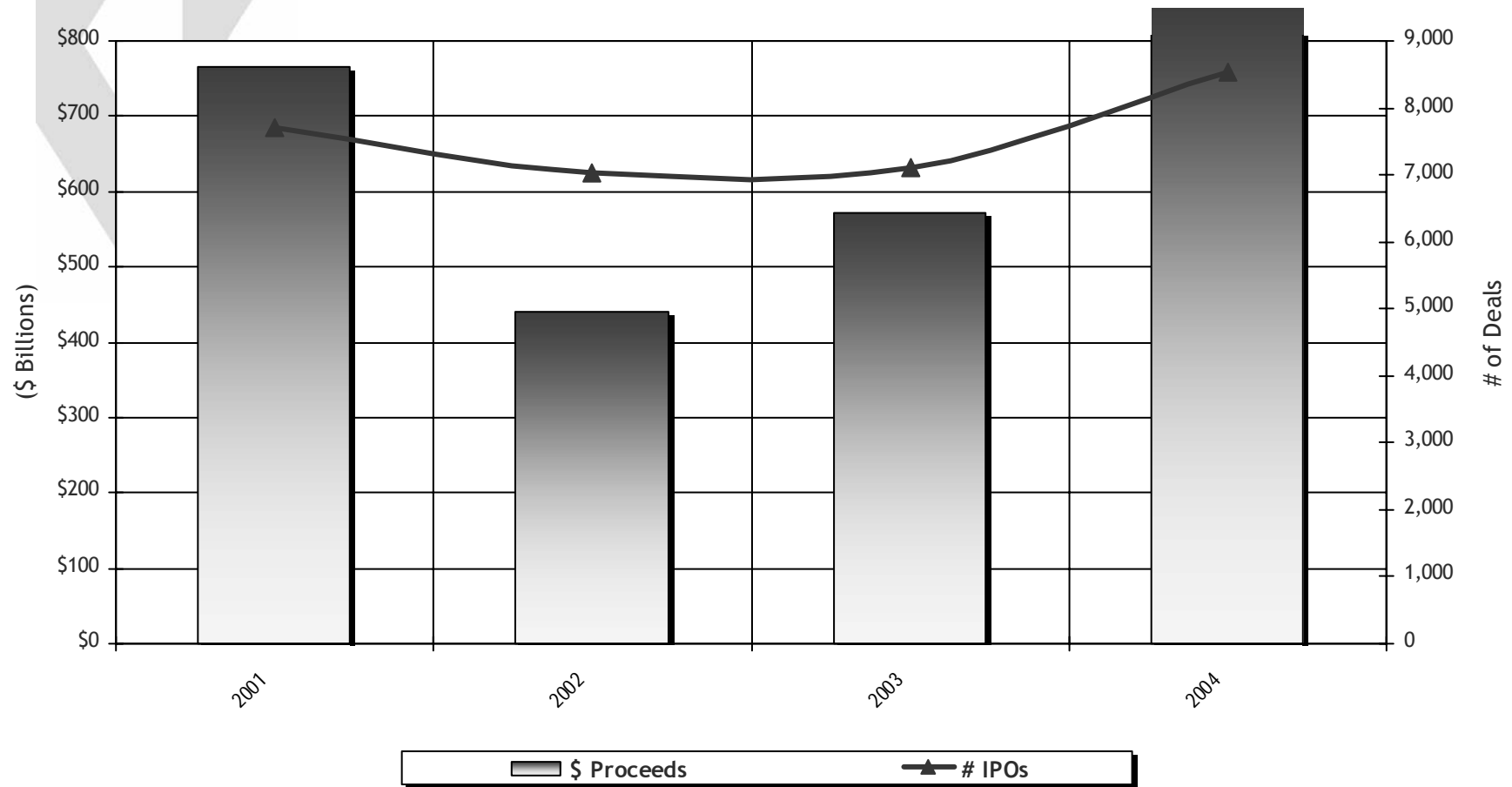


US IPO's by number of issues



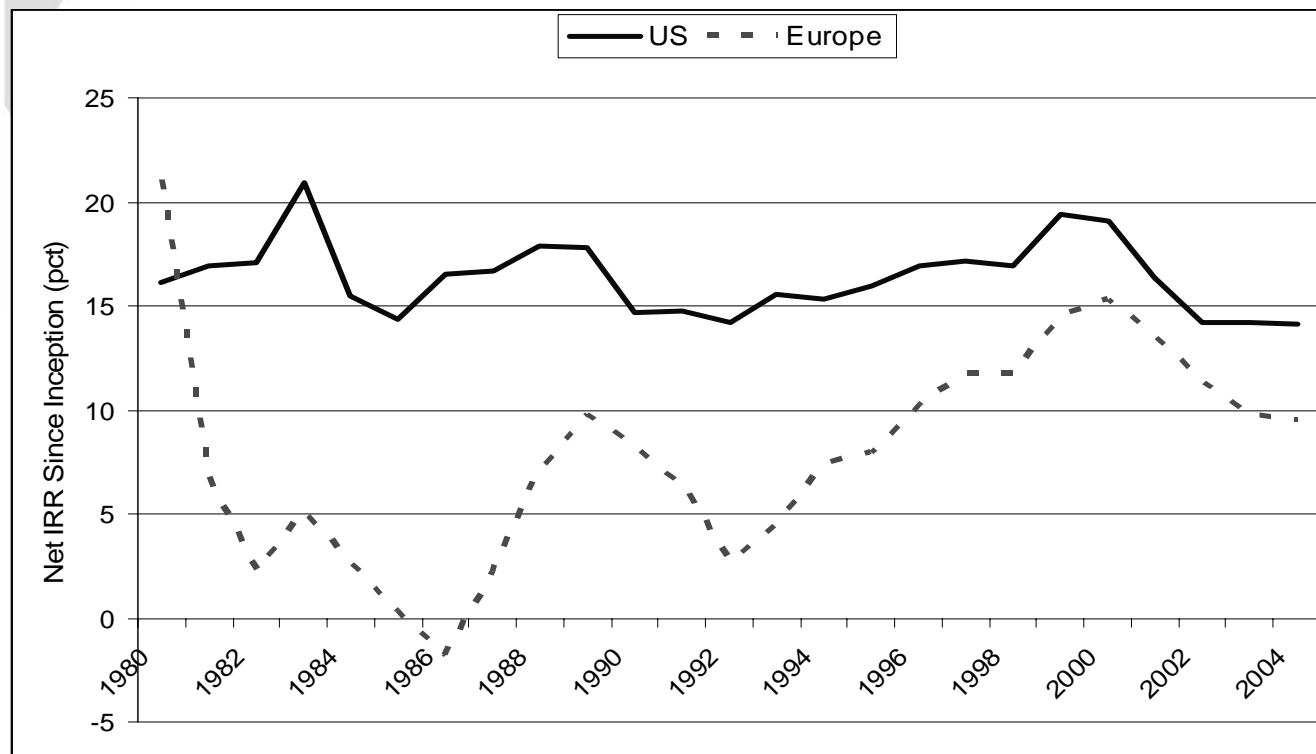
US M&A

By number of Deals & Rank Value
2001-2004



European versus US private equity cumulative IRR

Since Inception by Calendar Year (Inception to December 31, 2004)⁽¹⁾



1) US Funds formed 1969-2004, European Funds formed 1980-2004

Source: Thomson Financial

European versus US private equity cumulative IRR

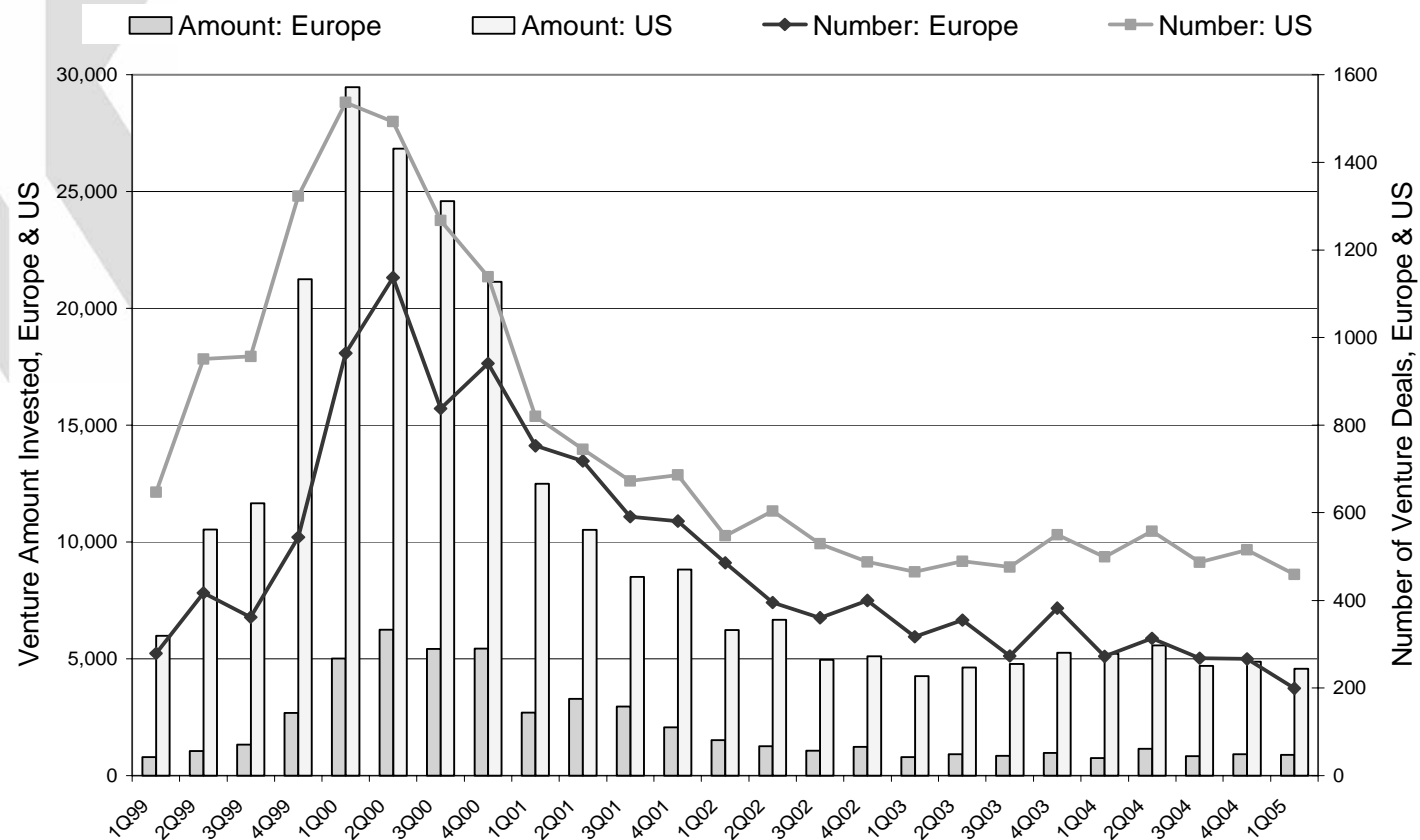
From Inception to December 31, 2004⁽¹⁾

Stage	No.	Pooled	Upper Quartile	Median	DPI	RVPI	TVPI
Early/Seed VC	545	20	16.2	2.7	1.29	0.54	1.83
Seed VC	65	10.2	13.3	4.0	1.08	0.39	1.48
Balanced VC	426	13.6	15.6	5.4	1.03	0.50	1.53
Later Stage VC	182	13.8	15.2	5.4	1.04	0.44	1.49
Total US Venture	1153	15.9	15.9	4.4	1.12	0.50	1.63
Development VC	173	8.2	7.4	0.0	0.74	0.68	1.42
Early VC	252	0.2	4.2	-3.1	0.40	0.60	1.01
Balanced VC	146	7.9	10.7	0.0	0.66	0.59	1.26
Total European Venture	571	6.0	6.7	-0.4	0.60	0.62	1.21
Small Buyouts	186	25.0	18.6	7.9	1.32	0.40	1.73
Medium Buyouts	105	16.4	16.1	6.8	1.07	0.42	1.49
Large Buyouts	82	17.4	18.8	7.0	1.01	0.59	1.59
Mega Buyouts	101	8.6	14.7	5.8	0.64	0.66	1.30
Total US Buyouts	474	13.1	17.8	7.0	0.81	0.60	1.41
Small Buyouts	218	11.2	15.8	7.6	0.92	0.51	1.42
Medium Buyouts	36	17.7	22.2	9.0	1.16	0.54	1.70
Large Buyouts	28	20.4	18.6	7.0	1.09	0.55	1.64
Mega Buyouts	25	6.4	12.8	1.8	0.38	0.81	1.19
Total European Buyouts	307	12.3	16.5	6.9	0.70	0.67	1.37

1) US Funds formed 1969-2004, European Funds formed 1980-2004

Source: Thomson Financial

Venture capital: United States vs. Europe



Source: Thomson Financial, VentureSource/Ernst & Young

US Venture Funds Annualized Net Cumulative IRR by Vintage Year As of December 31, 2004

