What is Venture Capital ?
History of Venture Capital

Formal Venture Capital investing in Thailand was initiated by the US Aid programme in 1988 when it formed an investment company, Business Venture Promotion, which was jointly owned and funded by several local banks. Business Venture Promotion's purpose was to invest in Small and Medium Enterprises (SME's) in Thailand which had strong growth potential. Following US Aid's initiation, many foreign VC companies such as H&Q Asia Pacific, Prudential, CitiCapital and others were founded in the early 1990's, at which time Thailand's GDP was growing at a double digit annual rate. These early pioneers then got together to form an Association to promote this infant industry in Thailand. The Thai Venture Capital Association (TVCA) finally became a reality in 1994 after a long debate with the Ministry of Commerce over how "Venture Capital" should be translated into the Thai language.

At present, approximately half of the TVCA's members, the Ordinary members, are Thai and international Venture Capital and/or Private Equity Fund Management firms. The other half, the Extra-ordinary members, operate businesses related to VC or Private Equity, such as financial advisory firms, accounting firms, legal firms, securities firms and finance companies.

Since 2000, the Thai government has understood the importance of the VC industry and has supported several VC funds, such as the SME Venture Capital Fund (Baht 1 billion), the Thailand Equity Fund (US$50 million) and the Thailand Recovery Fund ($250 million). The government is also considering giving tax incentives in order to promote more VC investment in Thailand.

Early History of the Venture Capital Industry

- It could be said that the first Venture Capitalist was Queen Elizabeth of Spain in 1492. She invested in her entrepreneur, Christopher Columbus, to pioneer in exploring a new continent, America.

- In 1618, a group of wealthy individuals invested their money in three small companies which were set up to manufacture and distribute office equipment. The three companies were combined and called Computing Tabulating and Recording Co., Ltd, which later was changed to IBM.

- In 1946, a formal VC institution was formed and called American Research & Development ("ARD"). In 1957, ARD invested $70,000 in 77% of a small company called Digital Equipment Corporation ("DEC"). In 1971, ARD's investment in DEC was worth 5,000 times its original investment. Within 26 years, ARD generated returns of its investment of approximately 15% per annum.

Evolution of Venture Capital Business

Venture Capital Business has always been with us in one form or another. When you want to start a shop or a business but do not have enough financial resources, you traditionally would turn to your parents, relatives and friends for their supports.
hope that one day you could grow the business profitably so that you can give them back the money with good return to them and yourself. These types of supporters are called **Angel Investors**. Venture Capital Business then gradually developed as wealthy friends got together and pooled their money for investment by entrusting one or more of the partners (called **General Partners**) to manage that pool of money to make long-term investment in companies with expectation of high potential returns. Most of the formal Venture Capital or Private Equity Funds in the United States are therefore in the form of **Limited Partnership**, whereby the silent partners are called **Limited Partners**. Nowadays, Pension Funds and Insurances companies are major sources of funds which invest in VC funds in this Limited Partnership form.

The VC Industry in Thailand

- Most Venture Capital and Private Equity Funds are managed by international fund management firms.

- Most VC firms in Thailand prefer to invest in Expansion or Mezzanine stage finance and typically emphasize specific industries.

- After the financial crisis of 1997, many VC firms turned to investing in restructured companies, including those listed companies on the stock exchange.

- Depending on the size of their funds, VC firms in Thailand invest amounts of capital ranging from Baht 5-20 million to US$10-50 million per investment.

Objectives

- To promote Venture Capital and Private Equity businesses (hereinafter will be called "VC Businesses") in Thailand.

- To support and assist members in all problems related to VC businesses in Thailand including negotiations with any foreign parties in order to promote VC businesses. The Association will also monitor VC businesses both inside and outside of Thailand for the purpose of promoting VC businesses.

- To promote closer working relationships among members in order to exchange ideas and opinions regarding technical knowledge, news, economic research and financial information for the benefits of all members.

- To communicate and distribute information and news about its members among the members and, with the permission of its members, to the general public.

- To work closely with the government in order to promote best practices in the VC industry in accordance with the government’s policy.

- To negotiate or enforce any rules and regulations for its members.

- To assist in settling any disputes among its members or between its members and other entities.

- To organize meetings, to promote sporting activities and to assist its members in any way which is not prohibited by the Association.

The Meaning of Venture Capital

- Long-term risk capital which makes long-term investments in a high-growth companies.

- VC expects high risk-adjusted return. In other words, high risk investment should give high returns.

- VC funds must invest and divest within a specific time frame. Most VC funds have 7-10 year lives.

- Formal VC funds are managed by professional fund managers. VC funds invest in companies with high growth potential so that the companies can eventually be listed on a stock exchange, which is the most popular potential exit for the funds, or sold to strategic buyers.

Type of Venture Capital

Venture Capitalists can be categorized in to three types:-

- **Angel Investors** are investors such as wealthy friends and family who usually provide seeds capital to start up a company or businesses

- **Limited Liabilities Companies** are investors who use their own internal cash within the companies to invest with entrepreneur, e.g. Business Venture Promotion, CitiCapital. This type of VC does not separate the funds and the Manager into two different entities

- **Fund Structure:** This type of VC will have funds and Managers in two separated entities, e.g. H&Q Asia Pacific, Prudential, Asian Direct. The fund-manager companies can manage more than one funds. The fund company will usually have limited life of ten years. The funds are usually set up as either limited partnership or limited liabilities company while the fund manager is either the general (managing) partner of the limited partnership or another limited liabilities company.

Capital Flow

INVESTMENT

DIVESTMENT

Source of Funds

Funds and Fund Managers

- There are many types of investors in VC funds, such as pension funds, insurance companies, banks, wealthy individuals and corporations.

- In the USA, funds are formed as limited partnerships; however, in Asia, most funds are formed as limited liability companies.

- Funds usually have 7-10 year lives, although some funds are evergreen funds.

- Fund Managers will sign a management agreement, in which the investment policy is set (e.g. funds cannot invest in residential real estate, casinos or gambling companies, etc.) and the management fees laid out.

- Fund Managers are usually paid annual management fees of 2-3% of the invested funds and also share around 20% of the total net profit of the funds, so long as minimum return hurdles are cleared.

Risks vs Return

VC investment is very high risk in nature. For example, if a VC invests in a start-up company, then probability of success is in fact less than 4%. Investors always expect risk-adjusted return, i.e. high risk=>high return. Normally investors in a VC fund expect a net return of at least 20% per annum, which means that the whole fund will have to get at least 25-30% return before any expenses or carried interest (profit sharing to the fund manager). In order to achieve the 25-30% target, the fund manager will have to target 35-40% in order to compensate for the failed investment in the fund.

Expected Return		Perceived Risk			
Investors	20%	Start-up risk	50%	Management Risk	50%
VC Fund	25-30%	Technology	50%	Production	50%
Each Investment	35-40%	Marketing	50%		
		Implied Success probability			3.2%

In the above table, If a VC Fund invests in a start-up company and we assume that each risk, i.e. start-up risk (S), management risk (M), technology risk (T), production risk (P) and marketing risk (K), is 50% chance of success and failure, then the probability that that particular start-up company will do everything right and become successful is S x M x T x P x K = 50% x 50% x 50% x 50% x 50% = 3.2%!!!

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