Asia-Pacific
Economic Cooperation

Securing Initial Equity Funding for Startup Companies – The Birth & Growth of SMEs in a Knowledge-Based Economy

APEC Small and Medium Enterprises Working Group

May 2000

APEC Seminar on

Securing Initial Equity Funding for Start-up Companies – The Birth and Growth of SMEs in a Knowledge-based Economy

— Agenda —

Day 1, Tuesday, 16th May 2000

Registration
08:30-09:00

Opening Remarks
09:00-09:10 *Opening Remarks*

- **Mr. Pin-kung Chiang**
  Chairman, Council for Economic Planning and Development, Chinese Taipei

Keynote Speech
09:10-09:30 *Creating a Friendly Environment to Incubate Knowledge-based Entrepreneurs*

- **Professor Don Lessard, Sloan School, MIT, U.S.A.**
  (Presentation by video)

Session One
09:30-11:00 *The Role of Government Funding for Start-up Companies and SMEs*

Moderator: Mr. John S. Wadsworth, Jr., Chairman, Morgan Stanley Asia Limited, Hong Kong

- **Mr. Saunders Miller, Senior Policy Advisor, Investment Division, U. S. Small Business Administration**
- **Ms. Susan S. Chang, Executive Secretary, Development Fund, Chinese Taipei**
- **Mr. Christopher Davis, Consultant, U.S. Small Business Administration**

11:00-11:15 Coffee Break

Session Two

11:15-12:30 *Venture Capital – Securing Initial Equity Funding for Start-up Companies and SMEs*

Moderator: Mr. Saunders Miller, Senior Policy Advisor, Investment Division, U.S. Small Business Administration

- **Mr. Ta Lin Hsu, Chairman, H & Q Taiwan Co., Limited**
- **Mr. Miin Wu, President, Macronix International**
- **Mr. Norihiko Ishiguro, Director, New Business Promotion Division, Industrial Policy Bureau, Ministry of International Trade and Industry, Japan**

12:30-02:00 **Luncheon Speech**

Opportunities of SMEs in the Globalizing Economy – Fitting into the Supply Chain of Global Products

- **Mr. Matthew F. C. Miau, Chairman, Mitac Group**

Session Three

02:00-04:00 *Investment Banking – Securing Subsequent Equity Funding for Start-up Companies and SMEs*

Moderator: Mr. Christopher Davis, Consultant, U.S. Small Business Administration

- **Mr. John S. Wadsworth, Jr., Chairman, Morgan Stanley Dean Witter Asia Limited**
- **Mr. C. Y. Huang, Vice Chairman, W I Harper Group**
- **Mr. Nelson An-Ping Chang, President, Chia Hsin Cement Corp.**
- **Mr. Johnny Chan, Chief Executive Officer, techpacific.com Limited**

<u>Day 2, Wednesday, 17th May 2000</u>

Session Four

09:00-10:45 *Developing a Healthy IPO Market*

Moderator: Mr. Jung Ho Kang, President & CEO, The Kosdaq Stock Market, Inc.

- ➢ *Market of the High Growth & Emerging Stocks (MOTHERS) of Japan*
- ● **Mr. Jun Shimizu, Chief Listing Officer, Department of Listing Examination, Tokyo Stock Exchange**

- ➢ *Growth Enterprise Market (GEM) of Hong Kong*
- ● **Ms. Ella Cheng, Director, The Stock Exchange of Hong Kong Limited**

- ➢ *Prospects of China's Private and Growth Enterprises*
- ● **Mr. Anthony Francis Neoh, Chief Advisor, China Securities Regulatory Commission**

10:45-11:00 Coffee Break

Session Five

11:00-12:30 *Developing a Healthy IPO Market*

Moderator: Mr. Anthony Francis Neoh, Chief Advisor, China Securities Regulatory Commission

- ➢ *NASDAQ of USA*
- ● **Ms. Cindy Wong, Assistant Vice President, The Bank of New York, Hong Kong Branch**

- ➢ *Taiwan Innovative Growing Entrepreneurs (TIGER) of Chinese Taipei*
- ● **Mr. Edward Y. T. Lee, Chairman, ROSE of Chinese Taipei**

- ➢ *KOSDAQ of Korea*
- ● **Mr. Jung Ho Kang, President & CEO, The Kosdaq Stock Market, Inc.**

12:30-02:00 **Luncheon Speech**
Entrepreneurship and the Knowledge Economy
- ● **Dr. Mitsuru Taniuchi, Chairman, APEC Economic Committee**

Session Six
02:00-03:15 *Case Study on Impact of Start-up Companies and SMEs on Sustainable Economic Development (Part I)*

Moderator: Professor Nigel A. F. Haworth, Head of Department and Professor of International Business, Department of International Business, The University of Auckland

- ➢ *Cases of Developed Economies*
- ● **Mr. John Griffiths, General Manager, Industry Policy Branch of Australian Department of Industry, Science and Resources (ISR)**

- ● **Mr. Naotoshi Osada, Executive Director, Japan Small and Medium Enterprise Corporation (JASMEC)**

- ➢ *The Case of a Developing Economy*
- ● **Dr. Chi Schive, Vice Chairman, Council for Economic Planning & Development, Chinese Taipei**

03:15-03:30 Coffee Break

03:30-04:30 *Case Study on Impact of Start-up Companies and SMEs on Sustainable Economic Development (Part II)*

Moderator: Mr. John Griffiths, General manager, Industry policy Branch of Australian Department of Industry, Science and Resources (ISR)

- *Successful Story in Traditional Industry*
- **Mr. Mark Jia-Hwan Han, President, Great Wall Group**

- *Successful Story in High-tech Industry*
- **Mr. Bruce Cheng, Chairman & CEO, Delta Electronics Inc.**

Concluding Session

04:30-04:45 *Concluding Remarks*

- **Mr. Paul S. P. Hsu**
  Senior Partner, Lee & Li, Attorneys-at-Law
  Professor of Law, National Taiwan University

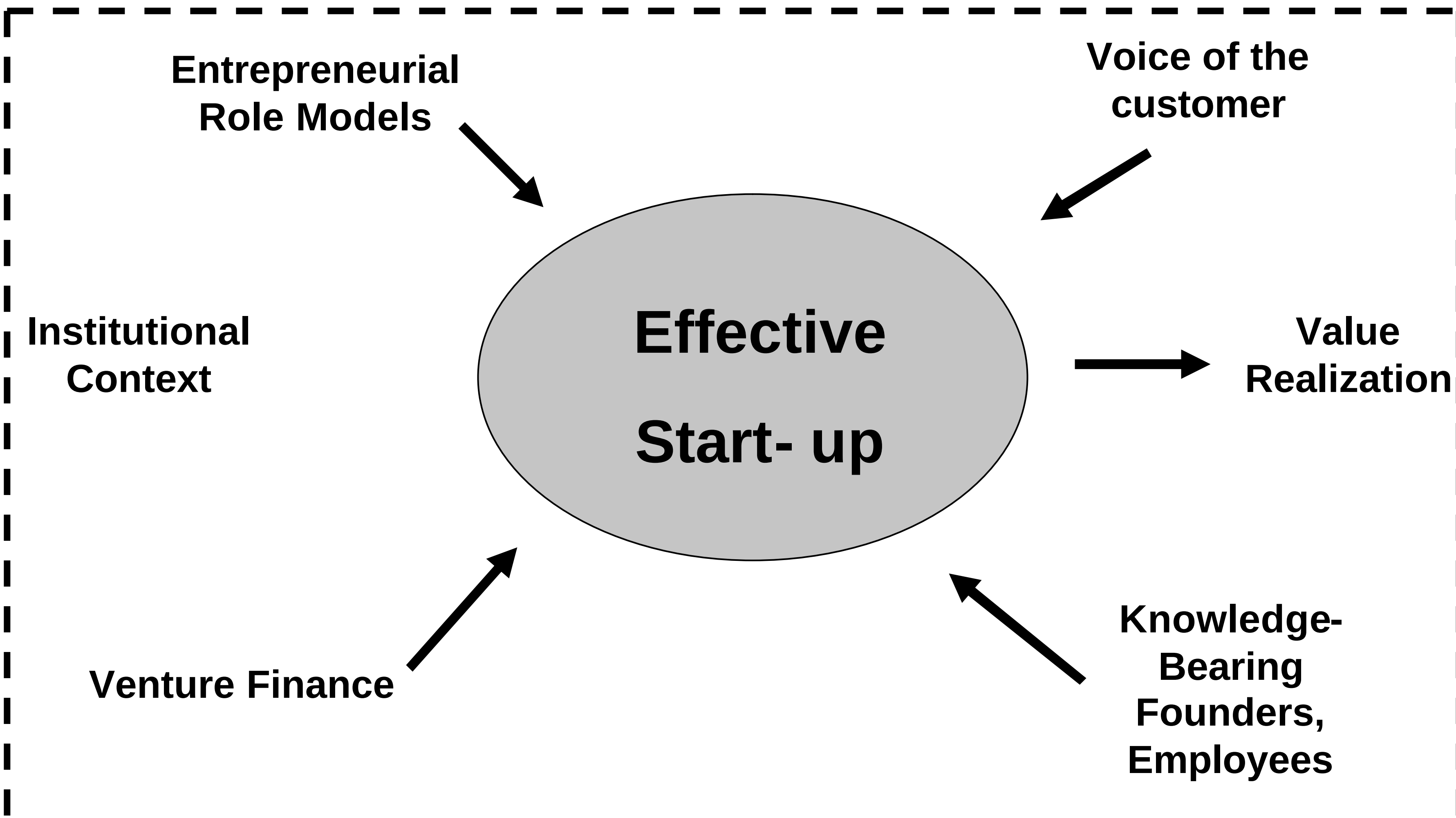
<u>Day 3, Thursday, 18th May 2000</u>

Field Trip

08:30 a.m.-10:00 a.m. From Hotel to Taoyuan
10:00 a.m.-11:30 a.m. Visit Chung Hwa Picture Tubes, Ltd.
11:30 p.m.-12:40 p.m. Lunch Break
12:40 p.m.-01:20 p.m. From Taoyuan to Hsinchu Industrial Park
01:20 p.m.-03:00 p.m. Visit Amtran Technology Co., Ltd.
03:00 p.m.-03:30 p.m From Hsinchu Industrial Park to Hsinchu Science Park
03:30 p.m.-04:00 p.m. Visit Hsinchu Science Park Administration
04:00 p.m.-05:30 p.m. From Hsinchu to Taipei

Creating a Friendly Environment for Knowledge-Based Entrepreneurs

The Venture Support System:



Institutional Content

Laws, Norms, Framing

- Rules Re: Establishment
- Finance
- IP
- Employment Relations
- Sales, Supply Relations
- Collaborative Relations
- Taxation

Rules for Finance Matter... A Lot

IPO’s in Germany

1996

1949

199
9

10 per year

80 per year

Newer Market

Source: Simon Johnson, MIT.

What REALLY matters?

“Balanced” contract enforcement

- Immediate Asset Recapture
- Limited Personal Consequences

Disclosure

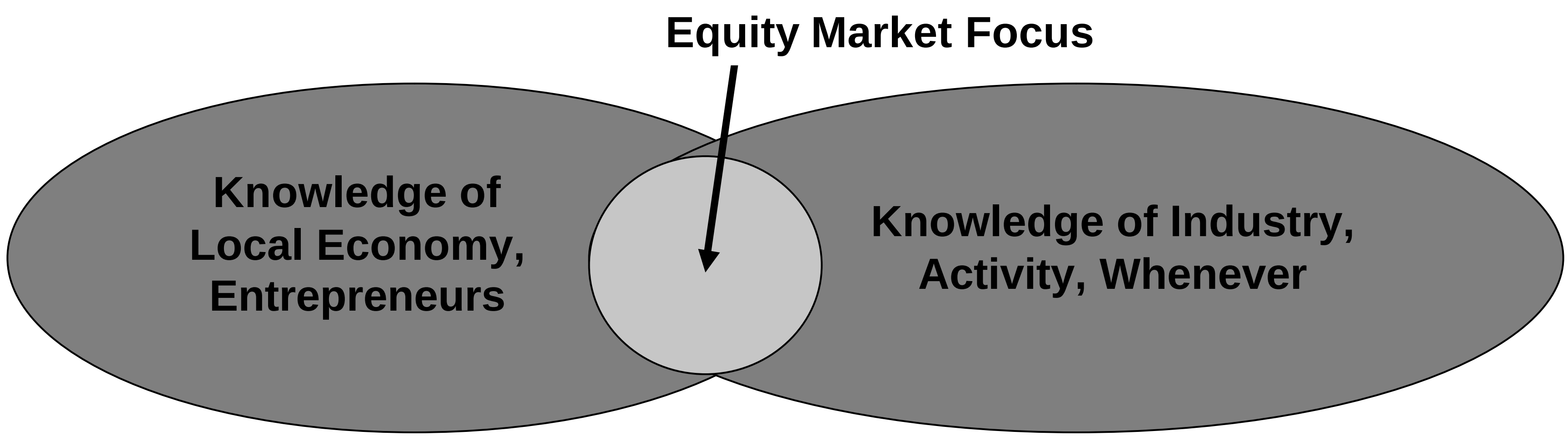
Access to Global Information, Liquidity

Global Access

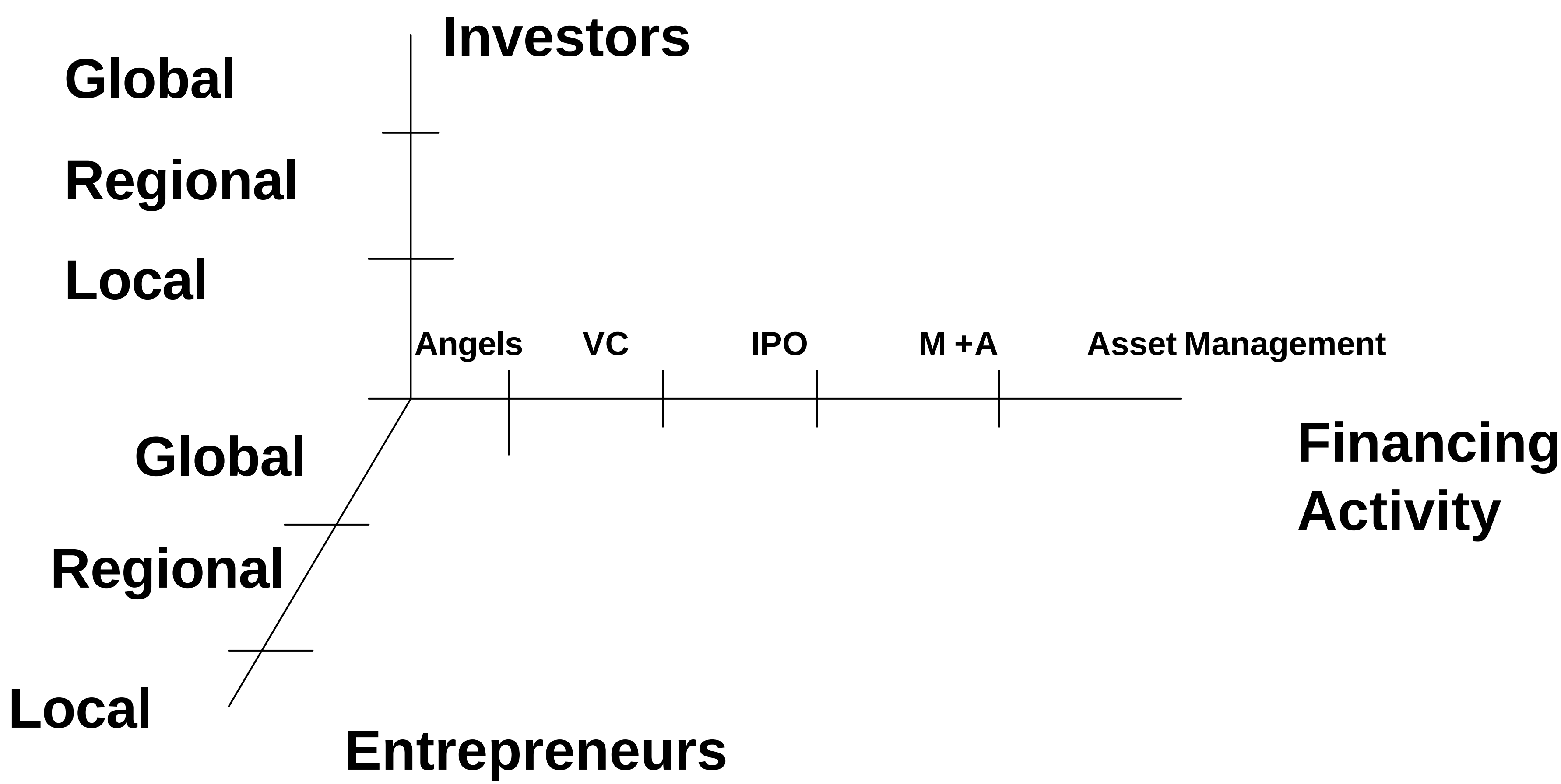
Venture Finance, Especially Early Stages, Requires Combination of:

- **Local Knowledge**
- **Global/Industry Experience Knowledge**

Investor Pool will be BEST If:



Client Focus



DESCRIPTION

SBIC Program

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Senior Policy Advisor
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Definition of Venture Capital

- Doing a financing in a private company that is too risky for a bank loan, and
- Where you expect that the company in which you have invested will grow substantially,
- Thereby making your investment worth considerably more.

Ultimate Goal of Venture Investing

➢ **Achieving liquidity through:**

- Selling the entire company
- Merger with a public company
- Repayment of the investment by the company's management at some modest increase in value, or
- An initial public offering (IPO). (While this method receives the most publicity, is actually the least common method for exiting an investment.)

Motivation of Fund Managers

- Salaries are not on a scale with investment bankers, so the
- Primary motivation: make money for their investors and personally benefit.
- Managers get 20% of the profits, known as “20% of the carry”.

Expected Returns on Investment

- Over a 10 year period, well-managed fund has a 23% ROI (return-on-investment)
- Return of 20% or more is considered good performance.
- ROIs of 40% to 100% during the past two years is abnormal — based mostly on internet profits.

New Way of Achieving Returns

ROYALTY FINANCING

- Investor receives interest payments, below market, of 8% to 10% on a loan.
- Also receives a percentage of the revenues or of the increase in revenues over a base amount.
- Royalty percentages range from 1% to 3%

What is an SBIC

- It is a venture fund just like all other venture funds with one major exception.
- SBICs can supplement their private capital with assistance from the U.S. government.
- Average SBIC has only $16 million of capital which is too little to be economically viable.

SBICs

- A fund needs to be able to afford the overhead to perform due diligence (analysis and investigations before investing), and oversight afterwards.
- Normally, the minimum required is $750,000 per annum for this overhead.
- Management fees are usually 2.5%.
- 2.5% of $30 million = $750,000
- Therefore, need at least $30 million.

Description of Leverage

- **SBA supplements private capital with two types of *“Leverage”.***
- **SBIC can issue *debentures* or *participating preferred securities*.**
- **Securities are pooled and trust certificates are issued.**
- **Institutional investors purchase trust certificates.**
- **SBA guarantees full repayment of principal and interest with the full faith and credit guarantee of the U.S. Government.**

Terms of Leverage

- **For debentures**
  - Can obtain up to 300% of private capital
  - 10 year term, no amortization, semi-annual interest payments.
- **For participating securities**
  - Up to 200% of private capital
  - SBA makes dividend payments until SBIC is cumulatively profitable. Then SBIC repays SBA, and
  - SBA gets approximately 10% of profits.

Other Terms of Leverage

- 10 Year term, 125 to 150 basis points (1.25% to 1.5%) over the 10 year Treasury rate (currently around 6.5%).
- Plus 1% per annum annual fee paid to SBA.
- 1% commitment fee plus 2% user fee, plus 1/2% underwriting fee.

Critical Point

- Capital of private investors is at risk ahead of the leverage provided by the government.
- Before the government can lose any money, the private investors have to lose all of their capital first.

The Beginnings

- **Study by Federal Reserve Bank of Boston in 1958 said there was a shortage of long-term equity-type capital for small businesses.**
- **A venture capital industry did not exist, and the term “venture capital” didn’t exist either.**
- **Only about 12 wealthy families and one public company did what is now called “venture investing”.**
- **Congress passed the *Small Business Investment Act* in 1958 and created the venture capital industry**
- **First SBIC was licensed on March 19th, 1959.**

PROGRESS

FY 99 - A Banner Year

- 53 SBICs licensed vs. 28 average in prior 5 years
- $2 billion increase in private capital
- Greater than all private capital in 35 years prior to 1994

Licensee Data

	1995	1996	1997	1998	1999
Number of Licensees	277	282	300	318	354
Private Capital ($billions)	$3.5	$4.5	$5.1	$6.3	$8.3
Outstanding Leverage	1.1	1.4	1.6	1.8	2.2
Total Capital Resources	$4.6	$5.9	$6.7	$8.1	$10.5

Investment Data

Number of Financings to Small Businesses

	1995	1996	1997	1998	1999
Participating Securities	126	234	495	651	856
Debenture	624	603	768	1,576	1,115
Bank SBICs	318	381	536	590	796
Specialized SBICs	1,153	889	932	639	328
TOTAL	2,221	2,107	2,731	3,456	3,095

Amount of Financings ($Millions)

Participating Securities	110	215	360	510	645
Debenture	282	313	360	493	640
Bank SBICs	704	972	1,531	2,127	2,870
Specialized SBICs	154	117	118	109	60
TOTAL	1,249	1,616	2,369	3,239	4,216

Investment Data

- **Average size of investment by leveraged SBICs in FY99: $664,000 to $1,500,000 depending upon the way the data is classified.**

Age of Businesses Financed

Under 1 Year	31%
1 to 3 Years	13%
3 to 6 Years	25%
6 to 10 Years	17%
Over 10 Years	14%

Equity Financing

The Small Business Bridge to Growth

The Capital Chasm

A Rocky Road

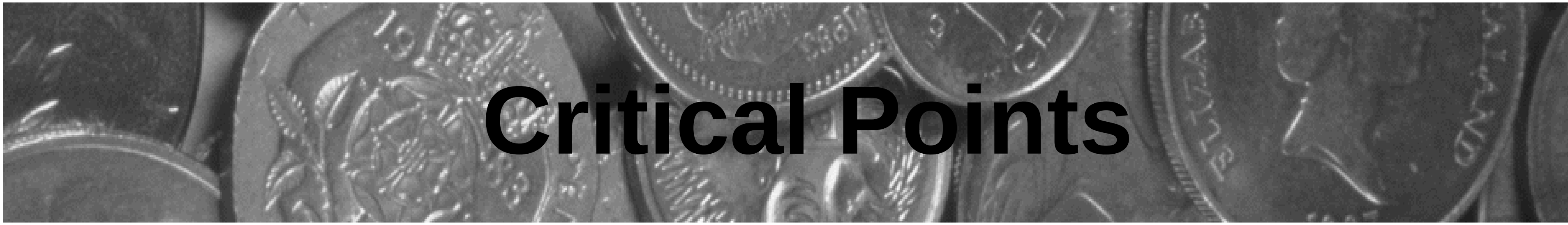
- **From 1959 through 1991, program had years with many problems.**
  - 1966 to 1970 saw program shrink from 735 SBICs to 350.
  - Late 1980s through 1991 saw over $650 million of defaults — a 44.5% default rate (but recoveries are over 60%).
  - Default rate now less than 1%.

Types of Problems

- **SBICs were too small.**
  - Now, minimum of $10 million usually required.
- **SBICs had inexperienced management.**
  - Experience is now required to get a license.
- **Owner/managers owned 100% of SBICs and committed fraud.**
  - Now, at least 30% of each SBIC must be owned by outside investors.

Additional Problems

- **Examinations were conducted only every 2 to 4 years.**
  - Now on-site examinations are conducted every 13 months.
- **There was too much *regulatory* oversight and not enough *financial* oversight and analysis.**
  - Now examiners and analysts spend more time on reviewing the valuations of SBIC portfolios.



Critical Points

Have never have had any political corruption in the program at either the federal or the state level.

Program has never utilized tax benefits to attract investors. Tax benefits are miniscule and meaningless.

Key Issues

- **Must recognize that private decisions are made by private managers with no approval process by the SBA.**
  - SBA defines through regulations what qualifies for investing.
  - Private managers have the skills & expertise & make decisions based on profitability & prudence. Government officials do not have these skills.

Issues for Governments

- Profit objectives of private investors can take precedence over the developmental objectives of the government.
- Every government must remember that ***private capital is at risk.***
- If a government tries to dictate to the private investors and micromanage them, it will scare off investors, and the program will fail.

A government can define the parameters of investing, but it cannot subsequently narrow these parameters or dictate how and where investment decisions are made, or the private capital will just go elsewhere.

Challenges Governments Face

- **Investing experience is a key to success and most countries lack this base of experience.**
  - This is an apprenticeship business in which those with skills teach others.
  - Bankers make terrible venture capitalists. (Bankers look at past performance to make decisions and venture capitalists look at the future potential.)
  - Option: have your country's funds establish a relationship with American venture funds.

Additional Challenges

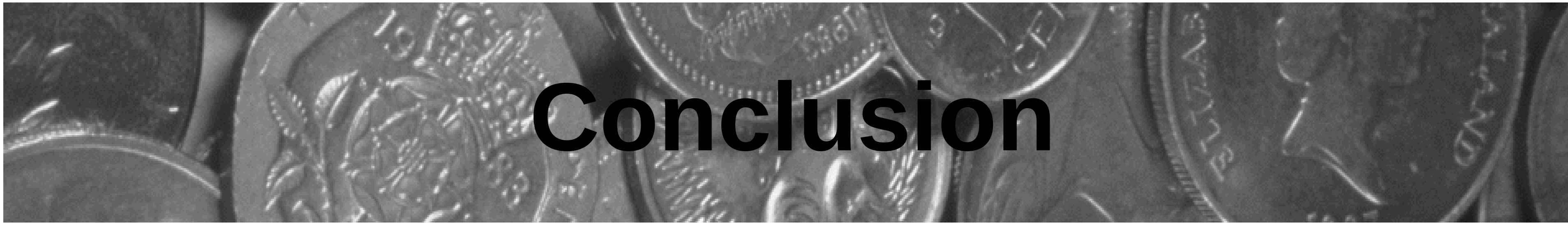
- **Regulatory experience is required for effective oversight.**
  - SBA learned many hard lessons over 35 years from 1959 to 1994.
  - SBA assisted Australian government to establish a regulatory framework in 1997, but
  - The SBA has no formal program to assist, and is short of staff.

Other Challenges

- **A venture program will definitely incur losses.**
  - Politicians may be unwilling to accept losses.
- **The investing culture by wealthy people is a critical ingredient that may be missing.**
  - Silicon Valley has it; Boston, Massachusetts has it; Minneapolis, Minnesota has it, but most of the U.S. lacks it.

Value of the Program

- **SBIC program has proven its value to the U.S. economy over a 41 year period.**
  - Nearly $21 billion has been invested in about 90,000 businesses.
  - SBA estimates that more than one million jobs have been created.
  - While Federal Express, Apple Computer, and America On Line are the high profile examples of SBIC financings, the tens of thousands of small business no one ever heard of are the real target market.



Conclusion

The SBIC program is a useful model to use as a starting point for developing a program that can be adapted to a nation’s culture to meet a country’s special needs and circumstances.

FOR MORE INFORMATION

www.sba.gov/inv

The Role of Government Funding for Start-up Companies and SMEs : The Case of Chinese Taipei

By

Susan S. Chang

Executive Secretary

Development Fund of the Executive Yuan

Presented at the APEC Seminar on Securing Initial Funding for Start-up Companies- The Birth and Growth of SMEs in a Knowledge-based Economy on 16th-18th May 2000 in Taipei

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? . The promotion of Venture Capital Funding

A. Regulations

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C. Government Participation in Venture Capital Company Start-ups

D. Achievements

E. Future Prospectives

? . The Development Fund's Equity Investment in Start-up Companies

A. Policy and Strategy

B. The Status and Performance of the Equity Investment

? . Government Funding for Small and Medium Enterprises (SMEs) in Chinese Taipei

V. Concluding Remark

? . Introduction

In the last 4 decades, Chinese Taipei has achieved a rapid economic growth with price stability. At the same time, the economic structure has also been transformed successfully from an agriculture-based, labor-intensive pattern to an industry-based, technology-intensive one. In particular, Chinese Taipei continued to perform well during Asian financial crisis since 1997.

The Chinese Taipei's real GNP growth rates in 1997-1999 reached 6.8%, 4.6%, and 5.7% respectively. While many Asian economics, such as South Korea, Singapore, Hong Kong, Thailand, Malaysia and Indonesia, posted negative growth rates in the same period. There are many factors behind the good economic performance of Chinese Taipei. One factor that could not be ignored in the environment favorable for the enterprises, especially SMEs.

According to the statistics of the Ministry to Economic affairs, there are 40 to 50 thousand newly registered enterprises and 6 to 7 thousand newly installed factories each year in Chinese Taipei. Since the availability of fund is the key factor for starting and running a company, I would like to elaborate what the government of Chinese Taipei has done for start-up companies and SMEs in the following paragraphs.

? . The promotion of Venture Capital Funding

A. Regulations

The government of Chinese Taipei began to promote venture capital funding in 1983. The main purpose is to enhance the development of technology-intensive industries and thus to upgrade its industrial structure. To accomplish the policy goal, the government promulgated the "*Regulations Governing Venture Capital Investment Enterprises*" in 1983, which include regulatory guidelines regarding the organization, minimum capital requirement, investment scope, management and supervision of the venture capital investments enterprises.

- Qualifications and Application Procedures

  A venture capital investment enterprise is required to be a company limited by shares with paid-in capital no less than NT$200 million. Prior to start-up before formation, an application has to be submitted to the Ministry of Finance for examination and approval.

- Investment Scope

  Since the expected mission of venture capital investment enterprises is to promote the development of high technology industries, the investment scope of venture capital investment enterprises is limited to foreign or domestic science and technology enterprises, other venture capital investment enterprises, and domestic general manufacturing industry. However, the total capital investment in the domestic general manufacturing industry shall not exceed 30% of the paid-in capital of a venture capital investment enterprise.

- Supervision of Business Operations

  A venture capital company is required to have a qualified management team, and a good internal control system. Its scope of business should comply with that approved by the Ministry of Finance, and any change should be approved or reviewed by the Ministry of Finance.

B. Incentives

In order to encourage the development of venture capital industry, the government of Chinese Taipei has provided the following tax incentives since 1984.

- An individual who participates in start-up or capital increase of a venture capital enterprise and holds the shares for at least 2 years may deduct up to 20% of the investment against his or her income technology industries in Chinese Taipei over the past years.

E. Future Prospectives

While the strategy taken by the government of Chinese Taipei to promote venture capital funding over the past 16 years, e.g. relatively strict regulation, tax incentives, and government participation etc, has been proved to be quite successful, some changes should be made to meet the new situation.

First of all, in view that tax incentives are redundant for a prosperous industry, the investment tax credit enjoyed by the investors of venture capital companies was abolished by the government at the end of 1999. Secondly, the strict regulations on the venture capital enterprises will be relaxed. For example, the removal of preapproval process is under consideration. In the coming years, the emphasis will be put on securing the funding source of the venture capital companies. In addition to banks and insurance companies that are now allowed to participate in the start-up of the venture capital companies, various pension funds, such as Government Employee Retirement Fund, Labor Retirement Fund and Labor Insurance Fund, etc., are encouraged to participate.

It is expected that the venture capital industry will keep on growing in the future and will continue to contribute to the growth of the economy as well as the development of science and technology in Chinese Taipei.

III. The Development Fund's Equity Investment in Start-up Companies

A. Policy and Strategy

The Development Fund was established by the Executive Yuan in 1973 with a aim to accelerate Chinese Taipei's economic growth and to upgrade its industrial structure. One function of the Development Fund is to make equity investment in major projects. In most cases, the investments were in tax.

- A company investing in a venture capital enterprise may exempt 80% of the resulting earnings from taxable income in the year.

- Currently there is no capital gain tax in Chinese Taipei. Therefore, the venture capital companies also enjoy this zero capital gain tax status when they execute shares of investee companies.

C. Government Participation in Venture Capital Company Start-ups

In order to encourage the establishment of venture capital enterprises, the Development Fund of Executive Yuan and Chiao Tung Bank jointly established a NT$800 million venture capital seeds fund in 1985, which was increased to NT$2.4 billion in 1991, for participating equity investment in start-up venture capital companies. The seeds fund had totally participated in the start-up of 16 venture capital companies, which produced a strong demonstration effect to other investors and had led to a boost in the venture capital industry in recent years.

D. Achievements

Over the past sixteen years, the venture capital industry, under the leadership of the government, has grown rapidly in Chinese Taipei, especially in recent years. As of the end of March 2000, the Ministry of Finance has authorized the 169 venture capital companies with a total registered capital of NT$142 billion (US$4.7 billion). There was only 47 venture companies with a total registered capital of NT$44 billion (US$1.47 billion) at the end of 1996. Since 1997 the venture capital companies have grown over 2 times in numbers and over 3 times in total registered capital. (Please refers to Table1). Up to the end of 1999, the venture capital companies in Chinese Taipei had already invested in 3,760 companies in the area of information, semiconductor, software, biotech and health care, and telecommunications etc. It is no doubt that the venture capital funding has made a great contribution to the development of high start-up companies. Some were in exiting companies that need additional capital. For any investment case coming in, an evaluation will be made. Usually a project must pass feasibility test and policy test before it is accepted.

Over years, the Development Fund's equity investments have been in line with the government's industrial policy. In the past, the investments were concentrated on major manufacturing industries, such as petrochemicals and semiconductors. In recent years, the focuses were on the emerging industries, such as information, telecommunication, aerospace and biotechnology etc.

To sum up, the Fund's policy and strategy of equity investment are as follows:

a. To investment in strategic projects consistent with government policy.
b. To invest in technology-intensive projects to introduce advanced technology from abroad.
c. To invest in leading high-tech projects to attract private capital into high-tech industries.
d. The Fund's participation in any project should not exceed 49% of the total paid-in capital of the investee company.
e. After the policy objectives of the investment have been achieved, the share will be transferred to recover the investment capital for reuse.

B. The Status and Performance of the Equity Investment

As of December 31, 1999, the Development Fund's equity investment at hand were 25 cases with a total book value of NT$29.9 billion (US$980 million). The categories of the 26 investments include semiconductor (4 cases), biotechnology (6 cases), information (3 cases), financial institutions (3 cases), machinery and automation (3 cases), aerospace (2 cases), and others (please refer to Figure.1). Besides, shares of 24 investee companies were completely liquidated.

The Development Fund's equity investments not only provide a good funding source for start-up companies with policy significance, but also produce a desirable economic benefit. In addition, the Fund itself also enjoys a good return.

At the end of 1999, the market value of the Fund's equity investment reached NT$240 billion (US$7.8 billion) which is about 8 times of the initial investment cost of NT$28.9 billion. Taking into account of the capital gains and dividends received, the internal rate of return (IRR) is about 35%.

IV. Government Funding for Small and Medium Enterprises (SMEs) in Chinese Taipei

Small and Medium Enterprises (SMEs) play an important role in Chinese Taipei's economic development. Over years, SMEs have been accounting for more than 95% of the total enterprises in Chinese Taipei. The government has been very concerned about the need of SMEs and has taken a lot of measures to help them solve problems and difficulties.

In 1999, with the promulgation of the "Statute for the Development of SMEs", the government has set up 10 assistance systems for SMEs, covering financing, business management, production technology, research and development, industrial safety, and marketing etc. Regarding financing and funding for SMEs, the "SME Development Fund was established accordingly in addition to the SME Credit Guarantee Fund set up in 1970s.

A. SME Credit Guarantee Fund

In order to address the problem of SMEs' lack of adequate collateral for financing, the government set up the "SME Credit Guarantee Fund" in July 1974. Up to March 2000, the Fund had provided credit guarantee to 115,739 enterprises, which represented about one third of the enterprises with a paid-in capital of NT$1 million to 60 million. The total cases guaranteed reached 1.72 million that help SMEs to get an accumulated loan of NT$2.71 trillion. Since 1993, the number of cases guaranteed has averaged NT$1 million each year. In 1999 alone, the amount of loan got by SMEs through guarantee reached NT$207.6 billion. At the end of 1999, the outstanding loan guaranteed by the Fund stood at NT$208.9 billion, which was 6.1% of the total loan granted to SMEs by all financial institutions. It is no doubt that “SME Credit Guarantee Fund” is very helpful for SME funding.

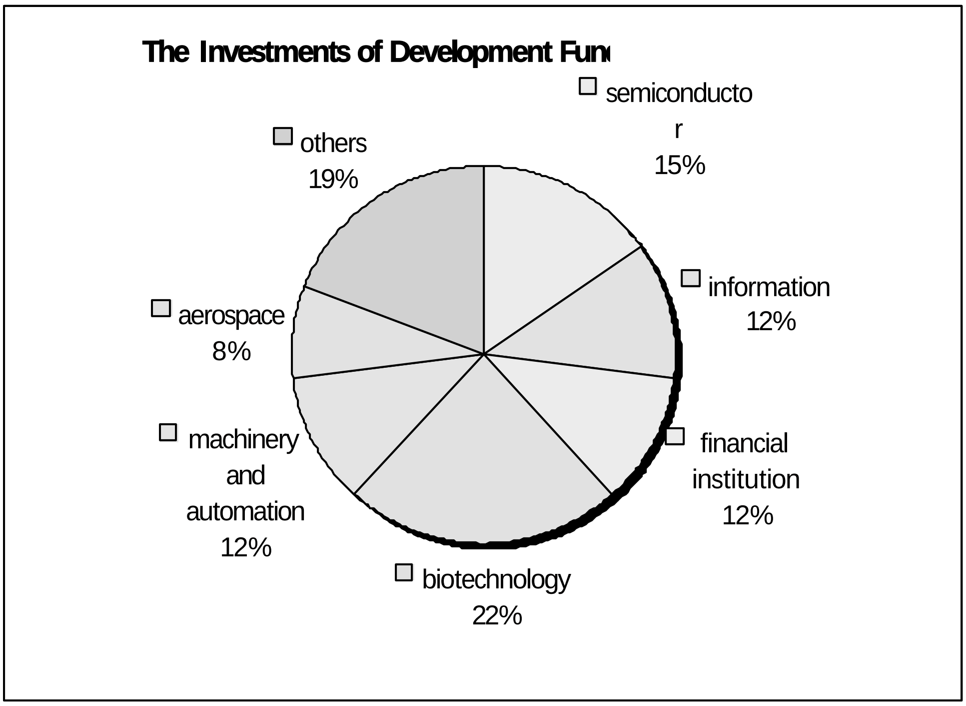
B. SME Development Fund

The SME Development Fund was set up according to the “Statute for the Development of SMEs” in 1991. The main functions of the Fund are to provide project loans to SMEs, to support SMEs assistance programs and to make investment related to SMEs. The Fund size is NT$12 billion at present. As of December 1998, the Fund had approved 2,480 loan applications with a total amount of NT$35.2 billion. Besides, the Fund had participated in the establishment of 2 SME development companies. The SME development companies are promoted by the government to provide funding for SME start-up, and to give various assistance to SMEs. Up to now, there are 3 this kind of companies established.

Table.1

Venture Capital Industry in Chinese Taipei				
	1996	1997	1998	1999
Companies				
Total number of firms	47	72	117	160
Growth rate	38.24%	53.19%	62.50%	36.75%
Funds (NT$ billion)				
Registered funds	42.13	65.19	97.79	134.1
Investments (NT$ billions)				
Total number of investments	1158	1839	2994	3760
Total amount invested	28.64	43.52	65.11	77.6

Figure.1



The Role of Government Funding for Start-up Companies and SMEs : The Case of Chinese Taipei

- **By Susan S. Chang**

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- ? . The Development Fund's Equity Investment in Start-up Companies
- ? . Government Funding for Small and Medium Enterprises (SMEs) in Chinese Taipei
- V. Concluding Remarks

? . The promotion of Venture Capital Funding

- A. Regulations
- B. Incentives
- C. Government Participation in Venture Capital Start-up Companies
- D. Achievements
- E. Future Perspectives

A. Regulations

- The "Regulations Governing Venture Capital investment Enterprises" was promulgated in 1983
- Qualifications and Application procedures
  - a company limited by shares
  - minimum capital NT$200 million
  - preapproval

♍ Investment Scope

- science and technology industry, such as information , semiconductor, telecommunication, consumer electronics, advanced materials, aerospace, biotechnology etc.
- other venture capital companies
- general manufacturing industries (ceiling: 30% of the paid-in capital)

- Supervision of Business Operation
  - a qualified management team
  - a good internal control system
  - regulation compliance

B. Incentives

- Up to 20% investment tax credit
- 80% deduction of resulting earning
- Zero capital gain tax

C. Government participation in VC Start-up Companies

- A NT$ 4.4 billion VC Seeds Fund (NT$800 mil in 1985 ⌫ 4.4 bil in 1998)
- The Seeds Fund participated in 29 VC start-up companies
- Produced strong demonstration effect
  - NT$ 4.4bil = US$ 144 mil

D. Achievement

- Authorized 169 VC companies up to March, 2000
- Total registered capital NT$142 billion
- Over 2 times growth in numbers and over 3 times in total registered capital since 1996
- Invested in 3760 companies up to December, 1999

Venture Capital Industry in Chinese Taipei

	1996	1997	1998	1999	2000.3
Companies					
Total number of firms	47	72	117	160	169
Growth rate	38.24%	53.19%	62.50%	36.75%	----
Funds (NT$ billion)					
Registered funds	42.13	65.19	97.79	134.1	142.0
Investments (NT$ billions)					
Total number of investee firm	1158	1839	2994	3760	N/A
Total amount invested	28.64	43.52	65.11	77.6	N/A

E. Future Perspectives

- The investment tax credit was abolished in December, 1999
- Regulation will be relaxed
- Securing funding source of VC companies

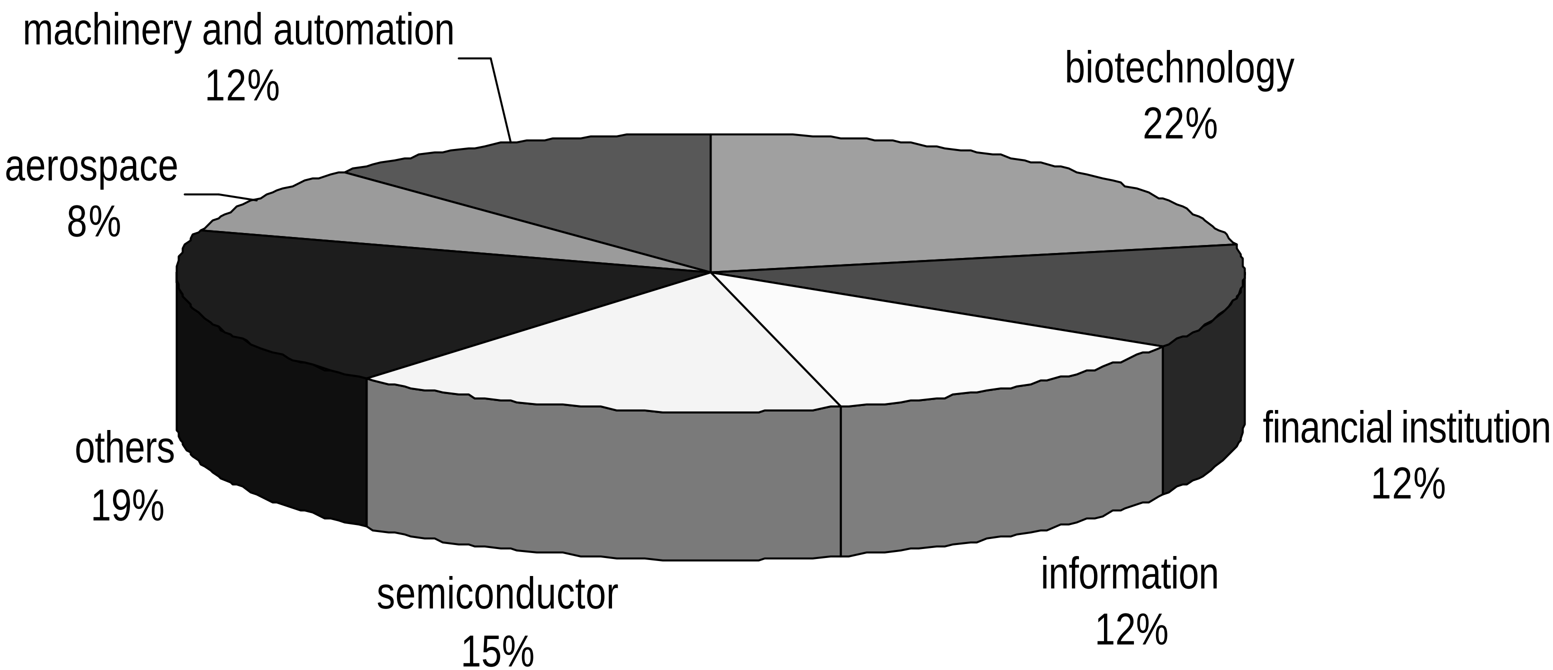
? . The Development Fund's Equity Investment in Start-up Companies

- A. Policy and Strategy
  - The Development Fund was established in 1973
  - DF’s investments have been in line with the government’s industrial policy
  - Hold up to 49% shares of investee companies
  - Liquidate shares after policy objectives achieved

B. The status and performance of the Equity Investment

- 25 cases of December,1999 with a total book value of NT$ 29.9 billion (US$ 980 million)

The Investments of Development Fund



? . Government Funding for Small and Medium Enterprises (SMEs) in Chinese Taipei

- A. SME Credit Guarantee Fund
  - Established in July 1974, to address the problem of SMEs lack of adequate collateral for financing
  - About 1 million guarantee cases per year since 1993
  - Outstanding loan guaranteed at the end of 1999 NT$ 208.9 billion

B. SME Development Fund

- Established in 1991
- Main functions
  - to provide project loan to SMEs
  - to support SMEs assistance programs
  - to make investment related to SMEs
- Fund size: NT$ 12 billion at present
- Performance
  - approval 2,480 loan applications with a total amount of NT$ 35.2 billion as of December, 1998
  - investment in 2 SME development companies

V. Concluding Remarks

APEC SEMINAR ON

SECURING INITIAL EQUITY FUNDING FOR START-UP COMPANIES – THE BIRTH AND GROWTH OF SMEs IN A KNOWLEDGE-BASED ECONOMY

Taipei, Chinese Taipei
May 16-18, 2000

Session One:
The Role of Government Funding for Start-up Companies and SMEs

Presentation by
Christopher Lane Davis

The SBIC Program: A Strategic Approach to Developing the Capital Market for Small Businesses

I. THE ECONOMIC RATIONALE FOR THE SBIC PROGRAM

A. Why small businesses matter:

1. Most new permanent jobs in the US are created by small businesses.
2. The formation and growth of small businesses is restricted by lack of access to capital, particularly equity capital.

B. Small businesses are the principal source of permanent new jobs in the U.S. economy - California as an example:

1. Most businesses are small businesses:
   - In 1996, California had 937,164 businesses. Over 99 percent had fewer than 500 employees. In fact, 98 percent (917,607 businesses) had fewer than 100 employees.
2. Small businesses employ most people and produce most new jobs:
   - Taken together, in 1996 small firms with less than 100 employees employed over 6.7 million people.
   - From 1993 to 1997, small businesses created over 1.3 million new jobs in California, while large businesses lost 277,443 jobs. Job growth occurred across all industry sectors.
   - From 1993 to 1997 very small businesses (less than 20 employees) accounted for 65 percent of this growth.

C. Studies of small businesses in the U.S. have consistently commented on both the relative scarcity of capital for small business and the importance of capital for small business growth.

1. The Small Business Investment Company program was created largely in response to a landmark study by the U.S. Federal Reserve in 1958,

that concluded that there was a shortage of capital for small businesses.

2. In 1998 a study done by the State of California Research Bureau of capital availability for small businesses in California, the center of venture capital activity in the U.S., found that small businesses still have access to less capital than they need for growth.
3. In March of 1999, Chairman Alan Greenspan noted in a speech on small business finance, that access to adequate capital remained a significant issue for small businesses in the U.S.

II. THE STRUCTURE OF THE SBIC PROGRAM

A. The strategy used by the SBIC program has three basic components:

1. Increase the number of private investors investing in small businesses,
2. Increase the amount of capital invested in small businesses by:
   a. Increasing the investment returns to private investors who invest in small businesses, and
   b. Providing additional government capital for investment in small businesses.
3. Insure that government capital is invested efficiently in profitable businesses by investing the government capital along side private capital.

B. The SBIC program acts through the capital market, rather than outside the capital market:

1. The SBIC program <u>increases the efficiency of the capital market</u> for small businesses by developing private market intermediaries – small business investment companies – that specialize in making investments in small businesses.
2. The SBIC program <u>increases the amount of capital invested in small businesses by private investors</u> by increasing the rate of return on investments in small businesses.
3. The SBIC program <u>provides government subsidized capital to small businesses through SBICs</u> (private intermediaries in the capital market), rather than dealing directly with individual small businesses outside the structure of the capital market.

C. The SBIC program strategy in more detail:

1. The SBIC program increases the number of investment intermediaries focused on investing in small businesses, and by increasing the number of investors, the capital market made more efficient in providing capital to small businesses:
   a. The government-financed leverage reduces the barriers to the formation of private investment companies, and *stimulates the formation of private investment firms*.

   b. The availability of government subsidized financing (leverage) to supplement private capital makes it possible to create an economically viable investment firm with less *private capital.*
   c. Investment companies (that make investments in small businesses) must have a certain minimum amount of capital in order to be economically viable:
      i. Capital must be sufficient to pay for investment management activities and overhead, and
      ii. Capital must be sufficient to allow the firm to obtain the level of portfolio diversification necessary to reduce risk and obtain desired returns.
      iii. Experience has shown that in the U.S., the minimum amount of capital required for an independent small business investment company to be successful is currently about $30 million.
2. An increased amount of private capital is attracted to investment in small business by increasing the rate of return on capital invested (successfully) in small businesses:
   a. The government supplies this capital to SBICs on terms *which increase the rate of return to private investors, but also increase their risk* (the seniority and the priority of interest payments on the leverage increase the minimum rate of return private investors need in order to make a profit)
   b. The decision to provide capital on terms which increase both the rate of return and risk is highly significant – *it reflects a basic judgment that private investors in this area are primarily concerned about rate of return* and will be more attracted by the increased rate of return than deterred by the increased risk.
3. Additional capital raised by the government is provided for investment in small businesses.
   a. Government credit is used to obtain capital from the capital market,
   b. Government raised capital is provided to SBICs for investment in small businesses
4. Government capital is invested efficiently in profitable businesses because the <u>government capital is along side private capital</u> through a large number of SBICs as intermediaries:
   a. Capital is provided to SBICs on a matching basis ($2 of government leverage for $1 of private capital),
   b. Require that the capital be co-invested with the private capital in small businesses.

c. Government capital is senior to private capital, so that the private investors in an SBIC bear the first risk of losses.

d. Government leverage is limited to approximately $100 million for any one SBIC, so that leverage is provided to a large number of SBICs.

III. GOVERNMENT INCENTIVES ARE STRUCTURED TO ONLY REWARD ECONOMICALLY SUCCESSFUL INVESTMENT ACTIVITY

A. Government leverage is specifically structured to reward private investment activity by SBICs <u>only</u> when the investments in small businesses are economically successful and profitable.

1. The incentive provided by the government-subsidized leverage is linked to the economic success of the private investments made by the SBIC.
2. Government leverage increases the private investors rate of return *only if the investment activity is successful* – investors receive no incentive if they make investments that are not financially successful.
3. The incentive provided through the use of government credit *increases the investment return to private investors, rather than lowering the risk of the investment*.
4. The use of government leverage increases the risk of the investment, because the seniority of the leverage and the priority of interest payments *increases the minimum rate of return private investors need in order to make a profit*.

B. The incentive provided by the leverage is significantly different than incentives like investment tax credits, because the incentive provided by leverage is *dependent on the financial success of the private investment activity,* in comparison to the incentive provided by a tax credit that is independent of the success of the investment activity.

IV. THE SCARCITY OF VENTURE INVESTMENT KNOW-HOW IS A STRUCTURAL PROBLEM IN THE CAPITAL MARKET

A. Specialized investment intermediaries – SBICs and other private venture capital funds - are necessary to permit the flow of capital from large capital pools and financial institutions to small businesses.

B. Venture capital investment is a distinct activity that differs in many important respects from other types of investment.

1. Investments in small private businesses have unique features that different from many other types of financial investments.
2. Managing investments in small private businesses require specialized skills that are different from the skills lenders and investors in publicly traded securities.
3. The presence of a substantial number of skilled professional venture capital investment managers is necessary to facilitate the flow of capital between capital pools (such as banks, pension funds, and other financial institutions) into small businesses.

C. Investing in small businesses is a specialized activity, which requires different a special set of skills that are different from the skills required for commercial banking or investing in publicly traded securities.

1. <u>Examples of differences in skills and outlook in contrast to commercial banking activity</u>:
   a. *Company valuation methodology*: future value vs. ability to pay interest and repay principal.
   b. *Transaction structures*: complex equity investment vs. loan.
   c. *Investor's role in the company*: active investor involvement in company management vs. passive reporting.
   d. *Exit strategies*: sale of company or IPO vs. repayment.
2. <u>Venture capital investment activity is distinct from the investment activity of small business owners who invests capital in a business he owns or operates</u>:
   a. Venture capital investment is focused on making investments that can be liquidated at a profit, rather than investing capital in a business on a permanent basis.
   b. Venture capital investment creates a flow of capital, from large capital pools, to small businesses, and on exit, back to the capital pool for reinvestment.

D. Unique features of venture capital equity investments:

1. <u>Deal flow</u>: access to a high volume of investment opportunities is necessary for successful investment activity:
   a. Good investment opportunities are hard to find and investors typically review 100 opportunities for every investment they make.
   b. There is no organized market for investment opportunities.
   c. Small companies have limited resources to search for investors.

2. <u>Evaluation</u>: investment opportunities in small private companies are particularly hard to evaluate:
   a. Investment structures are more complex than normal:
      i. Investors must plan for multiple rounds of financing.
      ii. Equity financing has to address larger uncertainties in pricing and valuation.
      iii. Investors must structure the financing to take exit issues into account.
   b. Investments are harder than normal to monitor:
      i. There are rarely outside investment analysts to provide data and reports.
      ii. Companies have limited resources to generate data and reports.
      iii. New and fast growing businesses are subject to more rapid and larger changes.
   c. Investments require active support form investors to provide continuing financial and non-financial resources.
   d. Investments are illiquid and require specialized skills to liquidate:
      i. There is rarely a market for private securities.
      ii. Sale of the company is a common alternative.
      iii. Taking a company public is a major project.
      iv. Specialized financial experience is necessary to assist a company with an IPO or negotiate a sale of the business.
   e. New and small companies have limited historical data on operations.
   f. Evaluation focuses heavily on assessing the quality of management.
   g. Companies are often focused on markets that are new or about which little is known.
   h. Companies are often focused on specialized technology, which is hard to assess and compare.
   i. Companies are unusually dependent on hard to predict future developments for success:
      i. Successful development of new products.
      ii. Successful recruitment of key management personnel.
      iii. Ability to attract additional capital in the future.

j. Investments in companies at different stages of development require different investor skills.

k. Investments in companies at different stages of development have different expected rates of return and expected times to maturity.

l. The small size of venture capital investment transactions makes them uneconomic for most large financial institutions to do directly.

3. The intensive investor involvement required makes it impractical for the staff of most large financial institutions to manage venture capital investments.
4. Large financial institutions can efficiently make large investments in intermediaries (such as venture capital funds), which then are able to make smaller investments in small businesses.
5. Intensive investor involvement is also necessary to provide other investment features that large financial institutions require, such as liquidity, reliable valuation and reporting.

V. THE ECONOMIC IMPACT OF INCREASING THE NUMBER OF PROFESSIONAL VENTURE CAPITAL INVESTORS

A. The flow of investment capital to small business is restricted by the limited number of investors with the experience and expertise required to invest successfully in small businesses.

1. This problem was acute in the U.S. in the 1950's, when "venture capital" investing was only done by a handful of wealthy families.
2. Beginning in 1959 the SBIC program resulting in the creation of literally hundreds of new investment companies focusing on small business, forming the basis for the contemporary US private venture capital industry.

B. The contemporary private venture capital industry in the US now has several thousand firms.

C. The increase in the number of investment professionals in the venture capital industry is a necessary condition for the current high volume of capital flowing to SMEs in the US:

Comparison of Private Investments and Public New Issues

Year	Private Investments by Venture Capital Funds and SBICs	New Issues: NYSE, AMEX, NASDAQ	TOTAL	VC as % of Total
	(Billions of U.S. $)			
1998	$17.1	$50	$67.1	25.5%
1999	$39.6	$105	$144.6	27.4%

(Venture capital fund data from PriceWaterhousCoopers Moneytree Reports; SBIC data from SBA; NYSE, AMEX and NASDAQ data from NASD)

Venture Capital
Secure Initial Funding for Start-up Companies and SMES

May 16, 2000

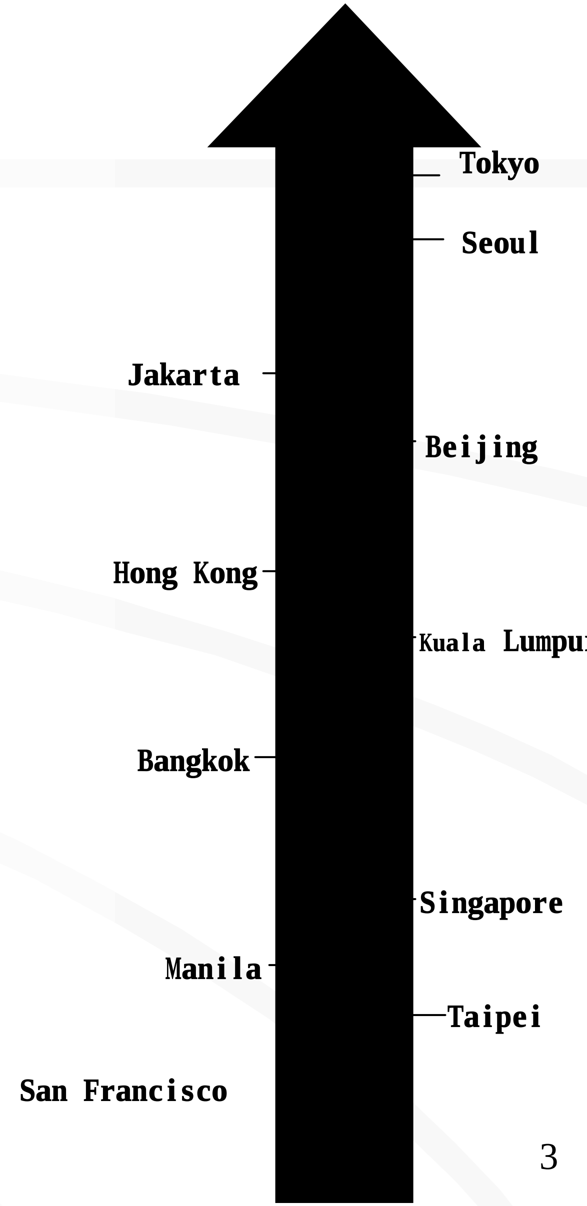
Ta-lin Hsu

H&Q Asia pacific

H&Q Asia Pacific

- Pioneered US Style V.C. Company in Chinese Taipei
- US$1.6 billion investment capital under management
- Offices in Silicon Valley and 10 Asian cities
- Invested in 250 companies. Out of 76 companies invested in Taiwan, 25 have made IPO

H&Q Investment & Management Offices



The Development of V.C.

- Venture Funds offered by Queen Isabella of Spain to support Columbu's expeditions
- In the US, Government funded Small Business Investment Corp. (SBIC) in the '50s
- Before '80, the "Old Boys' Network"
- V.C. Took off since '80's

What is V.C

- Venture Capital
- Private Equity

Stages of Funding

Seed Money

ß

First Round

ß

Subsequent Round

ß

Mezzanine Round

ß

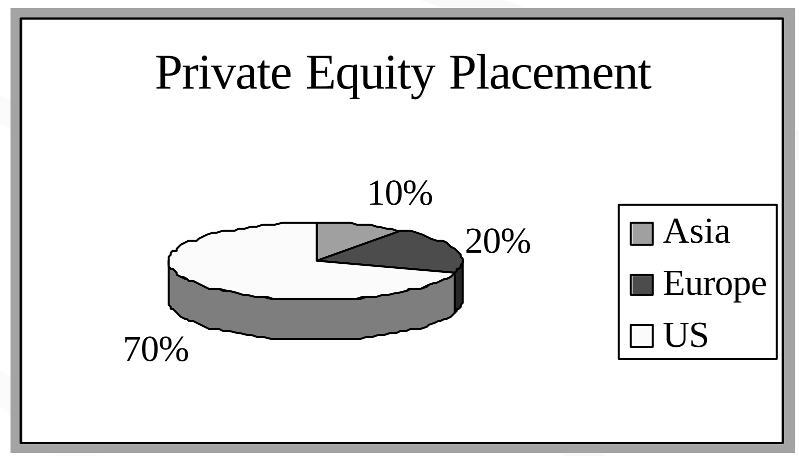
Initial Public Offering (IPO)

ß

Secondary Offering

Sources of V.C. / Private Equity Funds

- Generates superior risk adjusted return on investment
- Capital provided by: pension funds, insurance companies, university trust foundations, private foundations, wealthy families and individuals (angels!!)
- Private equity funds have numerous themes:
  - – buyout or LBO funds,
  - – venture capital funds,
  - – funds of funds



Asset Allocation Shift

Asset	Old Allocation	New Allocation
Fixed income, stock, bond	85%	60-70%
Real Estate	10%	10%
Alternative (hedge fund, VC, LBO, etc.)	3-5%	**10-20%**

Benefit of Private Equity

- Direct Injection of Capital
  - Create Businesses
  - Create Jobs
- Long Term - Stable Money
- High Return Potential

Structure of V.C.

- Limited Partnership
- V.C. Firms

Abundance Of Institution Capital

- Large pool of institution money
- Requires professional management

Initial Funding
-- Traditional Industries

- SBIC in the US, SME Association in Taiwan, MOF in Japan, other successful programs in APEC Countries.
- Loan and Government Subsidy
- Job Creation

Initial Funding

-- Knowledge Based Industries

- V.C., Private Equity
- Equity / Management Participation
- High Growth, High Risk, High Return

Silicon Valley -- Location

- An area, not a city
- From San Francisco to San Jose, 80 Km in distance and 700 Km^2 in Area
- Mild Weather
- Beautiful Landscape
- Diversified Cultural Tradition
- Well Developed Commence
- S.F. known as one of the "most livable Cities" in the World

Silicon Valley -- Background

- Frederick Terman, Chairman of School of Engineering at Stanford University, first promoted the merge between academic research and applied technology
- Founded Stanford Industrial Park
- Hewlett-Packard was established in1939 in the Park
- Today, Silicon Valley has the highest concentration of leading high-tech companies in the world

Silicon Valley
-- Current Condition

- 20% of the top 100 Electronic and Software companies in the U.S. located here
- Represents over 40% of the total market capitalization of all High-Tech companies in the U.S.
- One IPO in every 5 days
- Average Salary Growth is 500% of u.s. average
- 50% of all V.C. Companies in the U.S. are Based Here

Silicon Valley Elements for Success

- Excellent living Environment
- Well Developed Social, Political and Cultural Traditions
- Entrepreneurial Spirit
- Synergy of Academic Research and Applied Technology
- Abundant Talent Resources

Silicon Valley (Cont.)
Elements for Success

- Multiple Funding Sources (Government, Industry, VC, Public)
- High Risk / High Return (IPO,M&A)
- Efficient Government and well Established Legal System
- Protection of Intellectual Property and Investors’ Rights

V.C. Success Story: Chinese Taipei Model

- Government started Hsin Tsu Science Base Industrial Park in 1979
- Established One-Stop Service to meet all Administrative and Regulatory Requirements
- Established Tax Incentive Program
- Attracted overseas talents to work in Integrated Circuitry, Computer and Peripheral, Communication, Fiber Optical, Precision Instruments, Biotechnology, etc.
- Higher Education Institutions nearby
- Brought in V.C.
- Stock Options and IPO

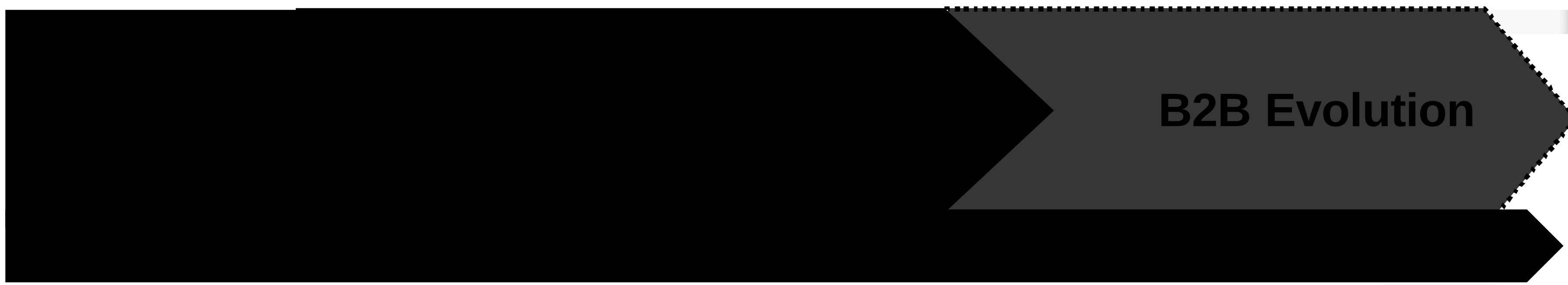
Chinese Taipei High-Tech Success Story

- Macronix International
- Miin Wu

Private Equity Opportunities in Asia

- New paradigm in Asia due to
  - Economic crisis
  - Restructuring of business
  - Internet boom

Business Models Have Been Proven



Internet Ready for Huge Volume

- Universal Access
- Security
- Bandwidth
- Robust and Reliable

B2C Models Validated

- eNetworks
- eTailing
- eMarketing
- eFinance

B2B Players to Emerge...

- Exchanges
- Aggregators
- Auctions
- Content & Community

$1.5 Trillion in Market Cap

Cisco, Dell, IBM, Microsoft, Verisign, Real Networks...

$500 Billion in Market Cap

AOL, Amazon, eBay, Yahoo!...

$30 Billion in Market Cap

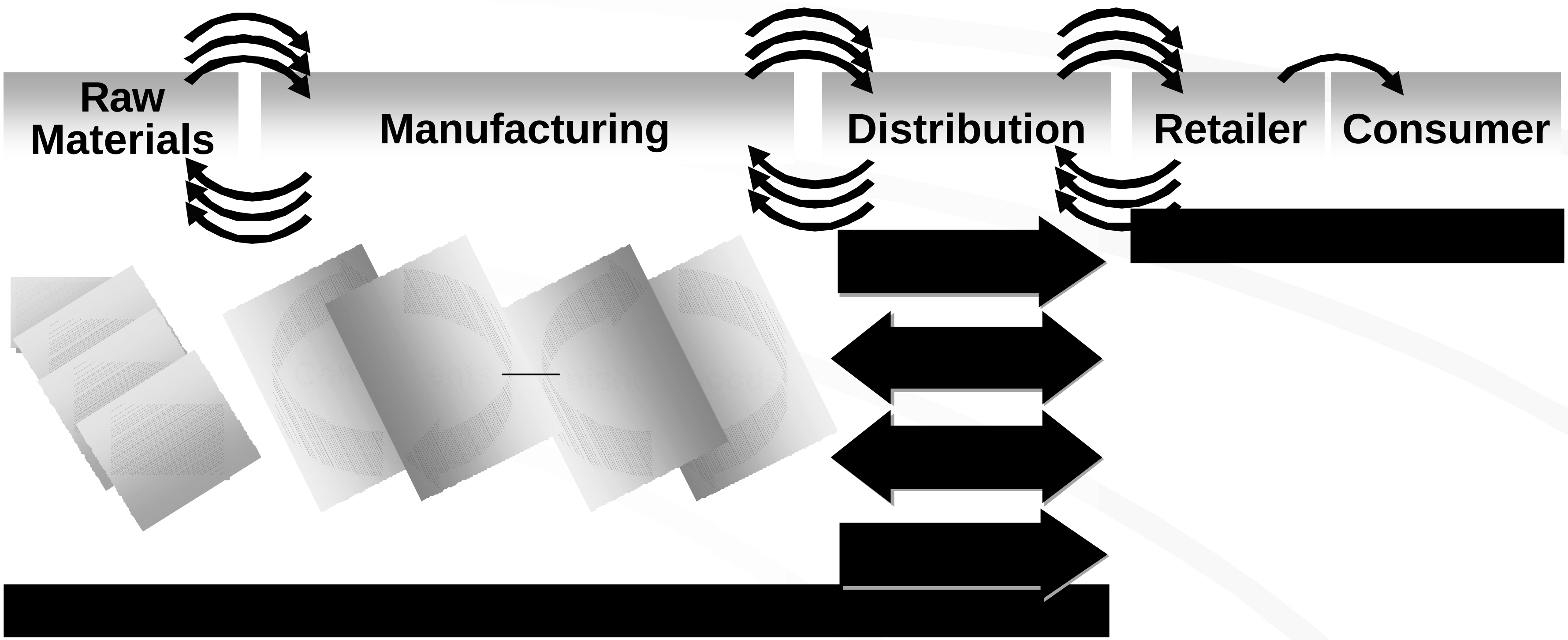
Ariba, Chemdex, ICG, VerticalNet, CommerceOne...

Source: Robertson Stephans, H&Q Asia Pacific

Transactions

- *B2B Drives B2C!*

- **The B2B transactions along each phase of the value chain — all of which occur before a single B2C transaction**



Source: Robertson Stephans, H&Q Asia Pacific

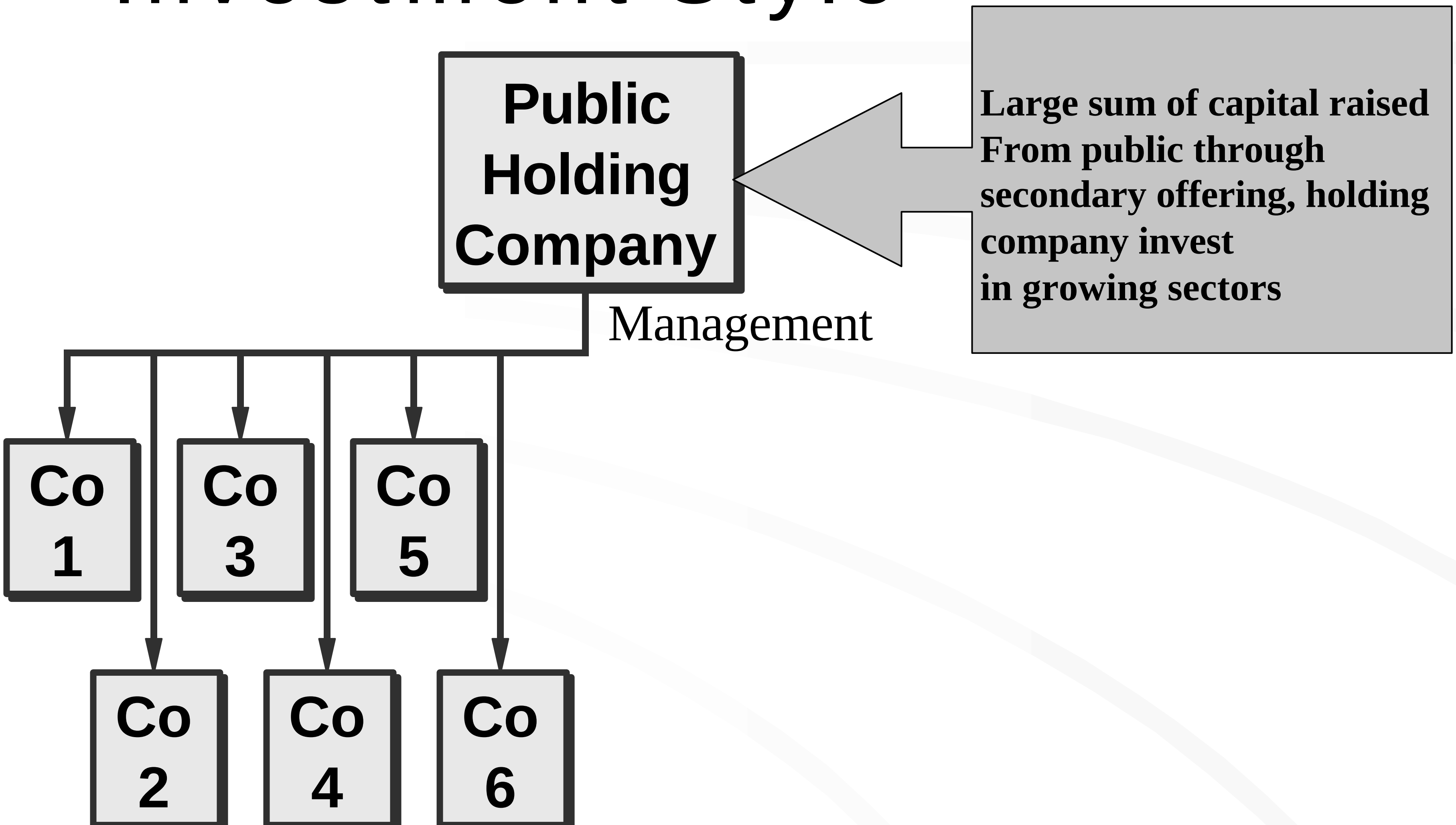
H&Q AP's Asia Internet Investment Style

Public Company

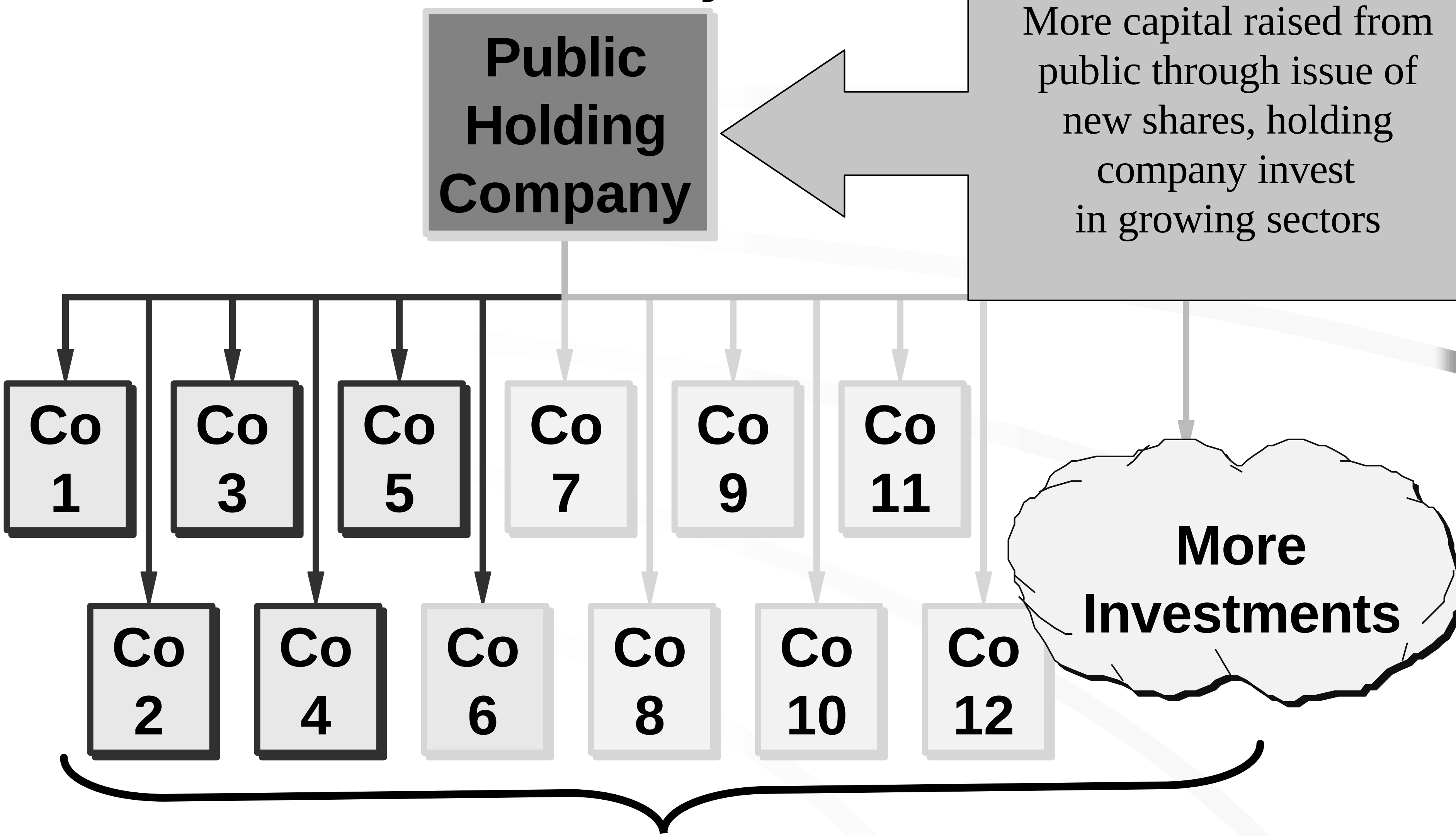
Management

Start with a Public Holding Company through Backdoor listing, Value Creation

H&Q AP's Asia Internet Investment Style



H&Q AP's Asia Internet Investment Style



Multiple Investment « Synergy

Strategy for Success in High-Tech Industries

- Attract Overseas Talents and Capital
- Short-term Plan: Improve Living Environment, Establish Industrial Park
- Mid to Long Term: Policy Development, Better Legal System Stable Policy
- Liquid Financial Market
- Create a constructive Cycle of Growth

Securing Initial Equity Funding
In Start-Up Company

Miin Wu
President

Macronix International Co., LTD.

US$ 32 M → US$ 690 M

In Ten Years

US$ 32 M → US$ 1,940 M

In Ten Years

MXIC

First Five Years

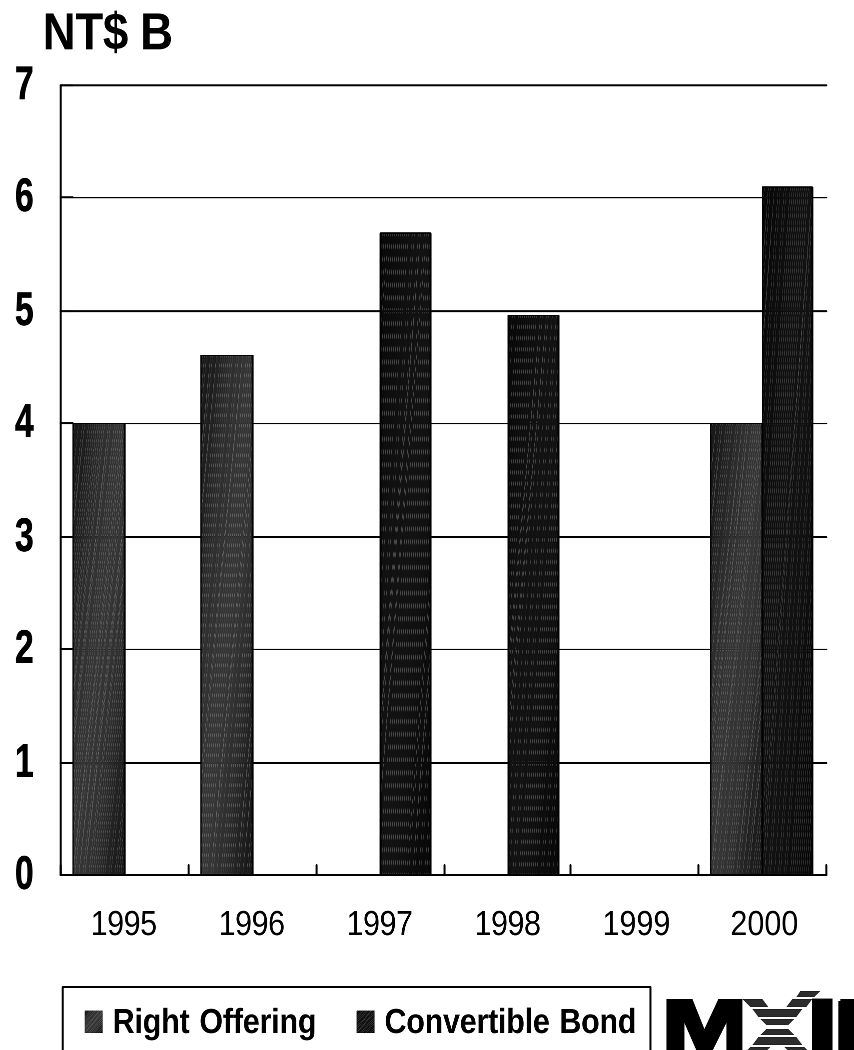
The Leverage Game

- Marketing Efforts
- Manufacturing Efforts
- Financial Efforts

Public Equity Funding

- IPO on TSE in 1995
- First Company from Chinese Taipei listed on NASDAQ IN 1996
- Convertible Bond in 1997,1998, 2000

Raised total of NT$29B in last five years

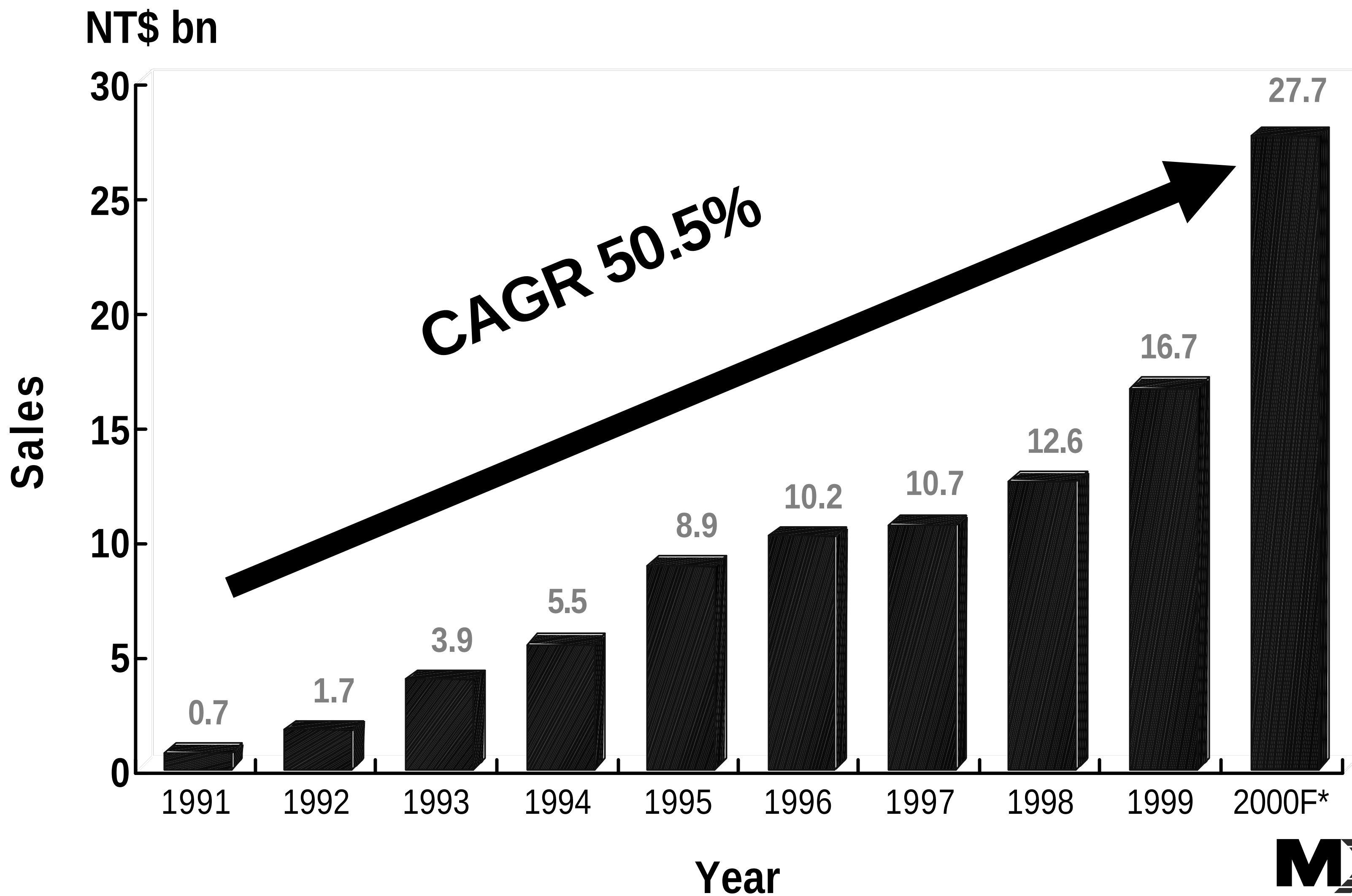


Second Five Years

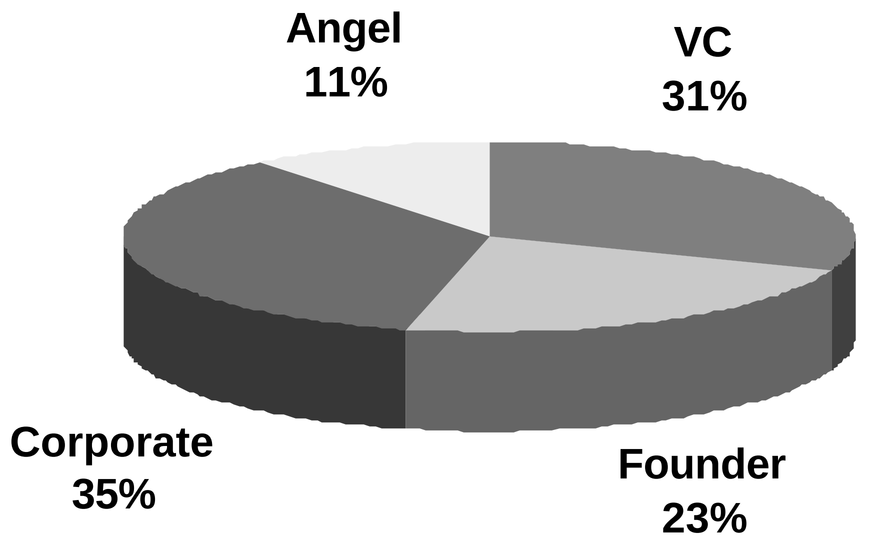
Strategic Alliances

- Cor-petition
- Risk Sharing

Macronix: Historical Financial Performance



How Macronix started-up



Venture Capital :

H&Q, Hotung, Hantech

Hanmore, Euro-Sino,

Chiao-Tung Bank,

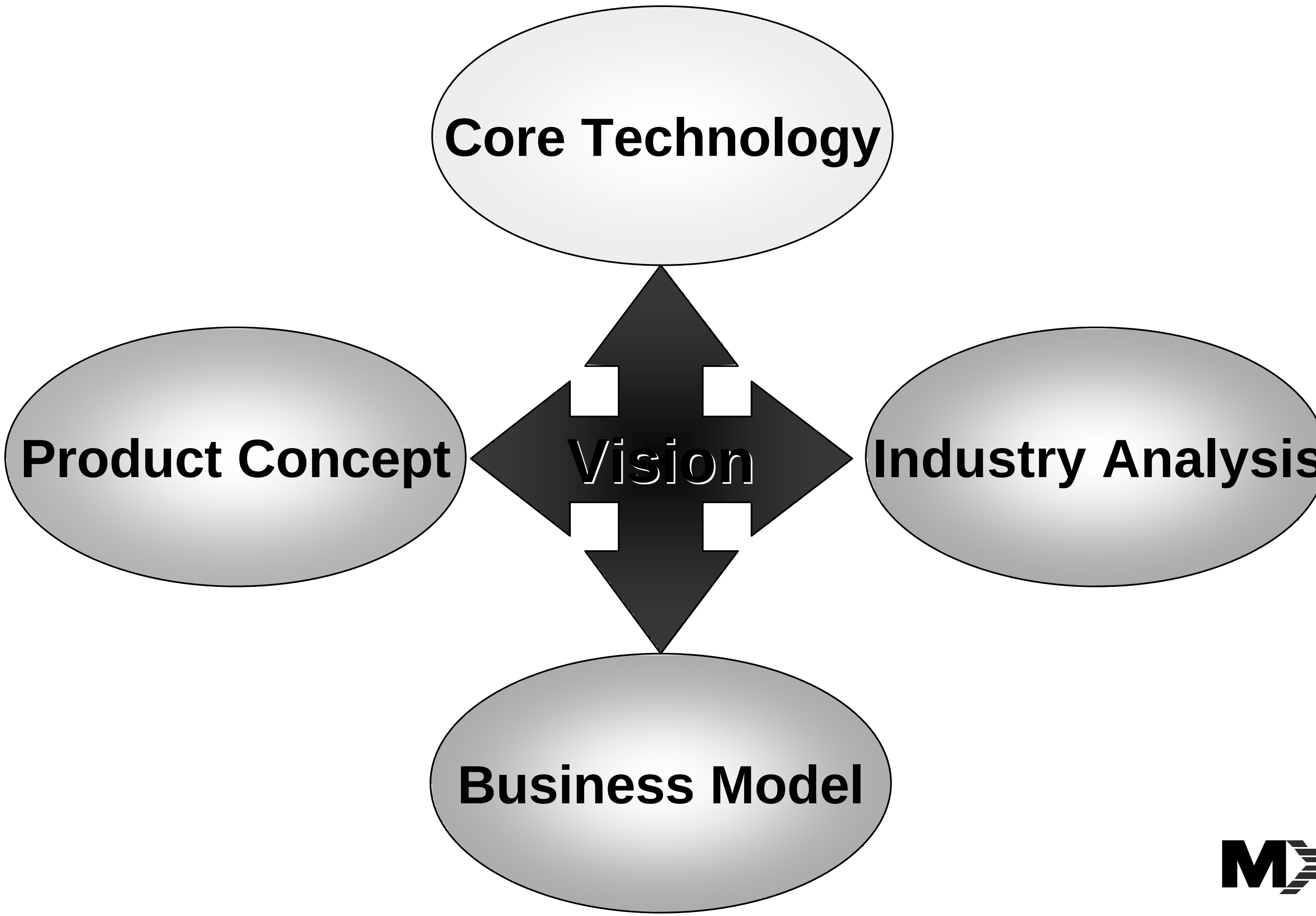
Universal,Tailink

Corporate Investor:

Delta Electronic,

PICVUE, Mercury

Criteria of Securing initial funding



Vision

- Long term goal
- Entrepreneur’s Capability

Vision Statement of Macronix

Macronix is and will continue to be a leading provider of innovative customer/application driven system solutions and non-volatile memory requiring state-of-the-art technology,the highest quality and trustworthy service for the computing, communication and consumer markets.

Core Technology

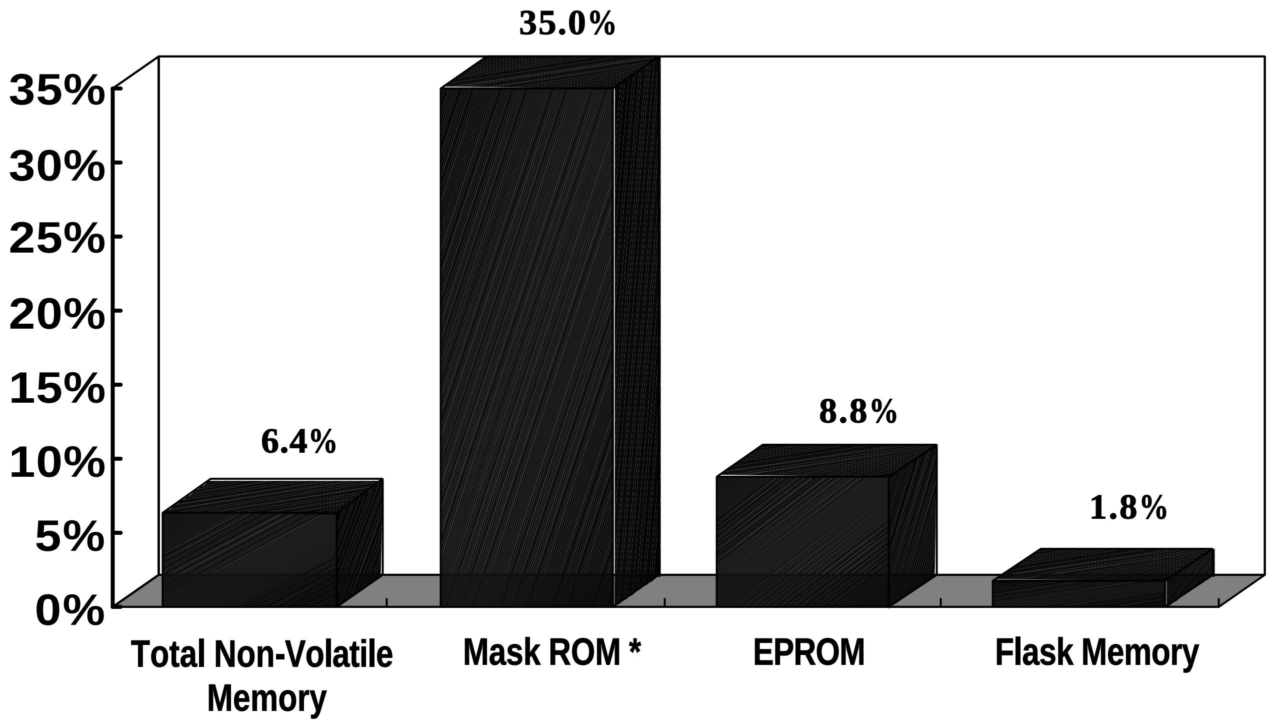
- Cutting edge technologies
- Competitive trade secrets
- High entry barrier

MXIC

Macronix: Unique Position & Core Technology

Leading Position in Non-Volatile Memory

Global market share 1998



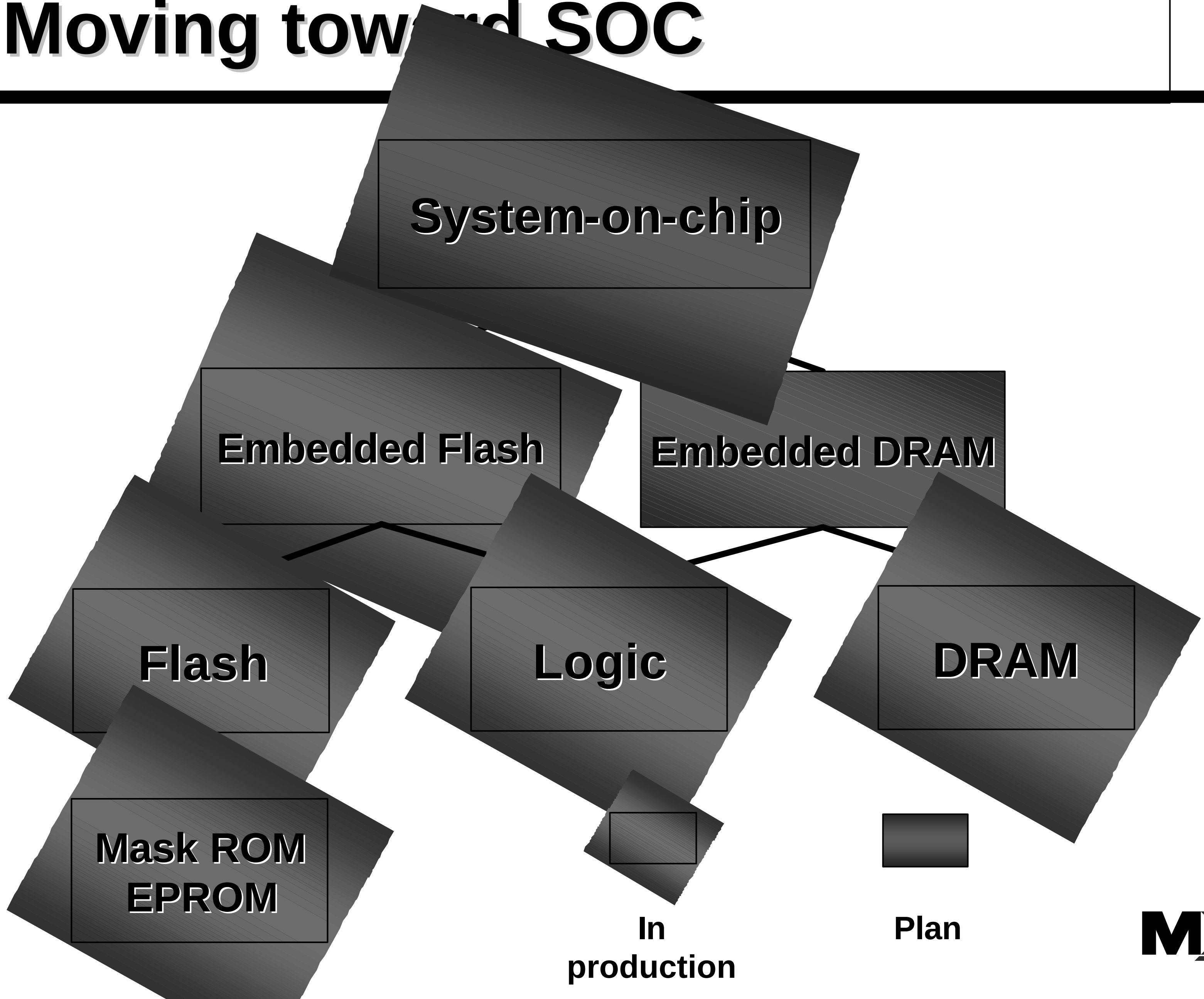
Global Ranking	6th	1st	4th	12th

Source : Datequest

* Market share for 1999

MXIC

Moving toward SOC



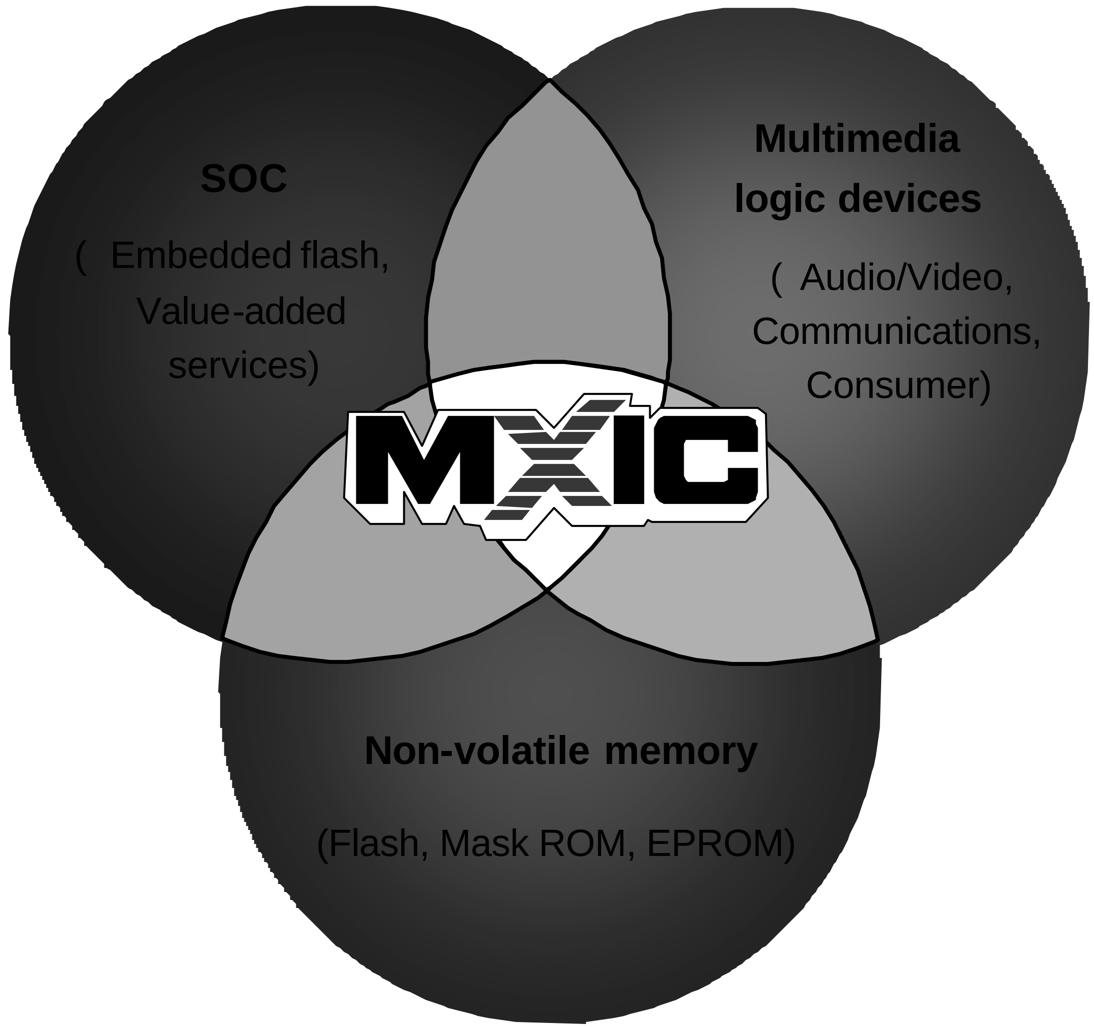
Industry Analysis

- Marketing Analysis
- Competitive analysis
- Situational analysis

Product Concept

- Be a leader of industry
- Solid product road map

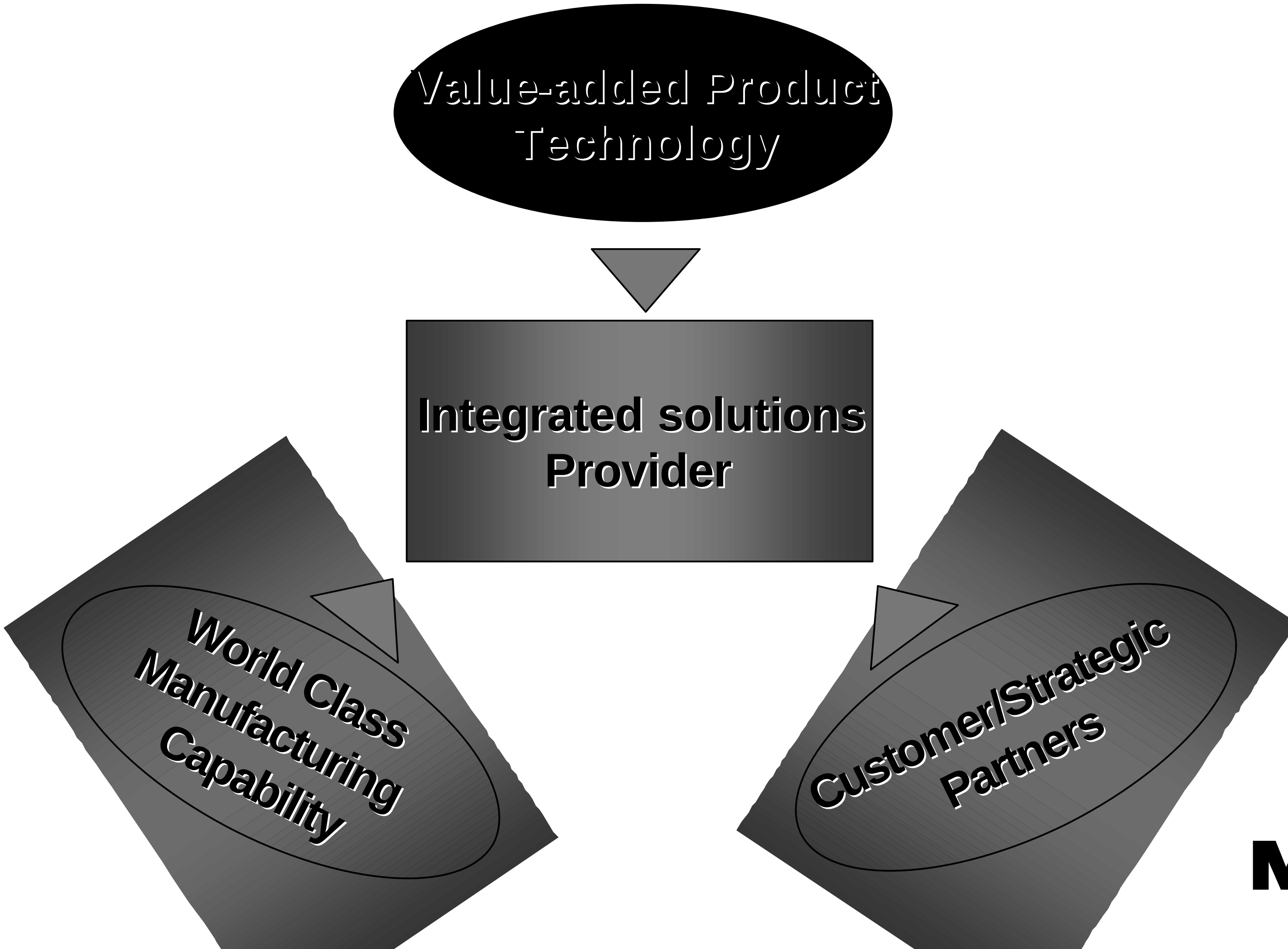
Macronix : Product Concept & Strategy



Business Model

- How to sell
- How to generate profit short term and long term
- Milestones of progress

Macronix Business Model



Macronix Key Customers and Alliances

Existing:

HEWLETT PACKARD

PHILIPS

MOTOROLA

VLSI Technology

GI General Instrument®

SAMSUNG CORPORATION

Inventec 英業達集團

TOSHIBA

To Come:

Infineon technologies

More to Come:

Conclusion

- Be Farseeing
- Be Sensible
- Be Realistic

MXIC

Facilitating IPO-Style Ventures

Norihiko Ishiguro
Director
New Business Promotion Division
MITI

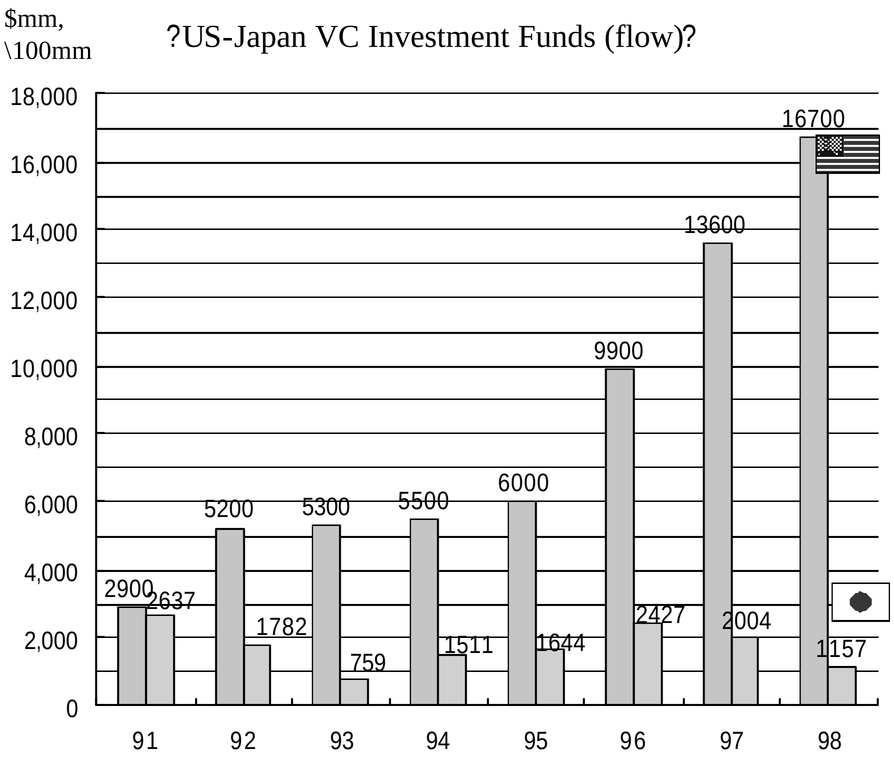
Agenda

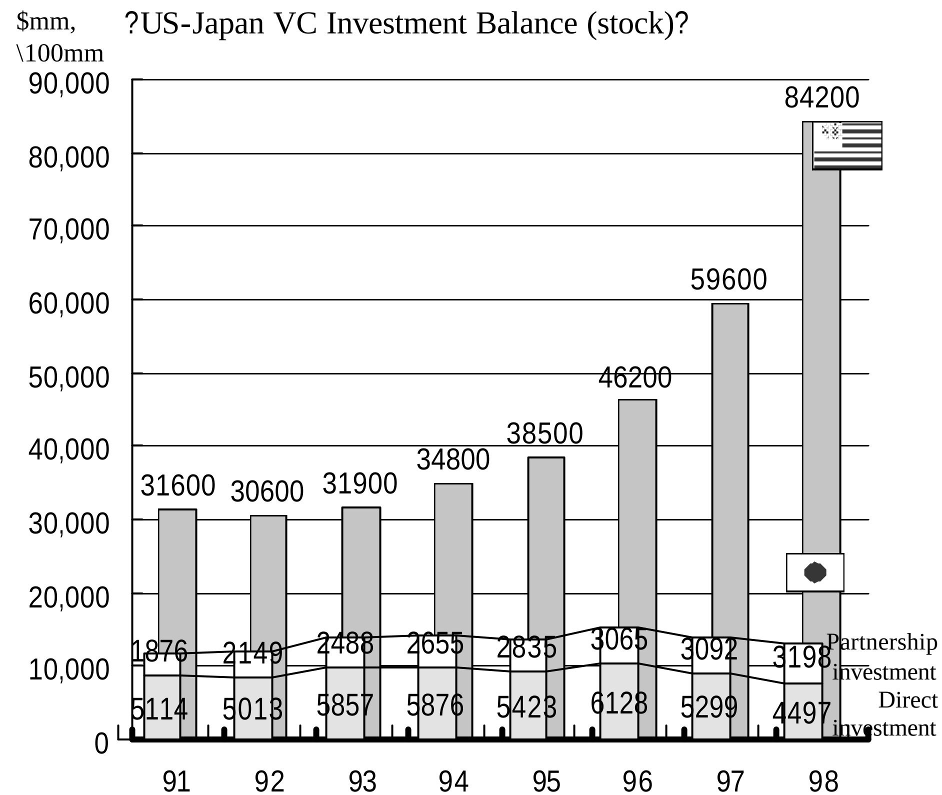
- Current Situation of VC
- Vicious Circle Related to VC
- Business Constraints
- What should VC Market encourage?
- Changes and Measurements

Current Situation of VC

- Investment in 1998
  - Disbursements from VC: $1.1 billion
  - Capital under management: $7.3 billion
- Hands-on style?
  - $0.45 million per portfolio company
  - 30 portfolio companies per venture fund
- How long to exit?
  - 25.4 yrs from startup to IPO in OTC Market

Invested Capital in VC Markets



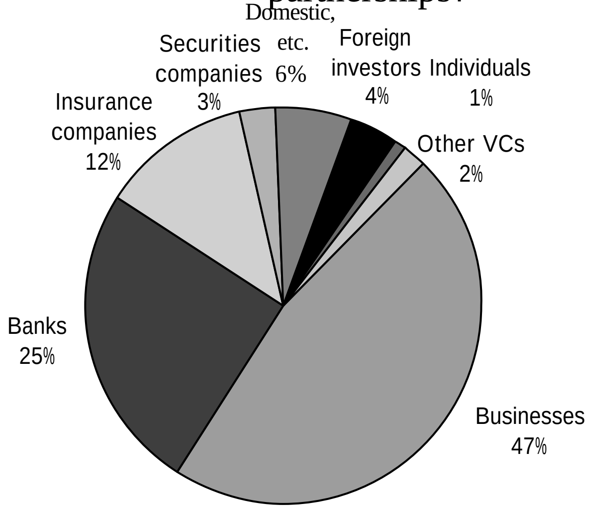


Notes: 80%-90% of US VC investment is from limited partnerships. Japan: MITI VEC (Venture Enterprise Center) survey, US: Venture Economics materials

Investors in VC Markets

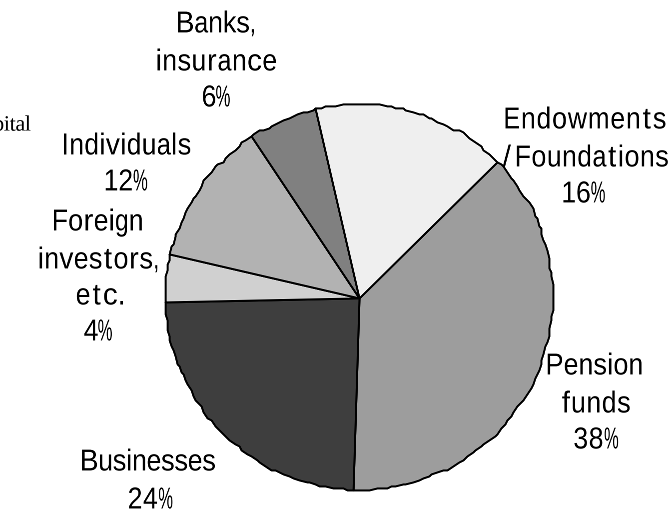
?Breakdown of companies investing in limited partnerships?

MITI's "1998 Venture Capital Fund Performance Benchmark"



Pension assets include ¥179 trillion in public pensions (¥8.5 trillion in national pensions, ¥125.8 trillion in employees pensions, and ¥44.9 trillion in mutual aid pensions) and ¥70 trillion in private-sector pensions (including ¥50.1 trillion in employees pension funds, ¥19.2 trillion in qualified retirement pensions, and ¥1 trillion in national pension funds) (FY3/98). These pension funds with massive assets currently have no investments in domestic venture businesses.

FY97 US Venture Capital Economics materials



In the 1980s, VC-related investments only accounted for 2%-3% of pension fund allocations, but now it has risen to nearly 10%.

Venture Capitalists' Style

Number of companies newly receiving venture capital

	1994	1995	1996	1997
Japan	1,491	1,977	2,174	2,547
US	465	624	1,046	1,298

Amount per investment

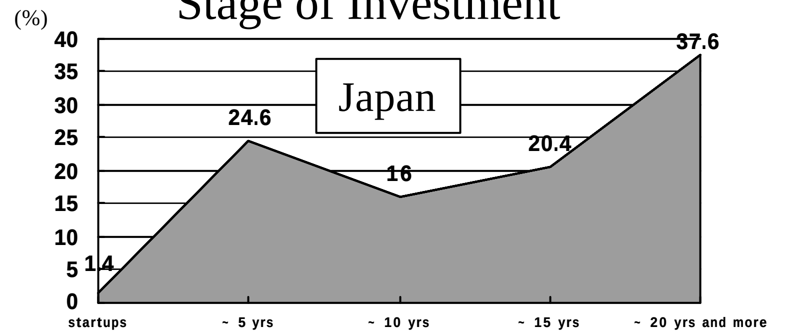
Japan: ¥45 million,
ie $400,000
US: US$4.9 million

Companies per fund

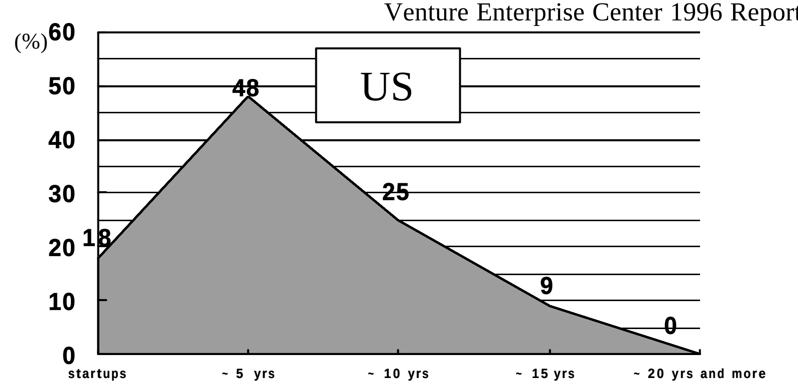
Japan: 30 companies
US: 6 companies

Source: FY99 "Annual Economic Report"

Stage of Investment



Venture Enterprise Center 1996 Report



NVCA 1996 Report

Vicious Circle Related to VC

- Capability in VC Markets
  - Not hands-on
  - Lack of gatekeepers
- Lack of Tangible IRR
- Investors' Activities
  - No pension funds, few angels, etc.
- Enthusiasm for New Ventures
  - ? Deals train venture capitalists and gatekeepers...

Business Constraints

- Restriction by Commercial Law
  - Number of stock options
  - Recipients of stock options within the firm
  - Number of preferred stocks
  - No stock-swap deals, etc.
- Limited Financial Vehicles
  - Vague limited partnership structure
- Limited Exit Opportunities
  - Less efficient OTC Market for IPO
  - Less active M&A markets for strategic buyouts

VC markets should encourage:

- Significant commitments and hands-on style investment by venture capitalists (at least 1%)
- Disclosure of performance from investment in VC markets
- Reasonable participation by investors, including pension funds, angels, etc.
- Risk taking activities and clear strategies by entrepreneurs to cultivate niche markets

Changes and Measurements

- New Exit Opportunities
  - Mothers* by Tokyo Stock Exchange (Nov. 1999~) * Market of the high-growth and emerging stocks
  - NASDAQ Japan by NASDAQ Japan Planning and Osaka Securities Exchange (Jun. 2000~)
  - OTC Market's self-reforming plan
  - Introduction of stock-swap deals

(cont'd)

Changes and Measurements

- Limited Partnership Act for Venture Capital Investment (enacted in 1998)
- Amendment of Small and Medium Enterprise Basic Law (enacted in 1999) and related 8 laws (enacted in 2000)
  - ex. Amendment of Law for Facilitating the Creation of New Business includes exemptions of Commercial Law

Amendment of Law for Facilitating the Creation of New Business

- Exceptions of the Commercial Law for new ventures seeking to go IPO
  - Raising the upper limit on stock options
  - Expanding the range of people that can receive stock options
  - Easing issuance conditions for preferred stocks, etc.
- Assistance for limited partnerships formed by venture capitalists

Exception of the Stock Option System

1.What is the stock option system?

Systems for providing employees and others with rights to purchases the shares of a company at pre-defined inexpensive price

2.Exception covered in this law (new stock warrants)

1.Expansion of the upper limit on stock options

Expanding the current upper limit in the Commercial Code of 1/10 of the total volume of issued shares to 1/3

2.Expansion of the range of people covered

Expanding the range from primarily employees of the company in the Commercial Code to include outside supporters that meet certain conditions

?Conditions? · Person or entity capable of supplying necessary knowledge or skills that contribute to company growth

· Appropriate conditions that require the company reaching certain growth targets in order to exercise the rights (such as not being able to exercise the options until the company goes public)

?Example of outside supporter?

Example 1) Consultant that helps set up sales channels or conduct marketing for the approved company

Example 2) Outside programmer that supports the approved company's Internet business

3.Anticipated effect of utilizing the stock option special measure

1. **Ability to secure human resources essential to the company's growth**
2. **Securing high-quality and ongoing assistance from outside supporters**

Exception for Issuing Preferred Stocks

1.What are non-voting right preferred?

One type of preferred shares that receive preferred dividend distribution versus common shares in exchange for not having voting rights

(Method of issuing non-voting right shares)

These shares can be issued via a board of directors resolution that sets parameters for volume and content

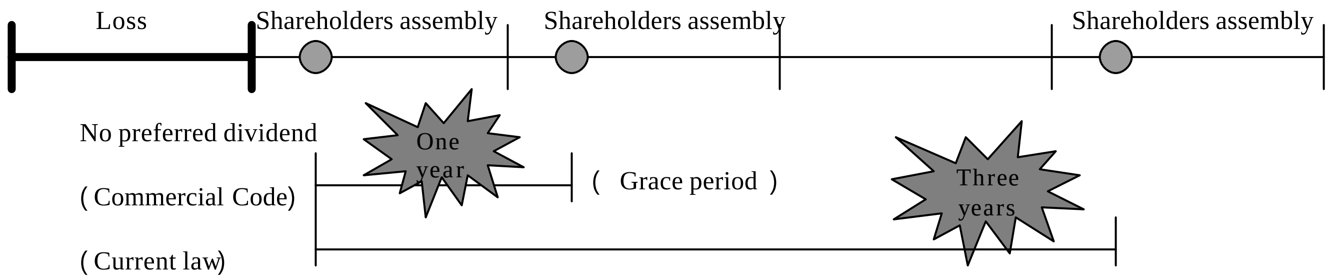
2.Exception in this law

1.Expansion of the upper limit on issues

Expanding the upper limit of 1/3 of total issued shares in the Commercial Code to 1/2

2.Extending the period before voting rights are reinstated

Accrued-type preferred shares (preferred shares that allow dividend shortfall to be carried over to the next year) have their voting rights reinstated if the promised dividends are not paid within one year. This revision extends the period to three years later.



3.Anticipated effect of these special measures

1.Ability to support flexible capital procurement that meets diverse investor needs

2.Ability to actively procure capital and maintain control over the business

Fundamental Expansion of the Tax Incentive for Angels

Tax Incentive for Angels

The tax incentive for angels has been fundamental reformed by adding a measure that reduces the tax burden on angel investors by only taxing 1/4 of capital gains earned when the subject venture company goes IPO to the existing special measure on angle losses (using losses from an angel investment to offset other capital gains by carrying losses forward for a period of three years after the year in which the loss is posted). A significant improvement in the investment environment for venture companies is anticipated.

(Features of the new tax incentive system)

• If an individual sells shares from an investment in a venture company within one year after the company goes IPO, only 1/4 of the capital gain is subject to taxation.

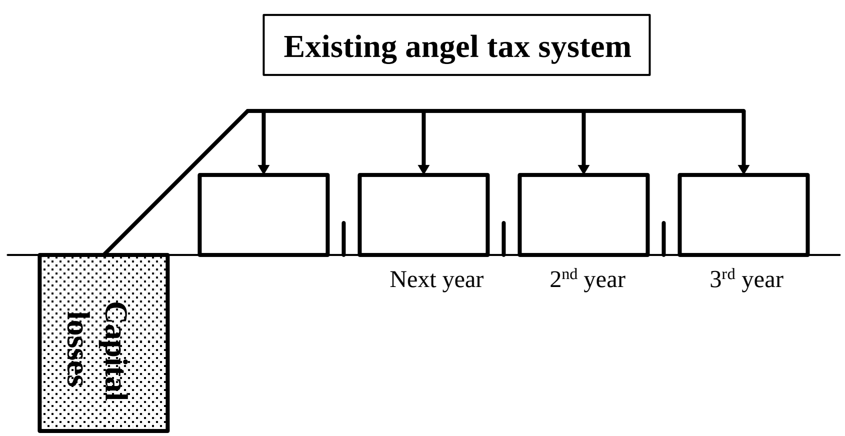
Note that this system only applies to shares acquired from April 2000 to March 2005 and that have been owned for at least three years prior to the company going public.

• Investors can also select to apply the special measure on capital losses under the current angel tax system. As a result, angel investors receive tax benefits whether they make or lose money.

(Companies covered by this system)

Small/mid-sized venture companies established for less than 10 years (unregistered, unlisted shareholding companies)

The previous session of the National Diet will substantially expand the companies covered by this provision from within five years of a company's establishment to within 10 years of a company's establishment.



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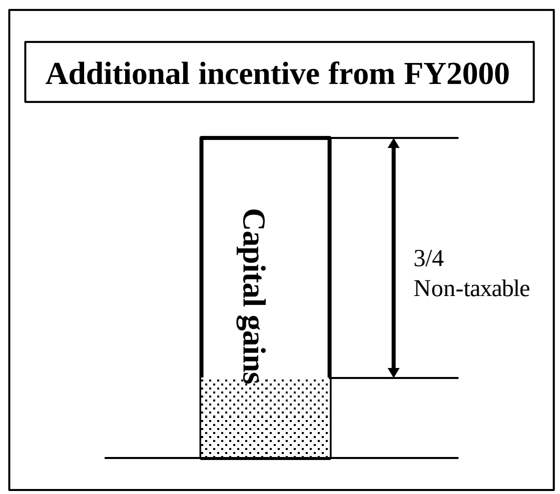

Concluding Remarks

Presented to

APEC Seminar on
Securing Initial Equity Funding for Start-up Companies –
The Birth and Growth of SMEs in a Knowledge-based Economy

May 16 - 18, 2000
Taipei

Concluding Remarks

A. Introduction

The APEC SME Sixth Ministerial Meeting was held on April 26-28, 1999 in Christchurch, New Zealand. In their Joint Ministerial Statement, SME Ministers recognized the fact that SMEs would be the engine for growth in the knowledge-based economies of the future. Responding to the regional financial crisis, Ministers considered ways to promote SME growth under four priority areas which included the improvement of capital markets and access to them. The lack of venture capital was identified by Ministers as one of the four difficulties for SMEs in raising capital and the Statement set forth that "Ministers agreed to raise with APEC Finance Ministers the urgency of removing barriers to the competitive provision of financial services to SMEs, especially with respect to the marshalling of capital and the creation of venture capital funds."

On September 9-10, 1999, APEC Ministers met in Auckland, New Zealand for the Eleventh APEC Ministerial Meeting. Among many other important tasks, Ministers confirmed in their Joint Statement that they welcomed the proposal by Chinese Taipei on *"Economic Revitalization Through Start-up Companies and Venture Capital"* (99/AMM/021) and looked forward to further work in this area in 2000.

In light of the above, Chinese Taipei has organized the APEC Seminar on *"Securing Initial Equity Funding for Start-up Companies – The Birth and Growth of SMEs in a Knowledge-based Economy".* The seminar was aimed at creating a forum for policy makers and business representatives from the APEC community to pool their wisdom for promoting the birth and growth of SMEs through venture capital and other sources of capital.

B. Participation

Enthusiasm towards the seminar was shown in the registration. Altogether, 135 participants from 16 member economies took part in the seminar, among them 43 were from government agencies and 92 from the private sector. This combination indicated that the subject attracted the attention of both the public and private sectors across the APEC community.

As far as the speakers are concerned, there were 25 speakers from 6 member economies who joined the seminar to share their knowledge and experience as well as making policy recommendations.

With the numbers of participants and speakers combined, the seminar grouped together 160 delegates in total, a sizable gathering as an APEC event.

With respect to APEC itself, Dr. Mitsuru Taniuchi, Chairman of the APEC Economic Committee joined the seminar as a speaker, and Professor Nigel A. F. Haworth, Coordinator of the APEC HRD Working Group Capacity Building Network participated as a moderator. Furthermore, the APEC Secretariat was represented by its Program Director, Ms. Siti Nugraha Mauludiah.

C. Overview of Proceedings

The seminar consisted of six sessions, which were conducted in the first two days, and a one-day field trip to two enterprises and one government agency.

<u>Session One</u>

In Session One of the seminar, panelists focused their discussions on the role of government funding for start-up companies and SMEs. According to the experiences shared by the speakers from the US and Chinese Taipei, the government funding programs in these two member economies were proven to be successful.

The Small Business Investment Company ("SBIC") program administered by the US Small Business Administration was introduced to address the structural market inefficiency that blocked capital flow to small businesses. The speaker pointed out that the SBIC program encouraged the formation of new venture capital funds, which channeled both private and government funds to small businesses. Under the SBIC program according to the speaker, investment decisions were made by private managers without government interference. Significantly, the program was administered strictly on a rule-based manner and no government corruption had ever occurred since the inception of the program. In addition to the various elements that have made the SBIC program successful, the existence of an investing culture was mentioned by the speaker as a critical ingredient for promoting start-up companies through venture capital and accounted for the difference in venture investing activity between different states of the US. Being a successful program, the SBIC was recommended as a useful model to be used as a starting point for developing a program that could be adapted to the culture of member economies to meet the special needs and circumstances.

In Chinese Taipei, the Development Fund established by the government has contributed to the economic growth and high-tech industry development. Similarly according to the speaker, although the Development Fund played an important role in fostering the venture capital industry and promoting SMEs, the government did not interfere in the management of the investment companies.

Session Two

The discussions in Session Two focused on the topic of venture capital as the initial equity funding for start-up companies and SMEs. It was recognized that venture capital, as one source of private equity, was a kind of stable financing for new companies because the investment of such capital was aimed at gaining long-term profit generated by the sustained growth of investee companies. Speakers also confirmed that venture capital helped to create new businesses and new jobs. Although venture capital investments carried high risks, such investment risks were always balanced by the potential of high returns according to the speakers. In light of this, the speakers suggested that an adequate legal environment such as limited partnership structure or similar structures that facilitate the formation of venture capital funds be created by the government for the promotion of venture capital in any given economy.

The session also provided participants with an opportunity to learn the recent changes in Japan where entrepreneurial spirit is becoming more and more prevalent among the younger generation. In order to make Japan's new dreams come true in the New Economy, the government has made efforts in legislative changes as well as creating more flexible IPO choices such as the Market of the High-growth and Emerging Stocks ("MOTHERS") so as to make access by start-ups and SMEs to the capital source easier.

A luncheon speech on the subject of "*Opportunities of SMES in the Globalizing*

Economy – Fitting into the Supply Chain of Global Products" was delivered following Session Two. It was pointed out that by employing domain knowledge and new business models, small businesses, be they in the traditional or high-tech industries, certainly had an important role to play in the New Economy as more business opportunities for small businesses would be enhanced.

Session Three

Session Three had speakers from the private sector to discuss the topic of investment banking as the subsequent equity funding for start-up companies and SMEs. The role of investment banks, both as the advisor to and the pre-IPO funding source for investee companies, was explained in great details.

Speakers noted that the potential of investment banking in the Asia-Pacific was increasing as governments were trying hard to promote more listing choices for high-tech companies and the Old and New Economies were converging. Nevertheless, it was recommended that measures be taken by governments to address relevant issues such as creating healthy IPO markets. In this connection, a disclosure-based, rather than merit-based, regulatory environment was proposed for consideration.

Session Four

Under the title of "*Developing a Healthy IPO Market*", speakers introduced the listing boards created for high-growth businesses in Japan and Hong Kong.

- MOTHERS of Japan

The speaker pointed out that MOTHERS of Japan was an IPO market for growth venture enterprises which was designed to transform and revitalize the Japanese market and to provide an array of investment products. Important purposes of MOTHERS included the providing of financing to venture enterprises leading to new industries and the creation of new employment opportunities.

As mentioned by the speaker, MOTHERS was characterized by four key features: innovative market without territoriality requirement, speedy listing, liquidity and transparency. Although the listing rules were more flexible which had shortened the screening time significantly, MOTHERS nevertheless required more frequent disclosure of information so as to reinforce transparency. Emphasis was also placed on disclosure when screening an application for listing. A MOTHERS Supporters Club has also been formed to facilitate the disclosure of information by listed companies and access to such information by retail investors.

- GEM of Hong Kong

Recognizing that SMEs would be the engine of growth in the New Economy of future, the Growth Enterprise Market ("GEM") of Hong Kong was brought into being in answer to the capital needs of growth companies. According to the speaker, GEM was a timely development as Hong Kong needed a wider economic base in the New Economy than the past time when the economy was mainly driven by the property and financial sectors. Entry barriers for listing were significantly lowered with the creation of GEM. Companies listed on GEM were more diversified than those on the Main Board.

The speaker emphasized that investor protection would be the key to success for GEM. Four areas were identified for enhancing investor protection; namely more disclosures, stronger corporate governance, adequate sponsor's scheme and investor education.

In addition to listing of local companies, GEM of Hong Kong also allowed the listing of overseas businesses.

- Private and Growth Enterprises of China

The topic of prospects of China's private and growth enterprises was also discussed in Session Four. According to the speaker, private enterprises of China have grown over the years both in number and in their contribution to the GDP of China. The importance of private enterprises and the Rule of Law were increasingly recognized by the government and was enshrined in China's Constitution through its amendment in 1999. Nevertheless, according to the observation of the speaker, the growth of China's enterprises was constrained by certain factors including the limited access to capital. In response, measures such as the encouragement of venture capital and the creation of second board were being taken by the government to address the problems encountered by private enterprises. It was expected that the private sector would experience positive development with China's entry into the WTO in the future.

Session Five

Session Five continued with the topic of developing a healthy IPO market with the introduction of the high growth boards in the US, Chinese Taipei and Korea.

- NASDAQ of US

NASDAQ was presented as an important board not only for US technology start-ups but also for similar companies in other parts of the world including the Asia-Pacific region. Statistics presented to the seminar indicated that companies from many APEC member economies were listed in NASDAQ.

- TIGER of Chinese Taipei

The Taiwan Innovative Growing Entrepreneurs ("TIGER") of Chinese Taipei was established as a capital market for SMEs. According to the speaker, the listing rules of TIGER were less stringent; for example, there were no profitability requirements on companies applying for listing. Nevertheless, an enhanced standard of information disclosure was applied to companies listed on TIGER.

- KOSDAQ of Korea

The KOSDAQ of Korea was introduced in the seminar as an important listing board for venture companies. As pointed out by the speaker, one of the chief factors of its success was the easy listing requirement. As knowledge-based companies would dominate the IPO market of Korea in the future, KOSDAQ was expected by the speaker to have the listing of significantly more growth companies.

As identified by the speakers, common to all the new markets which were designed to facilitate IPO's for newly created enterprises was the delicate balance between increased ease of getting to market and the investor confidence in the quality of disclosure. The penalty for poor disclosure or misstatements in the offering material must thus be swift, severe and visibly administered.

During the Q&A session, participants and speakers pondered the issues of what developing member economies should do, and what APEC could do, in promoting start-up companies and SMEs. One speaker mentioned certain elements, including an organized structure such as the accounting system, transparency and fair judiciary, as preconditions for developing economies to build an equity market for start-up companies and SMEs. Options proposed by the participants included: (a) for the individual economies to build their own IPO markets; (b) for developed economies to provide access to their existing IPO markets to companies from other economies; or (c) the creation of an APEC IPO market for start-ups and SMEs of all APEC members. One speaker stated that the seminar was a very good foundation for moving the subject forward. It was suggested that the information disseminated in the seminar be further exchanged among the APEC members, and that APEC Ministers be recommended to take initiatives for capacity building so as to improve the management of the government and the private sector with regard to the subject of the seminar.

Session Five was followed by a luncheon speech on entrepreneurship and the knowledge-based economy. Referring to relevant statistics, the speaker indicated that in the knowledge-based economy, the growing importance of entrepreneurship was widely underscored. Accordingly, it was emphasized that priority consideration should be given to public policies for promoting and fostering entrepreneurship. The interaction among entrepreneurship, culture and institutional factors was also explored during the speech.

The speaker further proposed for adjusting institutional arrangements so as to affect the culture in favor of entrepreneurship. In this regard, Japan's recent efforts in fostering entrepreneurship were highlighted. These efforts included the legislative changes to facilitate the issuing of stock options, relaxation of regulations of the labor market and the strengthening of cooperation between corporations and universities.

Session Six

Session Six was conducted through case studies on the impact of start-up companies and SMEs on sustainable economic development. The session was divided into two parts, focusing respectively on the macro economy and the micro economy.

In the case of developed economies, Australia and Japan shared their experiences in this area. As far as Australia is concerned, it was pointed out that its future economic prosperity and its continued sustainable growth were dependent on a dynamic and viable SME sector. Access to finance was considered one of the challenges encountered by SMEs and one of Australia's SME growth policies was to reduce venture capital market inefficiencies. The speaker emphasized that, among others, SME policy should be developed with industry using a whole-of-government approach and equity financing for businesses should be encouraged. The speaker also emphasized the importance of good data to enable SME policies and programs to be evaluated.

With respect to Japan, it was pointed out that SMEs accounted for a significant portion of its economy. In view of their importance, the government of Japan has adopted policies to support venture businesses. Notably, one of the characteristics of SMEs policies of Japan as observed by the speaker was the change in concept by recognizing SMEs as the source of dynamism and the creator of attractive jobs and opportunities.

Chinese Taipei's experiences in SMEs were also introduced in the session as the case study on a developing economy. SMEs' contribution to Chinese Taipei's dynamism was well recognized by the speaker and their flexibility and adaptability were explained in detail in various industrial sectors.

At the end of Session Six, two companies from the private sector presented their stories of success respectively in the traditional and the high-tech industries. Both companies described the importance of funding in the start-up as well as growth stages and the employment of innovative technologies in a knowledge-based economy.

Field Trip

As part of the seminar, a field trip was arranged for participants to visit certain successful companies of Chinese Taipei which started as small businesses and have just recently gone IPO. Enlightening dialogue was conducted between participants and representatives of these companies. In addition, arrangement was made for the meeting with representatives of the Hsinchu Science Park Administration, the authority in charge of Chinese Taipei's high-tech incubating industrial parks.

D. Conclusions

As a general note, discussions in the seminar reaffirmed that the importance of SMEs in the knowledge-based economy or the New Economy was widely recognized. Various topics have been touched upon throughout the sessions for the promotion of start-up companies and SMEs.

Since funding is crucial to the birth and growth of SMEs, discussions have covered the areas of securing initial equity funding (i.e., venture capital), subsequent equity funding (i.e., investment banking) and creating healthy IPO markets such as the flexible listing boards available in certain APEC member economies for high-growth companies. In addition to these arrangements, the role of government funding was also discussed as an important catalyst for the development of the venture capital industry.

Discussions also confirmed that the global supply chain in the New Economy would present abundant opportunities for start-up companies and SMEs in the traditional industry as well as the high-tech sector. Moreover, the issues of culture and entrepreneurship were addressed during the seminar in the context of the knowledge-based economy.

The impact of start-up companies and SMEs on sustainable economic development was explored in the seminar both in the macro and micro economic perspectives.

All the above-mentioned discussions confirmed that the government has an important role to play in terms of creating a conducive legal and institutional environment to secure various stages of equity funding for start-up companies and SMEs, foster entrepreneurship, etc.

The coming of the knowledge-based economy or the New Economy represents a paradigm shift toward the focus on the mechanism of encouraging entrepreneurship and innovation through start-up companies and SMEs. This is of particular significance in the process of economic revitalization in the APEC community as a whole, and APEC has been encouraged to play an important role in this area.

An important theme underpinning much of the discussion was the need for close cooperation between governments and the private sector in the creation of a positive environment for SME development in APEC economies. This is particularly true for the start-up phase of SMEs and for the availability of appropriate funding for start-ups.

As the discussions progressed, it became clear that APEC could make a wide range of positive contributions to SME development, as recognized by Ministers in their discussions in New Zealand in 1999. Two important contributions could be made in terms of, first, information exchange and, second, capacity building. Information exchange includes two important elements: information exchange about institutional developments in member economies in support of SMEs and similar exchanges about the development of appropriate regulatory and legal frameworks. Capacity building also has two key dimensions: capacity building, particularly management training, associated with the implementation of measures to support SME development and capacity building in support of the regulatory and legal regimes set in place.

As expected by APEC Ministers, the results of this seminar will be presented to the forthcoming SME Ministerial Meeting and the annual APEC Ministerial Meeting for Ministers to take appropriate initiatives in promoting start-up companies and SMEs in the APEC context. It is believed that the contribution by all the speakers and participants in this seminar will eventually have positive effects on the individual member economies and the APEC community as a whole. Through joint efforts in promoting start-up companies and SMEs, APEC is expected to take the lead in enhancing sustainable growth and ensure that future prosperity can be shared by all members of the APEC community.