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### ASSESSMENT OF VENTURE CAPITAL AND INVESTMENT OPPORTUNITIES IN SINGAPORE

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# ASSESSMENT OF VENTURE CAPITAL AND INVESTMENT OPPORTUNITIES IN SINGAPORE

Dept. of External Affairs  
Min. des Affaires extérieures

JAN 5 1995

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The Canadian High Commission in Singapore, Commercial Section, commissioned SRI International to prepare this analytical overview of investment and business opportunities in Singapore. This report is designed to help Canadian organizations meet their initial information needs regarding participation in these business areas in Singapore. The information presented is believed to be accurate and from sources that SRI believes to be reliable. Readers are urged to verify upon pertinent information before committing resources.

Dept. of Expenditure  
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## **INDUSTRY OVERVIEW**

### **BACKGROUND**

The Singapore government's directives for continuing and extending its competitive advantage greatly benefits the local venture capital industry. The national strategic development plan includes thrusts into high technology and financial services so that Singapore can be a regional center in both fields. The venture capital industry receives strong encouragement and support from Singapore's government because this type of investment activity is seen as a means for achieving the country's economic growth goals. The Economic Development Board's (EDB) objectives for the venture capital industry are:

- to promote the Singapore venture capital investment,
- encourage Singapore companies to diversify into technology-related areas,
- and to promote innovation and entrepreneurship.

The government has provided a host of tax breaks and subsidies for businesses in line with its strategic thrusts, as well as providing its own expertise through its ministries and agencies.

The history of venture capital in Singapore is short. Venture capital funds are both privately and publicly held. South East Asia Venture Investment Company (SEAVI) was the first venture capital firm, established in 1983, with a start-up capital investment of S\$70 million (C\$44.6 million). Transtech was launched in 1986 with S\$55 million (C\$35 million). In 1985 the government initiated its own fund of S\$100 million (C\$63.7 million) through the EDB.

1987 was a watershed year for the venture capital industry, when the government established Sesdaq, a second-tier stock market catering to the needs of small companies. This provided an easy disinvestment route for portfolio firms wishing to make their holdings public.

### **CURRENT SITUATION**

Today there are nine professionally managed venture capital funds focused on Singapore with an estimated combined total capital of S\$300 million. There is also local venture capital investment focused on the Asean region as a whole worth an estimated S\$350 million. Corporate in-house venture funds and specialized mezzanine funds account for S\$400 million. Thus the total value of venture investment in Singapore is roughly S\$1050 million (C\$668.8 million). The investment pace of venture funds was estimated to be S\$75 million for 1989.

The typical recipients of venture investment are small and medium sized enterprises (SMEs). These type firms form a large component to Singapore's economy, measuring up to 90% of the total number of business establishments, providing 44% of total employment, 24% of value-added and 16% of direct exports.



## *INDUSTRY OVERVIEW ...*

### **FUTURE TRENDS**

To date, more than 40 companies in Singapore have received venture capital funding, and 9 have been successfully listed on the stock exchanges. As these successes continue, the industry promises to grow at its rapid rate. SEAVI forecasts that the investment pace of venture funds will fall in the range of S\$100-150 million annually through the 1990s.

There are four major trends that will facilitate venture capital growth in the Asean region for the 1990s:

- ***Dynamic Economic Growth***  
First and foremost, Asean nations are experiencing high economic growth. These countries are embracing high technology, and becoming cost leaders. Many MNCs are locating in Asean, and the spill-over for subcontracting affects many small and medium sized enterprises. These SMEs also benefit with the rise in welfare of domestic populations, who will be able to afford higher quantity and quality goods.
- ***Market Capitalization***  
The capital markets are becoming more sophisticated with foreign investment and local speculation driving market capitalization. This provides more and better divestment choices for venture capital firms.
- ***Intra-Regional Cooperation***  
Intra-Asean projects and cross-national investing are expected to increase through higher levels of Asean economic cooperation. Tax and ownership laws and regulations are changing as nations understand that increased economic liberalization is to their benefit.
- ***Increasing Professionalism***  
As the venture capital industry becomes widespread and recognised as a legitimate industry, so will acceptance of investors and entrepreneurs in the role of venture capital professionals. This, in turn, will provide a better business environment for venture capital activities.



## **FUND MANAGEMENT STRUCTURE**

### **ROLE OF SINGAPORE VENTURE CAPITAL FUNDS**

Risk capital sources take four different forms:

- Individuals and private sources of capital
- Corporate resources for expansion and diversification
- Corporate in-house venture funds
- Professionally managed venture funds investing in country or regional funds

Singapore venture capital funds are managed by experienced business professionals, who are willing to provide active support to investees. This can take the form of business expertise or the use of their extensive contacts. Venture capital funds have five aspects wherein they can help their investments:

- Financial, tax and strategic planning
- Assistance in identifying opportunities for joint ventures with major corporations
- Marketing and new business development, mergers and acquisitions, licensing, procurement or sale of technology
- Sourcing of materials and access to manufacturing facilities through associated businesses and contacts
- Planning and preparation for public listing

### **INVESTMENT TARGETING**

Singaporean funds typically look for a medium to long term investment horizon of 3-8 years. They will buy into new as well as existing projects. Also, venture funds usually will take a minority stake in the companies that they buy. This level of involvement is geared to giving the entrepreneur full autonomy, and hopefully preserve the motivation to survive and excel.

A potential portfolio company is evaluated on four main points:

- **Potential for Capital Gain**  
Since small and young companies usually offer little in the way of profit, the typical range for appreciation should be between 30 and 40% compounded annually. This is necessary since high risk funds aim for returns of 20% annually, despite the fact that some portfolio companies may go bankrupt and 20% of a fund's capital is expended on its own overheads.
- **Liquidity**  
A key concern is how difficult will it be for the investor to realize gains when the portfolio company is ready for divestment.
- **Possibility of Future Capital Injections**  
Under-capitalization is one of the major reasons why SMEs flounder, especially high technology companies operating under the uncertainty of R&D progress. Therefore, the fund will attempt to gauge the probability of future additional financial support.



## *FUND MANAGEMENT STRUCTURE ...*

### *INVESTMENT TARGETING ...*

- ***Ability of the Current Management Team***

Human resource assessment is a difficult task, but investors want to see drive, integrity, and experience in the company's leaders. Financial commitment by the management is commonly used to gauge its level of dependence and commitment to the company.

### ***DIVESTMENT STRATEGIES***

Once a portfolio company has developed to the stage where more conventional sources of capital are available, the fund will divest its investment. The three main options are to list the company on the stock exchange, sell the company to another party, or sell through a leveraged buyout by the management.



## **INDUSTRY ANALYSIS**

The government sees venture capital as a catalyst for facilitating economic development. It can stimulate new, desirable economic activity by pooling risk capital with entrepreneurial talent and advanced technology or innovative business concepts to create new products and companies. With this in mind, the EDB has identified five factors for generating a successful venture investment climate:

- An ample supply of risk money, namely investors
- An ample supply of available investment projects and entrepreneurs
- A mechanism for matching investors with entrepreneurs
- The presence of divestment mechanisms
- A congenial, modern business environment

Because of its youthful nature, the Singapore venture capital industry is undergoing some difficulties in its development. In particular, there have been some difficulties with Singapore funds invested in the region. Since the aims and means of venture capitalists are not widely known, there is an element of distrust by investors, government authorities and entrepreneurs. Thailand, Malaysia, Indonesia and the Philippines all have nominee laws that prohibit majority ownership in any foreign venture in those countries. Businessmen and government authorities alike are apprehensive about losing control of their interests to what they perceive as the whims of out-of-touch foreigners.

Currently, there is both a shortage of entrepreneurs with experience and skills and a shortage of venture capital professionals. The inflow of money has been enormous; thus, compounding the dearth of qualified people is the problem of too much money chasing too few quality business prospects. The result has been export of capital to the United States where the venture capital industry is well established in places like Silicon Valley and Boston. Hence opportunities exist for foreign SMEs from established venture investment countries since none of the funds is fully invested.

With these challenges has come progress. Tax incentives are being discussed in Thailand and Malaysia. There has been an influx of investment managers from other professions, and venture capitalists are learning to work within the various equity rules. As the industry matures, industry officials anticipate greater acceptance and institutional support.





## INDUSTRY ANALYSIS ...

### KEY PARTICIPANTS

The venture capital industry in Singapore spans a wide spectrum in investment targets, as well as actual investors. The preferred size of incoming investment ranges from S\$100,000 to S\$1 million. Geographical preferences are Singapore, Southeast Asia and the United States, in that order. Investment preferences vary greatly, as some funds are focused on a specific technology, while others are willing to look at any potentially lucrative deal. High technology industries that receive constant venture capital review and investment are:

- Computers and computer peripherals
- Semiconductors
- Telecommunications & data communications
- Other electronics
- Software
- Office automation
- Robotics
- Scientific and technical services
- Advanced materials
- Biotechnology
- Medical and healthcare products

The major funds are :

Managing Company/Fund	Fund Amount (\$)	Date Established	Amount Invested (\$)	Life of Fund	Average Life Invested	Investment Criteria
<b>EDB</b> Venture Capital Fund	100m	1986	More than 33m (11m in Transtech)	N.A.	N.A.	N.A.
<b>South East Asia Venture Investment Ltd</b> Seavic	56m	1983	39m	10 yrs	3-5 yrs	Asia/technology transfer
VIS1	14m	1983	14m	10 yrs	3-5 yrs	Singapore/technology transfer
VIS2	27m	1988	2m	10 yrs	3-5 yrs	Singapore/technology transfer
<b>Transtech Venture Management Ltd]</b> Transtech 1	55m	Sep 1988 }	35.5m excluding warrants/options	12 yrs	4 yrs	Hi-tech, no global restrictions
Transtech 2	23.5m	Sep 1986 }		12 yrs	4 yrs	Singapore/technology transfer
<b>Elders Pica (Pte) Ltd</b> Elders Pica Asian Ventures	30m	1986	15m	7 with option to extend to 10 yrs	3-5 yrs	Singapore, Malaysia, Hongkong, Japan, South Korea, Taiwan and Australia - medium technology
<b>Walden Management Singapore Ltd</b> Pacven	40m	1988	new (still raising funds)	12 yrs	N.A.	N.A.
<b>DBS Venture Investments</b> Shenton Emerging Capital Fund	10m	1987	N.A.	N.A.	N.A.	Emerging growth (public) companies



## **MARKETING MECHANISMS**

Singapore venture capital funds are not fully invested, and therefore are still looking for prospective investments. Entrepreneurs and SMEs can approach funds to apply for investment money.

The typical application format has ten parts:

- ***Executive Summary***  
A summary of the main points in the proposal, including a synopsis of managements goals
- ***Company's Background***  
Information about its history, ownership, board of directors, products, current developments
- ***Products***  
A description about the product range, its competitive strengths and weaknesses, patent and licensing status, as well as new product developments
- ***Markets and Competition***  
A market overview wherein the company competes, market structure and competitor evaluation
- ***Manufacturing Plans***  
The manufacturing strategy
- ***Sales and Marketing Strategy and Plans***  
The target market, its size and growth rate, its present market share and projections, plans to enter other markets, distribution strategy, and who will manage sales and marketing
- ***People and Staffing Plans***  
The proposed organization structure, incentives for key people and requirements for additional assistance
- ***Financial Information***  
Recent financial statements for the last few years of operations and projections for three years of sales in terms of units and cost; gross margins; expenses in sales and marketing, R&D, administration and general; other income and expenses, net profits before tax; and cash flow
- ***Capital Sought***  
The amount of capital required, the timing of the requirement and the main uses to which the money will be put
- ***Benefits to the Investor***  
What equity is offered for the capital required



## *MARKETING MECHANISMS ...*

In return for financial support, portfolio companies should expect to accommodate their investors on several levels. Venture funds typically expect rights such as:

- A seat or seats on the board of directors
- Approval of the annual company strategy
- Approval of all expenditures above a certain preset level
- First refusal on future financing and anti-dilution protection
- Guarantee that the entrepreneur remains with the company

Since a fund will have many investments, the above conditions are meant to protect the fund's investment against problems within the control of management; notwithstanding this, the fund managers typically abstain from managing their portfolio companies, so a great deal of latitude is given to the management to pursue their mission.

Industry representatives list reasons why proposals can go awry. The most common have to do with the management of the portfolio company. The management may show too little commitment, financial or personal, or it may simply be inexperienced in the field of SMEs. Another consideration is the perception that there is an incomplete team in place, or overdependence on a certain individual. Other objections have to do with the company's strategy, as it may have tunnel vision and be too narrowly focused, or lack comprehensive research. Also, while all these factors may be in the company's favor, if the market is too small or competitive, and growth will be slow, the chance for investment will be greatly diminished.





## **VENTURE CAPITAL INDUSTRY INCENTIVES**

The EDB has introduced various measures for venture capital development in Singapore. It publishes a venture capital directory to assist local entrepreneurs to find funding by listing active venture investors and their respective investment preferences. In 1986, the EDB introduced the Venture Capital Club, whose purpose is to be "an avenue for local entrepreneurs to interact with potential investors." Club meetings allow members and guests to exchange and share experiences and information on venture projects. Also, entrepreneurs can present their ideas and plans to investors for possible funding.

The EDB offers tax incentives for venture capital firms. The Venture Investment Tax Incentive works in a two pronged fashion:

- Firstly, if a fund invests in an approved project, the fund is not charged capital gains tax on the sale of that project. For a project to be approved, the EDB must judge whether the investment can add to the further growth of Singapore, and involve high risk. If the investment is foreign, there must be a link to Singapore, either at the present time or expected in the future. If the investee company goes bankrupt after three years of operation, there is a provision for writing off the parts being sold. The write-off is in the form of a tax credit which can be carried forward.
- Secondly, approved venture capital funds and management companies will be granted a tax-free position for a period of 5-10 years, and this is often as long as the life of the fund. The EDB will evaluate the fund's and management company's objectives as they relate to the EDB's strategies for economic development in order to decide whether to grant this tax concession.

An entirely different tax scheme available to venture capital investors is "*Pioneer Status*." This provides a tax abatement for up to ten years. In order to receive this status, the firm may be local or foreign, but must be incorporated and operating in Singapore.



