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After the boom

QIMING VENTURE PARTNERS' 2010 investment in Chinese start-up restaurant chain YPX Cayman was a product of its time. This was a period of relative calm in the venture capital industry and several investors dipped their toe into the consumer space while pursuing pure technology deals.

"The investment thesis was that Chinese economic growth was 10% a year, so in an offline sector that was fast-growing you could do 20% a year, and if you are among the category leaders you might be able to grow 40% a year. You didn't have to be on internet back then, and you could also pick up assets relatively cheaply," Hans Tung, who led the deal for Qiming, told AVCJ last year. "What has become more obvious over the past five years is the impact of e-commerce on the offline economy."

Qiming has accumulated more than $650 million in commitments for its fifth China VC fund, capitalizing on a technology boom that has seen select start-ups soar in valuation as they progress through the funding rounds. GGV Capital, where Tung now serves as managing partner, is expected to close its latest fundraising effort with $1.1 billion for a Sino-US strategy encompassing a core venture fund, a top-up vehicle and an early-stage fund.

If these experiences are anything to go by, demand for exposure to China venture capital remains strong. But what kind of investment environment will these GPs face in 2016?

A regression into the restaurant space is unlikely because the fundamentals that underpin the internet economy are still moving in the right direction. The combination of rising smart phone penetration and increased consumer spending is a recipe for disrupting existing business models, and its influence now stretches from e-commerce into a host of other segments.

However, the consensus appears to be that valuations have gone too far. According to AVCJ Research, $11.6 billion was deployed across about 860 China venture capital deals in 2015, up from $8.8 billion for a similar number of transactions the previous year. In terms of capital invested, 2014 and 2015 together are just shy of the cumulative total for the preceding four years.

But this does not tell the whole story. The vast majority of venture capital deals fall into the technology, media and telecom (TMT) space – $9.9 billion out of $11.6 billion – but the surge in later-stage investments in these companies is not fully captured by the VC data. There were 75 TMT growth rounds worth a combined $19.4 billion in 2015, up from $5.5 billion across about 30 deals the previous year.

KPMG and CB Insights' 2015 global venture funding report notes that median late-stage deals in Asia have been greater than both the North America and Europe over the past year, rising to $150 million (versus less than $50 million in the other two markets) in the final quarter. Yet the same report records substantial drop-offs in funding for VC-backed companies in North America and Asia – led by China – during those three months. It would appear that China's headline number is being held up by mega-deals as the broader market fades.

This corresponds to anecdotal evidence and AVCJ Research's records. China VC investment in the final three months of the year was the weakest since the second quarter of 2014 in terms of capital deployed. It was the same for TMT venture deals specifically even as growth transactions in that space held steady from the previous quarter.

It remains to be seen whether Chinese companies can continue to raise these mega-rounds. While consolidation will allow market leaders to strengthen their positions and pursue growth strategies that are not based on customer acquisition at the expense of competitors, the valuations will probably even out. Mergers of one-time rivals will also reduce the number of large players to be funded.

Early-stage may see their paper gains on these unicorns eroded and the possibility of complete wipe-outs cannot be discounted. But the leading players will gain more than they lose from the tech bubble, come the final reckoning. As to how the likes of Qiming and GGV will deploy their capital, questions will be asked about the viability of top-up funds that allow firms to participate in growth rounds for existing portfolio companies. But an early-stage space with more realistic valuations is an appealing prospect.

After all, in addition to backing YPX, in 2010 Qiming re-upped in Xiaomi and e-Hi Car Services and got its first exposure to Dianping.

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NEWS

ASIA PACIFIC

JC Flowers to buy Chi-X trading platforms

J.C. Flowers has agreed to buy the Australia and Japan businesses of Chi-X Global Holdings, an alternative equity trading platform that competes with primary exchanges, as well as the company's Hong Kong-based technology services unit. It follows the sale of Chi-X Canada to NASDAQ.

PE-backed e-Shang agrees merger

Warehousing operator e-Shang as agreed to merge with its counterpart Redwood Group, creating a real estate logistics platform with more than 3.5 million square meters of projects in operation or under development. While Warburg Pincus and APG Asset Management have invested in e-Shang, Redwood's backers include PGGM, Morgan Stanley, CBRE and PAG.

AUSTRALASIA

NZVIF, Taiwan's NDF to anchor another VC fund

New Zealand Venture Investment Fund (NZVIF) and Taiwan's National Development Fund (NDF) will each commit $7.5 million to a cross-border technology fund. The Global from Day One Fund II – which primarily targets New Zealand start-ups – has raised NZ$30 million ($19.3 million) towards an overall target of NZ$45 million.

GREATER CHINA

Qiming raises more than $650m for fifth VC fund

Qiming Venture Partners has closed its fifth US dollar-denominated China venture capital fund, having received more than $650 million in commitments. The vehicle, which was launched in November, was oversubscribed with strong demand from existing investors.

Meituan-Dianping raises $3.3b

Meituan-Dianping, a China-based online-to-offline (O2O) services platform created through the merger of two rivals, has raised $3.3 billion in funding at a valuation of $18 billion. Participants included Tencent, DST Global and Temasek.

Asia PE returns will rise as GP skills develop

Distributions from private equity funds in Asia, which have in the past been lackluster compared to those in certain developed markets, are expected to rise as the industry matures and GPs develop their skill sets. "Distributions have exceeded capital calls for two years, but over the past vintages DPIs [distributed to paid in] have not been very high," Yong-Hak Huh, founder and CEO of First Bridge Strategy told the Hong Kong

Venture Capital & Private Equity Association's (HKVCA) Asia summit. "Asian GPs have not been performing to the level of US buyout funds."

Some of the challenges associated with investing in Asia don't necessarily relate to the quality of the managers themselves, but GP reporting is in certain cases still opaque, making it harder for LPs to make decisions based on already limited track records. However, Frank Su, a senior principal for private equity at Canada Pension Plan Investment Board, observed that the talent pool is deepening in Asia – within the GPs and in the surrounding services industry.

Among emerging markets GPs specifically, skillsets are developing in areas such as buyouts. John Huo, director for PE at Manulife Financial, sees a link between this and fund performance. "In Korea and Japan there are more buyout funds so you see better DPIs," he said. "China has been evolving so there will be more control deals and better DPIs as GPs become more mature. They won't be sitting on investments and waiting for IPOs, which is not the best strategy."

China's Lufax raises $1.2b round

Shanghai Lujiazui International Financial Asset Exchange (Lufax), a Chinese online finance platform controlled by Ping An Insurance, has completed a $1.22 billion round of funding. The round, which values the company at $18.5 billion, included $924 million raised from new investors plus $292 million from existing backers.

Hony reaches $1.25b mark on latest fund

Hony Capital has reached a first close of $1 billion on its new Greater China-focused fund and raised and additional $250 million towards a second close. Hony Capital Fund VIII, which has a target of $2 billion for the core corpus, had its first close a couple of months ago.

SouFun spin-out set for reverse merger

SouFun Holdings, a US-listed Chinese online real estate portal backed by the Carlyle Group and IDG Capital Partners, plans to spin out its online media and finance service units into a domestic backdoor listing. A shell company will issue RMB16.18 billion ($2.46 billion) in shares, giving SouFun a 70% stake.

KKR forms distressed investment partnership

KKR has teamed up with China Orient Asset Management and China Orient Summit Capital (COS Capital) to make credit and distressed opportunities in the country, with real estate a key area of focus. COS Capital will be responsible for day-to-day management of investments.

CDH targets $1.1b buyout of US-listed Zhaopin

CDH Investments is part of a consortium that has submitted a take-private offer for Chinese recruitment website Zhaopin, which is majority owned by Australia's Seek. The bid values the US-listed company at $1.1 billion,

Principle targets $350m for China fund

Principle Capital, a Chinese PE firm that has previously raised around RMB4 billion ($608 million) for renminbi-denominated funds, is targeting $350 million for its debut US dollar vehicle. The International Finance Corporation said that it is considering a $30 million commitment to Principle Capital Fund IV.

Cocoon launches $720m European tech fund

London-based Cocoon Networks, which is backed private equity firms China Equity Group and Hanxin Capital, has launched a GBP500 million ($720 million) venture fund to invest in UK and European technology start-ups. The fund will concentrate on financial technology, biotechnology and medical devices, as well as creative industries that intersect with technology.

CMC invests $100m in sports marketing firm

CMC Holdings, an investment platform launched by Ruigang Li, founder of media-focused PE firm CMC Capital Partners, has invested $100 million in SECA, a Beijing-based sports marketing and management firm. Retired Chinese basketball player Yiao Ming is a shareholder in the company.

Innovation Works seeks $250m for Fund III

China-based early-stage investor Innovation Works, which was founded by former Google China head Kai-Fu Lee, is looking to raise $250 million for its third fund. The International Finance Corporation is considering a commitment of $15 million to the vehicle.

NORTH ASIA

J-Star buys nursing care business

J-Star has made another investment that leverages Japan's aging population with the acquisition of Platia, a nursing services business that specializes in caring for people with dementia. Platia runs one elderly nursing home, two day care centers and two offices that coordinate home visits by nurses.

Korea's KIC appoints new CEO

Korea Investment Corporation (KIC) has appointed Sung-Soo Eun, most recently an executive director at the World Bank, as its CEO. Eun's previous posts include deputy minister of international affairs at Korea's Ministry of Strategy & Finance and assistant secretary to the president for economic policy. His predecessor, Hong-Chul Ahn, stepped down last November.

ChatWork raises $12.5 Series B round

Japan-based business chat platform ChatWork has raised $12.5 million in Series B funding from Jafco, SMBC Venture Capital and GMO Venture Partners. The company works with 86,000 companies across 204 countries, providing a multi-lingual platform that has secure messaging, video chat, task management and file-sharing functions.

Go Scale still wants global deals, despite Lumileds loss

Go Scale Capital will continue to target international acquisitions, including in the US, despite the termination of a deal for Philips' LED components and automotive lighting unit due to regulatory concerns. "We will continue to pursue deals in this industry, we are looking to invest up to to $10 billion in this space," Sonny Wu, chairman of Go Scale, told AVCJ. "We are looking at everything, not just LED but also areas such as electric vehicles and clean energy." Asking if he would still look at US acquisitions, Wu added, "Why not?"

Go Scale, which is sponsored by VC firms GSR Ventures and Oak Investment Partners, agreed to buy an 81.1% stake in the Lumileds unit in April, with Philips holding on to the remaining 18.9%. The deal valued the business at $3.3 billion. The acquisition was to have been financed in part from funds managed by Go Scale, which total at least $500 million. The remaining equity would have come from co-investors, including Hong Kong investor Kin Ming Cheng's Asia Pacific Resources Development Investment (APRD), government-backed Nanchang Industrial Group, and a number of LPs from GSR and Oak's funds.

Philips said in October that completion was uncertain because the Committee on Foreign Investment in the United States (CFIUS) had "expressed unforeseen concerns." Go Scale said that both parties repeatedly made their case "under the principles of openness and fairness," but failed to address government concerns that have yet to be fully explained.

SOUTH ASIA

SAIF, Norwest, Accel back India's Swiggy

Indian food delivery platform Swiggy has raised $35 million in Series C funding from a group of investors, including existing backers SAIF Partners, Norwest Venture Partners and Accel Partners. Along with the existing investors, Singapore-based RB Investments and US-based Harmony Partners also participated.

IVP leads $30m Series C for Qubole

Qubole, a big data firm based in India and the US, has raised a $30 million Series C round led by Institutional Venture Partners (IVP). The capital will be used to expand the availability of Qubole Data Service, a big data analytics platform, and to introduce more customizable analysis tools.

Panel proposes India PE reforms

A panel appointed by the Securities and Exchange Board of India (SEBI) has recommended a string of reforms intended to create a more supportive environment for start-ups in the country by easing restrictions on those who invest in them. Measures include changes to the tax system and dropping registration and capital requirements for investors in domestic PE funds, and allowing greater participation from pension funds, insurance companies and religious and charitable trusts.

SAIF principals to form early-stage fund

Two principals at SAIF Partners, Mukul Singhal and Rohit Jain, have left the company to start an early-stage venture capital fund of their own. The new fund, which has not been named, will invest in 15-20 start-ups per year, committing about $500,000 each time.

SoftBank commits $14.7m to Housing.com

SoftBank has invested INR1 billion ($14.7 million) in Indian property listing platform Housing.com. This is Housing.com's first funding since a December 2014 round worth $90 million, also led by SoftBank. The new capital will be used to support new strategies and accelerate growth plans.

Jungle, Blume in $7.2m round for SnapBizz

Jungle Ventures, Blume Ventures, Konly Venture and Taurus Value Creation have led a $7.2 million round for India-based retail technology developer SnapBizz. The company SnapBizz builds all-in-one electronic business platforms for small retailers, targeting corner grocery stories, known as kiranas.

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Nature vs nurture

With private equity's traditional training tools coming under increased scrutiny, some are calling for standardized qualifications - before outside forces take matters out of the industry's hands.

PRIVATE EQUITY CAN BE A FORBIDDING field for those just entering it. It certainly seemed that way to Chester Moynihan, founder of Australian distressed asset investor Allegro Funds, when he entered UK-based Permira as an analyst.

Fortunately for Moynihan, his employer had anticipated his difficulties, and already had a plan. It sent him to the British Private Equity and Venture Capital Association's (BVCA) residential training course, which featured presentations from senior industry professionals plus the chance to compare notes and experiences with his future peers. "It got you off to a strong start in that regard," he remembers.

Opportunities like this are not always available to newly minted PE professionals, and the type of training available depends on one's location. For example, the Australian Private Equity and Venture Capital Association (AVCAL) provides training through its PE 101 sessions. Unlike the BVCA's offering, however, these classes are limited in scope, lasting hours instead of days, and therefore cannot cover as wide a range of material.

"They're trying to do something that the BVCA, I thought, actually did better," Moynihan says. "What I liked about the BVCA course was that it was not just great content, but it was residential. The networking side of it was actually very good, and you knew that as you progressed in your career, you actually had reasonably good contacts to call on."

Push and pull

While new PE professionals have traditionally been trained by the firms that hire them, many in the industry believe there would be value in an objective industry-wide qualification. However, efforts to establish such a standard must overcome industry inertia as well as the skepticism of some established players. The most effective push may come from outside the establishment altogether.

The desire for more objective standards stems from concerns with the existing training model. At present, the question of qualifications is a matter for each firm to handle on its own, during the hiring process. The emphasis is on learning through experience. Those recruited from related industries are expected to apply existing skills to investing, while in-house programs are developed to bring new entrants up to speed.

Many in the industry justify this model as best suited to the type of individual who will do well in private equity. Moreover, the kind of skills needed may not be suitable to a classroom.

"I don't think you can necessarily teach people private equity, or how to make money," says David Willis, national sector leader for private equity at KPMG in Australia. "A lot of this you learn over time. Many people will take views of sectors and management from things they've seen in previous deals, and use that as a base for how they make decisions about new investments."

The fact that many of the currently successful private equity firms and professionals did not go through a formalized training process could make it hard for the idea to gain traction. If the current system is working, then introducing a new qualification or standard serves little purpose, and might be counterproductive.

However, entrenchment of the traditional approach should not be a challenge to its reexamination. While the idea of on-the-job training may serve the industry in some ways, in others it could become a liability.

For one thing, building up experience takes time, during which the new professional's contribution to the firm is limited. The individual may miss valuable investment opportunities through misreading the market, or waste his time chasing leads that appear attractive but that he should know are ultimately not productive.

"Humans are wired the wrong way. We get happy when the market is going up, and panic when it's going down," says Nick Nash, former head of General Atlantic's Singapore office and currently group president of consumer internet platform Garena. "It takes training to learn to react the opposite way, which is actually correct."

In addition, while there are methods of proving competence that are commonly accepted in the industry, these also may not be as useful as they first appear. For instance, many firms look on an MBA as a positive attribute that shows a candidate's intellectual preparation – and in fact, taking a break to get an MBA is still a commonly accepted practice.

Though challenging, many programs include little, if any, material that is directly relevant to private equity. Getting an MBA can still be a worthwhile achievement, and the training might help with some aspects of the job, such as managing a portfolio company, but it is not the indisputable sign of competence that some would like to see.

One of the most widely accepted marks of expertise in the industry is experience. Having worked for an investment bank, or another firm, can be a useful endorsement on a candidate's CV. But hiring managers who assume that such experience indicates a professional's knowledge of the relevant sector may find out otherwise, to their detriment.

"Having worked at an institution doesn't actually mean they're qualified," says Chang Sun, co-founder and managing partner of Chinese agriculture-focused GP Black Soil Capital Partners and former Asia managing director at Warburg Pincus. "People try to dress up their resumes with the likes of Goldman Sachs and Morgan Stanley, as if that's enough. But they may be working in the arbitrage department, or the fixed income department of these institutions. It may not have anything to do with their work today."

> "They might do things on their own; within each firm they will have their own training programs and their own standards"
>
> – Chang Sun

No reference point

The trouble spots pointed out by industry players point to a single, overriding concern: the lack of a common reference point of education and experience that can be used by both candidates and their potential co-workers and managers. This type of qualification is already well established in other branches of financials

services, but several factors have prevented its establishment in the world of private equity.

One of the most significant challenges is the lack of pressure on GPs from those with the authority to demand it, particularly regulators and LPs. Regulators have not tended to hold private equity practitioners to the same kind of requirements as they hold those in other areas of financial services, in part because PE is not seen as being as risky as public market investing. For instance, capital is called for individual investments rather than committed up front, and direct participation is for the most part restricted to qualified institutional investors.

Of course, this is not uniform in the industry, as regulations differ from market to market. Indeed, in many markets funds must be registered and regulators make this conditional on meeting certain requirements. However, these usually apply to senior management rather than junior employees. Even if they sit a test, it may not make sense in the context of the industry.

John Levack, co-founder and managing director of Electra Partners Asia and chairman of the technical committee at the Hong Kong Venture Capital & Private Equity Association (HKVCA), points out that Hong Kong's Securities and Futures Commission (SFC) requires locally-based funds to have a regulated officer who has passed the exam for stockbrokers.

"A guy who had run the Hong Kong Monetary Authority, allocating $40 billion to private equity firms from reserves, recently had to pass this exam," he says. "He sat it and he said there wasn't a single question in it that was relevant to private equity. That's an insult to him."

Despite the lack of pressure from above to adopt new standards, several industry bodies have gone ahead with attempts to create industry standard qualifications. One of the most prominent is the Chartered Alternative Investment Analyst (CAIA) program, which was developed by the Alternative Investment Management Association and the Centre for International Securities and Derivatives Markets.

The CAIA Charter is designed to provide new entrants with a basic level of investment skills. Charter holders are expected to be able to evaluate investment opportunities, identify drivers of returns, and recognize sources of risk and operational implementation issues.

"PE professionals with a CAIA designation have a common understanding of techniques, terminology, and best practice within the PE industry," says Peter Douglas, a principal at CAIA Singapore. "They have an immediate global network and a unique understanding of many other investment techniques and assets, with good triangulation of PE within the universe of potential investment and asset classes."

Along with global designations such as CAIA, regional industry organizations can also contribute to industry qualifications. These efforts tend to vary, however, based on the relative level of enthusiasm within each region for the goal.

The HKVCA has established a particularly thorough approach. Its education program targets professionals at several career levels: the "Fundamentals of PE" course is aimed at junior professionals and back office employees and covers the basics of the industry, while the newly established "Mid-level Training" course is intended for experienced PE professionals seeking to raise their careers to the next level. It deals with topics such as negotiation, leadership skills, operational improvement, due diligence and fundraising.

Additionally, the association conducts master classes throughout the year on topical concerns, and is growing its outreach efforts for universities and other stakeholders – including the SFC and the Inland Revenue Department, for whom HKVCA set up tutorials in their own offices.

> **"They have an immediate global network and a unique understanding of many other investment techniques and assets"**
>
> – Peter Douglas

"What we realized was that they wouldn't come and attend our normal classes, because they'd be embarrassed, they wouldn't feel like they could put their hand up and ask a question," says Levack. "It was much better to do it there."

Other regional organizations have not made education as high a priority, however. AVCAL offers its PE 101 course on a regular basis to new PE professionals, and the China Venture Capital and Private Equity Association (CVCA) offers a similar program called CVCA Academy, but both are more limited than HKVCA's offering.

Overcoming obstacles

The inconsistency among these training efforts speaks to the challenges of creating an industry-standard qualification. Despite the benefits touted by some players, others are skeptical about the likelihood of following through.

One obstacle is the difficulty of getting GPs to cooperate on the development of a standard. Though firms are willing to spend money to benefit themselves, convincing them to invest in an effort that might help their competitors as well is a different story. Chang Sun remembers an attempted industry-wide compensation survey by Powers Watson several years ago that never managed to get the participation of a meaningful number of GPs.

"I think on their own the GPs won't do anything together. They might do things on their own; within each firm they will have their own training programs and their own standards," says Sun. "But I don't think it will be universal."

Another reason for skepticism is the specialization of GPs. While the idea of a global standard for private equity investors is appealing in theory, firms often are focused on such a narrow geography or sector that a universal qualification is too general to benefit most firms.

However, others argue that this objection focuses on the wrong participant. The real reason for a qualification is to prove that one meets a certain standard of knowledge or judgment.

It is suggested that reticence in the industry could be overcome through pressure rather than persuasion. If LPs or regulators decide to encourage or require GPs to prioritize holders of a particular qualification in their hiring, the managers will be far more inclined to do so. With the insistence of enough investors or regulators, the presence of the qualification in the industry could reach a tipping point.

The Institutional Limited Partners Association's (ILPA) private equity principles offer an example of how this process could play out. Though the principles generated some resistance among GPs at first, their widespread adoption by LPs eventually caused most funds to accept them as a normal cost of doing business.

Indeed, some proponents of a qualification warn that it may not be a movement that the industry can ignore. Private equity is subject to more scrutiny than ever before, whether it is LPs demanding more regular and detailed information disclosure, the European authorities imposing stricter controls on who can market funds and how, or US regulators investigating fees and accounting procedures.

In other areas of financial services, pressure from multiple sources – and, in some cases, the weight of scandals – has resulted in formalization of standards, including training and qualifications. Private equity may be no exception, and GPs need to be part of the discussion, not on the receiving end of diktats.

"If we can get to the point of having a little certificate to say you're certified by HKVCA as a way of showing that you've achieved a level of knowledge about how the whole industry works, then that would be the decent outcome," says Levack. "The same way you have certified accountancy, this would just say you've achieved a certain base level of knowledge."

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Late starter

Hong Kong is following in Singapore's footsteps with the announcement of meaningful support for technology start-ups. Why is the government moving on the issue now, and what difference can it make?

UNTIL RECENTLY, RYAN CHEUNG HADN'T considered becoming an entrepreneur. After graduating from Hong Kong University in 2011, he followed the well-trodden path into financial services and joined a global private bank. But life as a small cog in a large machine was unfulfilling. Cheung wanted his own business.

This led to the launch of Clipper, a self-developed mobile promotions platform that connects offline retailers with online customers, early last year. Within 12 months, Cheung sold the business to a Singapore-listed company.

He chose to exit because the online-to-offline (O2O) segment, with its emphasis on high cash burn and offline expansion, didn't seem sustainable. For his next venture, Cheung went asset-light, creating an online content generation app called Bessup. Three months in, there are already more than 100,000 users and the next step is to introduce an e-commerce element in order to monetize the concept.

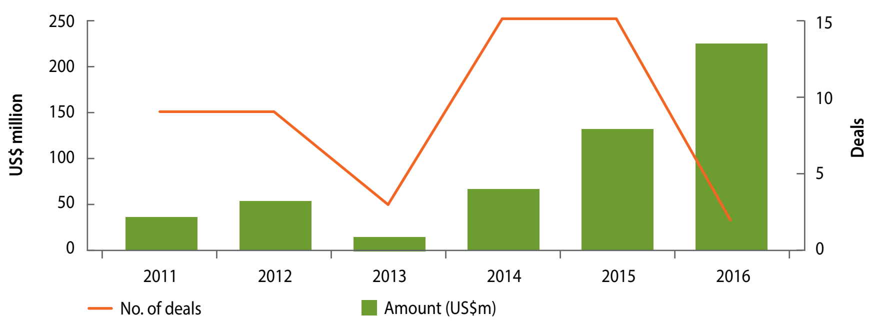
"It's the right time to start your own business. Thanks to today's advanced technology, if you have a great product you can scale up quickly," he says. "But the Hong Kong market is too small, so we have to think about going global early on. It would be difficult to expand an O2O business in Hong Kong."

Cheung is part of a small but growing band of entrepreneurs in Hong Kong. The government has ambitions to make it bigger. In his latest policy address, Chief Executive C.Y. Leung announced plans for a HK$2 billion ($256 million) fund that will co-invest in start-ups alongside venture capital funds on a matching basis.

After years of criticism for not being as proactive as Singapore in advocating local entrepreneurship, Hong Kong appears to have taken a page out of Singapore's playbook with the matching fund program. It is not a coincidence.

"We were analysing Singapore and making recommendations to the government on improving on what Singapore has done," says Melissa Guzy, co-founder of Abor Ventures and chairman of the Hong Kong Venture Capital & Private Equity Association's venture committee. "The Hong Kong government has been taking its time, but it has a long-term view on making sure that the program works, and supporting innovation."

VC investments in Hong Kong start-ups



Source: AVCJ Research

Gathering pace

VC investment in Hong Kong reached $131 million in 2015, according to AVCJ Research, up from $67 million in 2014 and $15 million in 2013. The total has jumped to $223 million in the first month of this year, although this says much about the depth of the market. Two companies – mobile lending and credit analytics platform WeLab and mobile app analytics platform App Annie – account for almost all the capital committed (and it is debatable whether App Annie qualifies as a Hong Kong start-up).

"The Hong Kong start-up ecosystem is very young but it has grown dramatically in the last few years so clearly the trend is going into the right direction," says Tytus Michalski, managing director at seed investor Fresco Capital. "Huge companies take years to build and I'm optimistic that we will see many large successes emerge from Hong Kong over time."

According to a survey conducted by InvestHK of 40 co-working spaces, incubators and accelerators, 1,558 start-ups were registered in co-working spaces as of August last year, up from 1,065 in 2014. In terms of the origins of the founders, 43% were from overseas, including mainland China and Taiwan, half were Hong Kong locals, and the remaining 7% were Hong Kong returnees. The best-represented sector was information, communications and technology (ICT), followed by hardware (which includes the internet-of-things), e-commerce, supply chain management and consultancy services.

Over the past 10 years, more global early-stage investors have turned their attention to Hong Kong, drawn by its financial sector credentials, rule of law and intellectual property protection, strong universities, and multiculturalism.

Mind Fund is one example. The early-stage firm focused on Silicon Valley for its debut fund, notably mobile image app Flipagram. Fund II was supposed to stick to a US-focused strategy, but Adam Lindemann, the firm's managing partner, wanted to look closer at Hong Kong. "Over the past few years, I have seen very strong evidence that Hong Kong is reaching the point of becoming a technology start-up hub globally. I would have never said something like that a few years ago," says Lindemann.

A mentor group – the Venture Investors Alliance (VIA) – is also being formed to support Hong Kong start-ups. Mentors include Nisa Leung of Qiming Venture Partners, Andrew Teoh of Ameba Capital, and Denis Tse of Asia-IO Advisors and formerly head of Asia for Lockheed Martin Investment, as well as Arbor's Guzy.

"The group isn't huge, but I would argue that we probably have as many early-stage, qualified VC investors as Singapore. Some have more experience than the whole of Singapore's venture community. For a long time, investors have been focusing on China, and now they've reached here. You start to them invest where they're living. There aren't many deals, but we are starting to see that," says Guzy.

For example, Sequoia Capital China, which has office in Hong Kong, is among the investors in WeLab. This is not a sentimental decision. WeLab is one of those start-ups addressing markets beyond Hong Kong, with most of its resources devoted to a peer-to-peer online platform that provides small loans for college students in mainland China.

Devil in the detail

Previous government efforts to support start-ups have focused on Cyberport – which has nurtured more than 160 start-ups since the early 2000s, offering working space at concessionary rates with flexible tenancy terms – and the Science Park facility. The policy address also outlined plans for a HK$200 million Cyberport Macro Fund to invest in ICT start-ups and HK$2 billion to be channelled through the Innovation & Technology Bureau into research projects.

However, this comparative largesse has yet to be complemented by fine detail. It is unclear how venture capital firms will be chosen for co-investment from the matching fund or how much will be put into each deal. Industry participants expect it to target early stage deals, typically seed to pre-Series A rounds.

"The matching fund is more about direct investments into start-ups, while the initiatives run through Cyberport, the Science Park and the universities will benefit the ecosystem in the medium to long term. This two-pronged approach makes a lot of sense," says Willy Lan, head of strategy and corporate development at incubator Jaarvis Labs.

For all the inspiration Singapore's matching fund program has given Hong Kong, the system has its critics. The primary concern is that the too much money has been pumped. Having started focusing on seed-stage investments, matching funds have since extended into the Series A space. Alongside the various other initiatives designed to facilitate funding or minimize start-up costs, some ask whether low-quality companies are surviving longer than they should because of this support. The challenge for all government-led VC initiatives is knowing when to step back and let the private sector take over.

"I think it's probably true to say that Singapore has made mistakes. It's a common sense that, when you aren't careful about what you're incentivizing, you can easily incentivize the wrong kind of behaviors," says Mind Fund's Lindemann. "You want to support the most deserving start-ups that have the highest potential. You don't want to encourage people who are good at applying for grants."

These are issues to bear in mind when building out a funding program, but at this early stage in the process, Hong Kong's priority is to be that catalyst. Entrepreneurs say there is plenty of angel investment available locally, with the problems kicking in when they try and raise larger rounds. Together with the relatively high-cost environment, it serves as a disincentive to would-be founders.

This conservative attitude towards innovation means Bessup's Cheung is the exception to the rule in that he was willing to give up a secure job to start his own business. Overcoming this hurdle rests on success stories – and founders who put their expertise and capital back into the system. Having seen Kuadi Dache, the ride-hailing app he launched in China, merge with Didi Dache last year and achieve a $15 billion valuation, Hong Kong-raised Joe Lee is now an angel investor. While he sees potential in Hong Kong financial technology, there aren't enough talented people looking to build businesses.

"Talent is the most important part of the start-up community. I could go to industry conferences and universities to share my experiences, but that's not enough to make a lot of noise. The government should bring together successful Hong Kong entrepreneurs to tell the younger generation that they can make a difference in today's world," Lee says. "But so far no one has contacted me."

Fintech start-up WeLab seeks scale

WELAB IS FACING A QUANTITY AND quality challenge. The Hong Kong-based mobile lending and credit analytics platform had approximately 60 staff when it closed its Series A round in January 2015. Now, with the Series B just completed, the headcount is up to 200, and by the end of the year it will be between 300 and 400. However, sheer numbers are only part of the issue.

"In a Series A round you want a jack of all trades – one guy who can do everything because you don't have a big office, you don't have the budget to hire specialists," says Simon Loong, founder and CEO of WeLab. "But as you get bigger you have to start specializing because that is how you become more sophisticated. It is like the growing process from a teenager to a young adult."

The transition that takes place in the early institutional rounds, from proving a concept at Series A through scaling up at Series B and C, often results in growing pains and can be capital intensive. While WeLab's first round of funding came in at $20 million, the successor is worth $160 million. Malaysia's Khazanah Nasional is the lead investor, with participation from ING Bank and state-owned Guangdong Technology Financial Group.

This reflects the growth in WeLab's two lending platforms. When the Series A closed, the company had 14,000 members and had processed over HK$1 billion ($129 million) in loan applications, primarily through the Hong Kong platform. It is now being outstripped by its mainland counterpart. Wolaidai, a mass-market peer-to-peer (P2P) lending platform, accounts for 2.4 million of WeLab's 2.5 million customers and roughly 70% of the RMB9 billion ($1.36 billion) in loan applications to date.


Fintech: Lending flexibility

The business model operates under the same rationale: filling the gaps in the market left by a banking system constrained in terms of reach and loan size due to the physical infrastructure it must maintain. "A bank may find that it cannot break even if it lends less than RMB200,000 because fixed costs are so high," Loong says. "For us, because we do it fully online, we can do deals of a few thousand renminbi and still be profitable."

A large portion of the Series B funding has been earmarked for taking the technology that has been proven over the last two years and making it work on a larger scale. However, WeLab also provides technology to third-party clients – it has 2-3 partnerships and this year will start working on initiatives with e-commerce platform Ule and Postal Savings Bank of China.

Loong sees enormous potential in these partnerships to take WeLab into new areas of consumer finance, and that is one of the reasons why ING, which has considerable experience in internet banking, came on board. "As we work, we discover that the methodology, the principles, the data we have collected have an application in other financial products, which means above and beyond lending," he says.

Investors see value in China auto disrepair

WHILE MOST ONLINE USED-CAR AUCTION platforms in China facilitate the trade of cars in good condition, Bochewang has found its niche at the other end of the spectrum – by selling vehicles in disrepair.

Following a similar business-to-business (B2B) business model to US-listed Copart, the company collects damaged cars from insurance companies and serves as intermediary as the vehicles are sold on to dealers, rebuilders and exporters. The buyers then repair the cars and re-sell them to individuals.

Fosun Kizon Capital saw the success of Copart and found there were few players in this space in China. In May last year, it teamed up with New Horizon Capital to provide a RMB100 million ($15 million) Series A round for Bochewang.

Last week, China Pacific Insurance Corporation led a RMB200 million Series B round for the company, having committed RMB100 million from its own. Other new investors included Ping An Insurance, Sino-Ocean Land, Far East Horizon, and Tsinghua University-owned Suzhou Automotive Research Institute, while Fosun Kizon and New Horizon both re-upped.

"Although Bochewang is working in a niche market, the supply of damaged cars is very reliable," says Wilson Jin, an investment director at Fosun Kizon. "They work with large Chinese insurance companies, which place great value on the quality of service. Once they establish a relationship with a platform, they become very sticky and are unlikely to shift to a competitor. It's almost a monopoly business."

This is also one of the reasons why several insurers decided to invest in Bochewang's Series B.


Autos: Pre-owned presence

In the US, approximately 300 million damaged vehicles are sold by insurance companies through online platforms every year. China's annual figure is 170 million but Jin expects it to surpass the US market within 5-10 years.

Bochewang already claims to account for more than 50% of salvaged vehicles sold through online platforms. The company has formed partnerships with nearly all Chinese insurance companies and recently added government agencies and car rental companies to its client list. It puts up more than 2,000 used cars for auction every month, facilitating over RMB100 million in transactions, and receives a 10% cut from each one.

Bochewang now has a presence in more than 60 Chinese cities, and plans to expand into 100 cities by the end of this year. A portion of the new capital will also be used to launch auto-related financial products and to enter the used components re-selling market. This is a relatively untapped market in China, although once againt there is an established model in the US.

"The largest company operating in this space in the US is called LKQ, which has a market capitalization of about $8 billion. That's definitely a key area that Bochewang wants to expand into. We see almost no competitors in this space," says Jin.

Asian Venture Capital Journal

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Age of the specialist

In addition to an advisory business that targets large-scale LPs, Hamilton Lane has a discretionary portfolio geared towards the middle market. It expects Asian GPs in this space to adapt to changing markets

THE INCREMENTAL, CHINA-LED slowdown in Asia's emerging markets economies has stimulated investor interest in distress and special situations – the funds best positioned to capital on dislocation and restructuring opportunities. Even the deal structures are suited to uncertainty, typically offering a combination of capital protection through yield and capital appreciation through an equity kicker.

It is in this context that fundraising by Asia special situation funds reached $3.1 billion last year, compared to $2.2 billion in 2013 and $1.8 billion in 2014. The market remains a relatively small one – a single manager, PAG, accounted for close to half of the 2015 total – but Mingchen Xia, a principal at Hamilton Lane, expects it to grow.

"We have received a lot of inquiries from clients about these strategies because economies in Asia are going through transitional periods and that will create opportunities," he says. "Although the private debt market in Asia is still small, some global investors are arriving and there will be more GPs in the region."

These new managers are likely to have similar origins to those already active in the market: the proprietary trading desks of investment banks, which were scaled back in the wake of the global financial crisis. Others will be of more local derivation as the current crop of pan-regional GPs is complemented by single country players. For example, firms may spin out from Chinese asset managers with ready-made networks of service providers in different cities who can help resolve distress situations. It is in keeping with a broader movement from offshore to onshore.

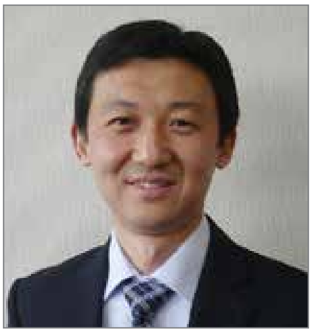
"A lot of managers don't have onshore execution capabilities so we will see more of them trying to build out their onshore lending businesses," Xia explains. "This approach makes sense but we need to wait and see what the outcome is. There to four years from now, we will have a much clearer picture on this market."

In the middle

Hamilton Lane serves as an advisor to institutional investors with $204 billion in assets and has a discretionary portfolio of more than $34 billion. The managed solutions usually involve customized separate accounts – industry participants say these usually start at $100 million – plus some comingled primary, secondary and co-investment fund offerings. The middle market is a natural area of focus, in part because some LPs cover larger funds directly and so don't include them in outsourced mandates.

The Asia allocation from the discretionary business is approximately 10% and China is the largest recipient of capital. Much as the interest in special situations reflects broader changes taking place in the country's economy, Hamilton Lane is looking for managers that can evolve to meet market needs.

"Two things are important right now," says Xia. "The first is domain expertise. In this slower growth environment, companies need help from outside investors, not just money. GPs need to be able to provide strategic value and that comes from domain expertise. The second is post-investment management or taking control of a company. When markets are more volatile, control gives you more flexibility on exit. As a minority growth investor, you don't have much influence."



> "If you've made some successful automotive investments then deal flow will come from this sector through referrals from entrepreneurs and from your network" – Mingchen Xia

These two elements come together in that a GP with domain expertise is more likely to have the confidence and ability to manage a company. This applies to a manager with a $2 billion China fund that might have up to 50 investment professionals split into teams responsible for different sectors, and also to array of sector specialists emerging in China. Technology, media and telecom has long been the preserve of the venture capital firms, but GPs are now emerging in healthcare as well.

The question for all of these players is to what extent their professed expertise translates into more effective deal sourcing and investment management. Xia warns that specialization doesn't arrive overnight. "If you've done multiple funds over the last 10 years then you sector expertise forms naturally," he says. "For example, if you've made some successful automotive investments then deal flow will come from this sector through referrals from entrepreneurs and from your network, and then you can accumulate more knowledge and expertise."

Beyond China

Of Asia's other emerging markets, Southeast Asia and India are not as far along the evolutionary curve, with generalist and opportunistic strategies still prevalent. Southeast Asia struggles due to a shallow pool of local GPs and limited capital markets. Xia does not see this changing unless the region can address its macroeconomic challenges.

"If countries can grow their manufacturing and consumer sectors and consumption-driven businesses then their economies will become more diversified," he says. "As a result, the capital markets will change, currencies will become more stable because they don't just rely on resources exports, and current accounts will improve."

India's macro position is more encouraging than it was several years ago and Hamilton Lane's GP wish list reads much like the China version: there is a desire for managers with the capabilities to pursue control deals and contribute on the operational side. The problem is that returns look good on paper but there haven't been enough realizations.

"India faces the same challenge on the capital markets side as Southeast Asia in that the market is very domestic and IPOs can be closed for long periods of time," Xia says.