FINANCING INNOVATION: ENABLING VENTURE CAPITAL IN APEC

Organized by the Advisory Group on APEC Financial System Capacity Building
APEC Business Advisory Council

21 May 2012
Sarawak Room, Basement II, Shangri-La Hotel
Kuala Lumpur, Malaysia

Summary of Key Outcomes

While it has not been possible to replicate in other places, including in the USA itself, the conditions that have made Silicon Valley the pre-eminent cradle of venture capital, the search for ways to develop venture capital across the region's economies continues. In this process, there is much that can be learned from experiences, and the ongoing efforts in many economies from which we can draw valuable lessons on what measures can lead to success.

An analysis of the venture capital ecosystem indicates several crucial roles that governments need to play.

The first is catalyzing angel and venture capital through support programs. Experiences of various economies, including China, Korea, Malaysia, New Zealand and Russia, as well as in economies outside the region such as Brazil, Israel, and the UK, illustrate various ways how such support could be structured. The experience of the Inter-American Development Bank's Multilateral Investment Fund also provides a good example of how lessons can be drawn from successes and failures of investments in seed and venture capital funds over the years that can be applied to refine later investment strategies. It is important, however, for any government support to succeed, that such support is geared toward commercial success rather than political objectives.

The second is providing an enabling legal and regulatory environment that will encourage the flow of more private sector resources into venture capital. These include the legal environment (such as laws governing bankruptcy, technology transfer, foreign investment and company organization), tax policies and incentives and protection of minority investor rights, among others. Due to the higher risks involved in the financing of venture capital, governments and regulators need to provide an environment that does not discourage such risk-taking, while ensuring the soundness of the financial system.

Governments need to provide an enabling environment not just for venture capital, but for a whole chain of financial activities that support companies across various stages of innovation, of which venture capital forms part. These stages of innovation stretch from invention and R&D through business plan and market definition, pilot production, marketing/sales/distribution, full commercialization, market expansion/increased penetration and sale of the company or product. This whole process involves a varied set of players including angel investors in the early stages, venture capital in the middle, and private equity, commercial and investment banks and institutional investors such as pension funds in the latter stages.

Exit mechanisms are also important, for which strong local capital markets that allow exits through initial public offerings and local companies that are attractive to strategic buyers must exist.

The third area where governments need to play an important role is in creating, maintaining and enhancing the fundamental conditions that encourage entrepreneurship and innovation, particularly at the incubation stage. These conditions need to provide an environment that is conducive to the growth of micro-, small and medium enterprises, the development of a cadre of good fund managers and human capital, that sufficiently rewards risk-taking and innovation and promotes good corporate governance, transparency, sound risk management, research and development, tie-ups between university and industry, foreign investment and international trade, among others.

International institutions, particularly multilateral development banks, can play important roles not just in catalyzing private investment in venture capital, but also in the discovery of what works and what does not through the documentation of their experiences in multiple economies over many years and identifying factors that account for success and failure.

APEC can have a role to play in helping governments of emerging economies in the region to identify ways of expanding venture capital. It can, for example, provide a platform for public and private sectors and related international institutions such as multilateral agencies to share experiences within and outside the region, to learn from these experiences, to discuss new ideas for policy and to facilitate capacity building for officials and regulators in translating these ideas into action.

An opportunity exists to discuss this further with APEC senior officials and ministers within the framework of an APEC Open Innovation Initiative, as proposed by the recent APEC Conference on Innovation and Trade. Under this initiative, policy makers are envisaged to work together with venture capitalists and financial institutions, research institutes, universities, businesses and non-government and other supporting organizations to promote an innovation-friendly business environment, human resources leading innovation and seamless interconnectedness in APEC, with the goal of expanding absorptive capacity for innovation, trade and investment.

It is recommended that APEC senior officials collaborate with ABAC and the Advisory Group on APEC Financial System Capacity Building under the APEC Open Innovation Initiative to develop public-private partnership mechanisms that can help governments catalyze angel and venture capital through effective support programs, provide enabling environments for financing business activities across various stages of innovation, and ensure the fundamental conditions for entrepreneurship and innovation, particularly at the incubation stage.