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VC/PE Firms Seeks Ways for New Projects, Inclining to Dedicated Post-investment Teams

Written By Fiona Fu, Analyst with Zero2IPO Research Center

China's Venture Capital/ Private Equity (hereinafter referred to as "VC/PE") sector has witnessed a sustained improvement of the related legal framework over recent years. With a lower access threshold and expanded exit channels for institutional investors, Chinese VC/PE market is undergoing a mushroom growth, being the backbone of China capital market. Various institutional players in the VC/PE community have developed mature fundraising, investment, exit strategies and internal governance mechanisms. Meanwhile, along with the influx of various capitals, the project resources at market become relatively limited, leading to the further fierce market competition. Therefore, to adopt long-term strategies and forward-looking arrangement, and explore actively the optimal development paths in terms of investment strategy and management mechanism on the basis of current market environment and institutional actualities, have been the top priority for VC/PE firms to achieve rapid development.

As the Greater China well-known VC/PE research institution, Zero2IPO Research Center recently released "Exclusive Research on Strategies of China's VC/PE Firms", analyzing typical strategies involved in every segment of Chinese VC/PE market in terms of fundraising, investment, exit and internal management of VC/PE. Parts of the Report are provided below:

VC/PE Institutions Have Gradually Expanded Project Sources

The past two years, considering increasingly abundant cash, higher investment enthusiasm and the further fierce project competitions on Chinese VC/PE market, various firms consecutively begin to attempt to explore new project resources. The current investment project sources of active VC/PE firms in Chinese market can be divided, on the whole, into two channels, i.e. independent development and channel dependence. Most firms do not rely solely on a certain project source, but take a combination of two methods, while also have their emphasis, so that they could seek for investment projects based on the investment objectives and standards.

I. Independent Development

Independent development is that, through in-depth study on macro economy, key industries and industry chain, VC/PE firms identify the most valuable segment, seek after the leading enterprises thereof, then negotiate and explore into the investment projects independently, while the method of contacting with potential companies include direct contact and attending industry exhibitions, etc. The major advantage of the mode of independence development to search for investment projects by is that, VC/PE firms are dominant in the investment process, and this mode can also help firms to know company situation in depth. At the same time, by reducing dependence on intermediaries, this mode can, to some extent, cut the cost of channel; the disadvantage of this strategy is that, personnel and time costs will increase due to a lot of industry pre-research work needed to do.

II. Channel Dependence

Accompanying with the Chinese VC/PE market gradually matures, many firms at the market have accumulated a wealth of industry resources, established a wide range of investment channels, including government departments, industry associations, regional chambers of commerce, high-tech parks, commercial banks, investment banks, securities companies, law firms, accounting firms and recommendation of entrepreneurs or friends etc. In addition, communication among the industry is also an effective channel to gain project information, for instance, firms focusing on investment of later period usually keep good cooperative relations with those focusing on inchoate investment, and thus learn the situation of enterprises at its expansion stage and late stage.

The advantage of this strategy is that, VC/PE firms may be exposed to some quality projects via the above channels, and thus lower the searching cost. For example, securities firms typically have some information about Pre-IPO projects; commercial banks have the opportunity to know those SMEs which have need to finance but not meet bank loan conditions. And during the process of doing business, accounting firms and law firms are likely to master the early situation of enterprise, entrepreneurs who contact with enterprises know more about excellent enterprises in industry upstream and downstream as well as investment opportunities. As for enterprises, some outstanding domestic enterprises, especially those in remote areas or the second and third tier cities, are still unknown about VC/PE firms so that there are less opportunities to access to investment institutions, under this circumstance, intermediaries can promote information communication between enterprises and investment institutions. The disadvantage of this approach is that, some intermediaries need to charge a certain percentage of consultancy fees, and may cover up potential problems of enterprises, or even obstruct due diligence investigations of VC/PE firms.

At present, newly-established firms which have not set up resources networks at market, and foreign investment institutions primarily investing in mainland China, but without localized investment teams, have more reliance on channel intermediaries on the market.

Inter-agency Cooperation and Co-investment Transactions Increased

At present, investment methods of Chinese VC/PE market can be mainly divided into two categories: co-investment and independent investment. Co-investment means two or more VC/PE firms invest in the same enterprise in the same financing round. With the increasing number of institutions on the market, cooperation linkage among inter-agencies is more and more frequent. The main driving forces for VC/PE firms to choose co-investment, we believe, should include:

I. Risk diversification: Investment risks of VC/PE firms caused by asymmetric information become intensified in the investment process, co-investment, to some extent, makes up the limitation on project evaluation and risk control of single firm, is helpful to optimize project evaluation decisions, reduces the risk caused by investment decision. Furthermore, by co-investment, VC/PE firms can strengthen the influence on portfolio companies so as to participate in corporate management in time.

II. Compensations for insufficient capital scale: Due to the high amount of investment for some projects, fund scale or fund investment limits under VC/PE firms makes them unable to complete investment independently, but if by co-investment, the capital scale is larger enough so that firms have more opportunities to enter into larger scale investment transactions.

III. Making up insufficient value-added service: In addition to financial support for portfolio companies, another feature of VC/PE investment is to provide aid of management, technology, market and other aspects needed. By means of co-investment, investment institutions can obtain complementary resources with each other, and further strengthen support and help for enterprises.

IV. Other factors: For example, after participating in initial rounds of financing, some firms focusing on early investment will assist enterprises to introduce other investors in the subsequent financing rounds in consideration of their own financial strength or optimizing ownership structure considerations, they usually play a role as lead investors or follow-up investors on the inchoate round, or never invest. Besides, along with the intensified project market competition, in order to avoid pushing higher valuation caused by competition for the project, institutional investors can achieve benefit sharing by co-investment.

Zero2IPO Research Center noted that some firms on the market seldom co-invest with other firms, even if in the co-investment, they also insist acting as the lead investors to ensure the dominance in the investment process.

Independent investment is that a VC/PE firm invests in a certain round of financing for an enterprise as the sole investor. The advantage of this strategy is that firm can dominate the investment process to prevent possible conflicts and frictions caused by too many investors, while the disadvantage is that, it requires relatively high capital scale under management; furthermore, the investment decision totally reply on independent judgments of company's investment team, which increases investment risk to some extent.

Set up a Separate Post-Investment Management Team, Investment Team Focuses on Project Development

For those active VC/PE investment institutions in Chinese market, post-investment management of project can be divided into two categories: project manager responsibility system and team responsibility system.

Project manager responsibility system is that, besides project development, filtration, investigation and investment, the project manager should be also in charge of management of portfolio companies after the completion of investment. The advantage of this strategy is that the project manager has a better understanding of the enterprise situation thanks to his/her full involvement since the very beginning of the project. Typical investment institutions adopting this strategy include DT Capital Partners.

In addition, there are also some firms to make post-investment management work independent, and appoint specialized staff to be in charge. The advantage of this approach is that, project leader can gradually withdraw from the later development work of company, but focus more on the exploration and development of potential projects, while the disadvantage is that the replacement of the project leader after investing will increase communication cost of portfolio company and investment firms. According to Zero2IPO Research Center, a number of investment institutions, including CITIC PE, KPCB and Jiuding Capital, have set up their own dedicated post-investment management teams. ■


CIIF 2011
China Industry Investment Forum
China Mobile-Internet Industry Investment Forum 2011
Date:August 18th, 2011 Venue:Park Hyatt Beijing
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Mobile
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Intelligent terminal is rapidly popularized,
Applications witness blossom,
The world of handheld mobile is full of brilliance…
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Leading the way of mobile Internet applications
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Changing social life in the information age
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Shangpin.com Closes US $50M Round C Raising

Jul. 27, 2011, PEdaily.cn

It was reported by Zero2IPO, Shangpin.com, a domestic membership luxuries shopping website, held a press conference on Jul. 27 and announced its completion of Round C financing at size of US $50M. Chenwei Capital acted as the major investor for this round financing, followed by Morningside Venture and Steamboat Venture, investors of previous two rounds. Lei Jun, a well-known angel investor, attended the press conference.

According to Shangpin.com, the raised capital would mainly fund the "Consumer Confidence Program" which include technical R&D, commodity sourcing, brand promotion, overseas operation, etc., to optimize each circle linking to consumers, from consumer communication, commodity sourcing and display, transaction flow, to operation system, consumer services, etc.

Chengwei Capital, the major investor of this round financing, has focused its interests on the enterprises featured by high growth, substantial competitiveness and potential of future leader in their fields.

It is learnt that Shangpin.com announced its round B financing in Oct. 2010 and won US $10M from Steaboat Venture, a VC under Walt Disney and Morningside Venture. Its round A financing was contributed by Morningside Venture and Lei Jun.

The investment philosophy of Lei Jun (a well-known angel investor) is to invest in familiar raiser, however, Shangpin.com is an exceptional. Lei Jun told that a consumer might spend RMB1 or RMB2 for SP, RMB30-RMB40 for online game, even RMB100-RMB200 for online shopping, but what had made him curious was how to encourage a consumer to spend RMB2000 to buy a commodity online.

Lei Jun says: "The consumer would not spend RMB2000 to buy before seeing the physical product if they are not confident enough". Lei Jun stressed that he definitely would not invest into a company keeping fraud accounts, and behaving honestly before starting a business is the key point. ■

Luxin Venture Capital Participates in Yellow Delta Fund with RMB100M

Jul. 28, 2011, PEdaily.cn, Christina Chao

It was re ported by Zero2IPO, Luxin Venture Capital released a statement on Jul. 27 and announced that it would contribute RMB100M to Yellow River Delta Industry Fund (Yellow Delta Fund) to be one of the limited partners.

Yellow Delta Fund was established as a limited partnership business and designates Yellow River Delt Industry Fund Management Co., Ltd., a 35% stake holder, as the general partner and management side and Agricultural Bank of China as its trust bank. The fund targets a total size of RMB20B, first phase size of RMB5B and is valid for a period of 8 years.

The statement indicates that the fund will focus on such areas as clean energy, new material, modern agriculture, electronic information, energy conservation, infrastructure project and modern services in the high efficiency and eco-economical regions of Yellow River Delta, aiming at promoting the economic construction in the delta through equity investment.

Umeng Wins US$10M Investment from Matrix Partners

Jul. 28, 2011, Tech.qq.com, Li Kang

On Jul. 28, Umeng, a mobile application service platform under Innovation Works, announced that it has completed Round A financing with major contributions from Matrix Partners. It is learnt that the capital size of this round has reached US$10M, which is the second financing of Umeng after winning angel investment from Innovation Works in Nov. 2010.

Jiang Fan, Co-founder and CEO told that with the raised capital, Umeng would increase the investments for talent recruitment and cultivation, enhance the construction of data center and internet services, as well as seek for new business opportunity.

Zhang Ying, the partner of Matrix Partner told through her microblog that they invested into Umeng in consideration of three aspects: first, Umeng owns top technical talents home and abroad and a team with strong executive ability; second, Umeng has made outstanding achievements although it is a one-year establishment, which gives a good illustration to its potentials for further development; third, there is great possibility for Umeng to be one of the basic platforms for future mobile internet.

Umeng launched its first statistic & analysis service for mobile application in Aug. 2010, providing real time and all dimensional data analysis services for domestic developers concentrating on Android and iOS application, covering user behavior analysis, operation analysis, promotion result analysis, etc. Through one-year development, Umeng has built up a team of 60 persons with core staff coming from Google.

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portal, plans to go public abroad at the end of this year, and underwriter has been identified.

It is reported that the listing of Duowan.com is pushed by Lei Jun, Angel Investor and Chairman of Duowan.com, and it will be listed and obtain financing before the end of this year in order to further expand its market share.

In addition to game information and online community, the major product of Duowan is Duowan voice tool YY. YY is a kind of team voice tool designed by Duowan game website that is a multi-user voice chatting tool targeting at Chinese users. A source said that, at present, the maximum quantity of online users joining in Duowan YY voice chatting is over 3 million.

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