

# VENTURE CAPITAL TO FINANCE STARTUPS

The situation of Vietnam

LAHTI UNIVERSITY OF APPLIED  
SCIENCES  
Degree programme in  
International Business  
Bachelor's Thesis  
29.11.2016  
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Degree Programme in International Business

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Venture capital to finance startups  
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Bachelor's Thesis in International Business, 57 pages, 2 pages of  
appendix

Autumn 2016

ABSTRACT

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The purpose of this study is to examine the venture capital industry of Vietnam, including its level of development, the difficulties in its development, government efforts and compare it with that of other ASEAN countries.

This research can be informative for venture capital funds or investors who want to penetrate Vietnam's venture capital industry. It can also be consulted by local entrepreneurs to increase their understanding of different methods of entrepreneurial financing, especially that of venture capital.

The first theoretical chapter will introduce different financing sources that a startup can tap on. The next theoretical chapter explains the venture capital process in greater detail.

In the empirical part, qualitative research method is used and the research approach is deductive. Data will be collected in different methods. Secondary data from various literature sources, including news, business journals, academic articles, statistics databases, official websites. Primary data is obtained by interviewing three Vietnamese nationals who work in the local investment industry.

It is concluded that Vietnam still lags behind ASEAN countries like Singapore, Malaysia, Indonesia in the level of development of the venture capital market. However, the growth potential is positive and the government is making strong efforts to support it.

Key words: entrepreneurial finance, venture capital, startup ecosystem, Vietnam

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## GLOSSARY

ASEAN	Association of Southeast Asian Nations
Venture capital fund	Venture capital fund refers to a kind of investment fund where the financial capital is pooled from investors for purpose of making venture capital investments. The fund's managing partners invest on behalf of the limited partners.
Venture capital firm	Venture capital firm is the management company of venture capital funds. This firm often employs individuals with technological, financial background and business experience.
General partner	A general partner is one of the managers of a venture capital firm. The job of the general partners is to source deals and to invest in the ones perceived as potentially returning the most money to the investors.
Limited partner	Limited partners refer to the investors of a venture capital fund. They are high-net-worth individuals, investment banks and institutions such as pension funds, insurance companies, and university financial endowments.
VC	VC is the abbreviated form of venture capitalist which is a general term for a person making venture capital investments. He/she does not bring only finances but also his/her own expertise to the investee company. In fact, the general partners and investment

professionals from venture capital firms are typically referred to as venture capitalists.

IPO

Initial Public Offering, which refers to the process when a company issues shares to the public for the first time.

## 1 INTRODUCTION

This chapter begins with the background of the research and indicating the reasons for choosing Vietnam's venture capital industry as a topic. The research objectives, questions, and limitations of this study are presented. An overview of existing literature and the chosen research method is also included.

### 1.1 Background

With a population of approximately 92 million people in 2015, Vietnam is the 14th most populous country in the world. Regarding its GDP growth, statistically, during the period of 10 years from 2006 to 2015 Vietnam has tripled its GDP from US\$ 66.37 billion to US\$ 193.6 billion. This has made the country one of the fastest growing economies of Southeast Asia with an average GDP annual growth rate of 6.12%. While it is still a developing country and Vietnam has targeted to become an industrialised nation by 2020. (World Bank Data, 2016)

One of the reasons for this high growth rate is the entrepreneurial culture of Vietnamese people. For instance, in Ho Chi Minh City – the most dynamic city and the centre of economy of the country, there are about 50 new businesses open every day (Van Dam, 2016). According to the report of the Ministry of Planning and Investment, there are 535 000 SMEs around the country, which contribute 45% of the GDP and accounts for 97% of the total number of firms (as cited in Tran, 2015). To start and develop a business, in addition to the human factor and a good idea, another top priority is financing. In fact, finding the capital to fund a business idea is always the biggest worry for Vietnamese entrepreneurs.

Business in Vietnam is traditionally financed by personal funds and bank loans. According to the statistics of Vietnam Chamber of Commerce and Industry (VCCI), 80% of the enterprises have more or less a part of their capital borrowed from banks (as cited in Ho, 2016). However, for SMEs, to access the capital of the bank is very difficult. To be more specific only 40%

of SMEs can tap this source of financing because small firms lack tangible assets to deposit and have to deal with a myriad of paperwork procedure. Once loans are granted, entrepreneurs must put up with a high interest of about 18-20% annually.

There are rarely any alternatives for Vietnamese entrepreneurs other than banks and banks are very selective to lend capital to risky projects. This short of financing methods is a handicap to the young and visionary entrepreneurs who have creativity, disruptive ideas and potentials. They need a funding alternative where the investment principle is, the more the risk the higher the profit. That's where venture capital funds come into scene. Since they are willing to accept greater risk in order to reap a greater profit, venture capital funds' main investments flow into startups, especially in high-growth business sectors like that of science and technology.

This topic is picked by the author because she is tremendously interested in understanding how the venture capital industry works. While it is an important method of investing in the startup world, the deployment and implementation of it are not simple and it still remains a capital source that many Vietnamese entrepreneurs have yet to know how to approach. Also, the author is passionate about how the financial-specialised knowledge can make a direct impact on the economy and the business world. In this case, how venture capital investments can directly empower startups and facilitate the development of a startup ecosystem.

This study can also be utilised by the local entrepreneurs to improve the understanding venture capital investment especially in start-up phase. It is also an informative research for any new venture capital funds or investors who want to step into Vietnamese venture capital industry. Moreover, the findings can lead to some suggestions for the government on how to continue facilitating the development of this area of startup financing.



## 1.2 Research objectives, research questions and limitations

The objective of this research is to help the reader to understand different startup financing sources, especially venture capital funding. Also, an up-to-date and comprehensive analysis on the venture capital industry in Vietnam, including a comparison with some South East Asian countries is provided.

This leads to the problem statement: “How has the venture capital industry progressed in Vietnam?”

To provide sufficient answer to the problem statement, the thesis will tackle those sub-questions:

- Why are the venture capital investments important for a start-up?
- What is the life cycle of a venture capital investment?
- How developed is the venture capital industry in Vietnam as compared to other countries in South East Asia?

Official information and statistics about Southeast Asian venture capital, including Vietnam, with the exception of Singapore, are extremely hard to find. The limitation of this thesis is that it can only compare the situation of Vietnam with countries with a relatively more burgeoning investment environment like Thailand, Indonesia, Malaysia, the Philippines. The remaining ASEAN countries where the investment environment is less established and information is too opaque are left out.

## 1.3 Research methods

The research is qualitative and deductive. “Qualitative data refers to all non-numeric data or data that have not been quantified and can be a product of all research strategies” (Sauders et al., 2009, 511). The deductive approach refers to the development of a clear theoretical position prior to the collection of data (Sauders et al., 2009, 39). In this study, theoretical chapters are introduced first and then followed by an analysis of qualitative data.

Data will be collected in different methods. Secondary data is obtained from various literature sources including news, business journals, academic articles, statistics, databases, official websites. Primary data is obtained by email interviewing of three people who work in the venture capital industry in Vietnam. According to Morgan and Simon (2004), an email interview consists of a series of emails each containing a small number of questions rather than one email containing a series of questions (as cited in Saunders et al., 2009, 351). For this study, the author prepared as a list of open questions and send to the interviewees by emails. After that, some more questions are sent to clarify the opinions of the interviewees. The information gained from the interviews will be analysed in the empirical chapter as a complement to the secondary data collected.

#### 1.4 Preliminary studies

Research of venture capital is well documented in the US and European countries. For Asia, if existing, it usually focuses on discussing the venture capital situation of a major and developed economy like China (e.g. Bruton & Ahlstrom, 2003) or they generalise the whole Asian experience (Bruton et al., 2004; Naqi & Hettihewa, 2007; Dai et al., 2012). For other emerging markets like those of Southeast Asian countries, the report “Private Equity in Southeast Asia” conducted by the Boston Consulting Group in 2012 is able to provide reliable information. It gives an in-depth outlook on the private equity situation of each country. A particular case is Scheela who is an active contributor of studies on venture capital industry of Southeast Asian area both as a whole (Scheela et al., 2015; Scheela et al., 2012) and by specific country, e.g. Thailand (Scheela & Jittrapanun, 2008), the Philippines (Scheela & Chua, 2011), and Vietnam (Scheela & Nguyen, 2004). However, his contributions seem to be the only few papers available. Except for Singapore, Southeast Asian country-specific research on venture capital is scarce. With only Scheela’s 2004 paper and another research by Klingler-Vidra in 2014, the venture capital situation of Vietnam remains under documented and studies comparing it with other countries in the South East Asian region is also lacking.

## 1.5 Structure of the thesis

This thesis includes two theoretical chapters, followed by an empirical chapter and a summary. The thesis is divided into 5 parts as illustrated in Figure 1.

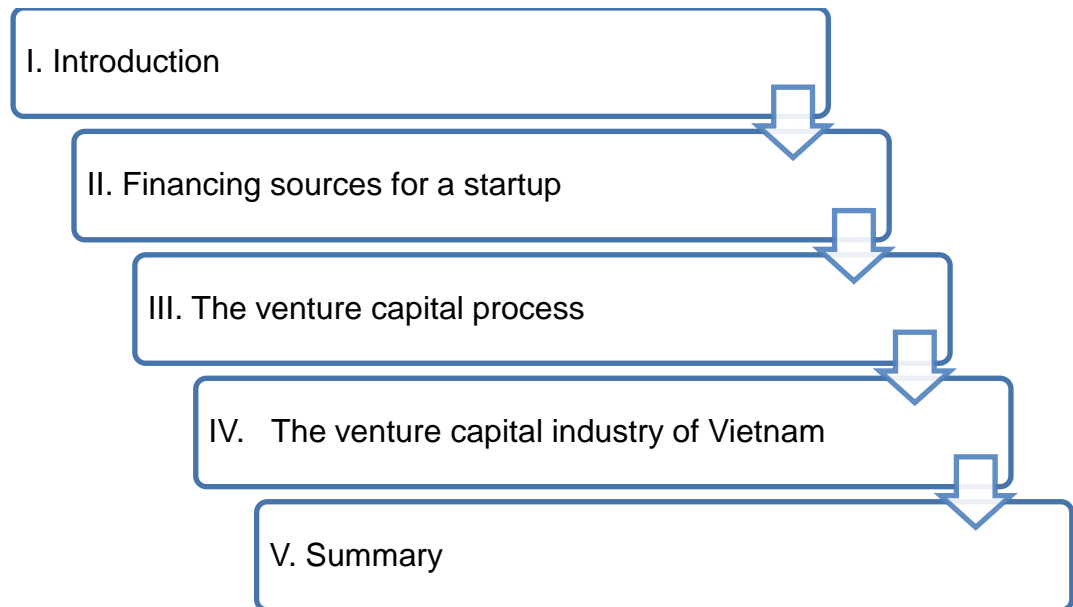


Figure 1. Structure of the thesis

This first chapter is the introduction. The remainder of the paper proceeds as follows: chapter 2 describes different financing sources that a startup can consider and answers the first sub-question 1. Chapter 3 provides information on all the aspects of the venture capital process, which addresses to the second sub-question. Chapter 4 is the analysis of the Vietnamese venture capital industry, which answers the third sub-question and provides a conclusion tackling the main research question. The thesis ends with a summary in chapter 5.

## 2 FINANCING SOURCES FOR A STARTUP

One of the most important issues that entrepreneurs have to face from day one is how to access capital. Some questions they usually ask themselves first and foremost about financing are how much money can and should be raised; when should it be raised and from whom; what are the characteristics of different sources of financing. To answer them, let's walk through an overview of all the usual types of financing for a startup.

### 2.1 Personal savings, friends and family

The most popular source of startup financing is personal savings. Based on a telephone survey of 600 small business owners conducted in March 2014 in the US, 77% drew on their personal savings to kick off their companies (Gallup Inc., 2014). In fact, it is important for entrepreneurs to invest their own savings in their business ideas as an indication of the confidence in his or her own idea.

Next to that, friends and family are also important providers of entrepreneurial financing. This capital source can be obtained quickly since they would like to see the founder succeed rather scrutinize the financial analysis or business plan. However, to minimise the possibility of damaging important personal relationships in case of failure, entrepreneurs usually repay such loans as soon as possible.

### 2.2 Bank loan

In addition to tapping on one's own savings and friends and family, an entrepreneur can also consider taking a personal loan if he or she has good credit and personal finances. Usually, a business owner applies for business loans to finance his or her company. However, at the kickoff phase, if there is not yet any revenue or any finances to meet the criteria of business lenders, a personal loan is more feasible. This type of loan typically comes in smaller amounts and relies on the individual's accountability rather than the business'. Some popular kinds of personal loans a startup founder

can contemplate include mortgage, car loans, instalment loans, home equity loans.

Credit card is also a noted resource. Startup owners can withdraw a cash advance on their credit cards within its credit limit to start the business. In fact, around 28% small business owners use credit cards to gather more capital, as reported in the previously mentioned survey (Gallup Inc., 2014).

A business loan is the most traditional and popular external financing option for startups and the primary providers of debt capital to small enterprises are commercial banks. Upon the business starting to be eligible for business loans, the founder can approach a bank for a business loan. A bank loan usually refers to a monetary sum lent to a borrower and the loan is paid back in monthly instalments until the maturity date. There are many categories of loans: long term or short term, fixed rate or floating rate, secured or unsecured. An unsecured loan means that there is no collateral backing them. On the other hand, secured loans are backed by business property, inventory or receivables. Over a period of years, the borrower repays the principal, plus interest, until he/she eventually owns the property free and clear. In the event that the borrower defaults on the loan, the lender has the right to take possession and sell the secured property to pay off the loan. (Investopedia; Ehrhardt & Brigham, 2011, 672-674)

### 2.3 Crowdfunding

Crowdfunding is the practice of raising capital by appealing to large number of ordinary people for small investments rather than having to look for a single large investment. Crowdfunding is usually conducted through online platforms such as Kickstarter and Indiegogo. Though it has gone viral in recent years, crowdfunding remains relatively uncommon for business owners unless their entrepreneurial firm belongs to a “trendy” industry like the tech sector. This financing source is usually utilized at the early stage of entrepreneurial financing. Crowdfunding investors do not exactly expect strong revenue growth as they are more interested in the innovativeness of

the business idea or model and the entrepreneur's competency. (Investopia; Kauffman, 2016)

There are many benefits from of this capital source. On the side of the entrepreneurs, they can get feedbacks from a larger crowd of investors. On the investors' side, the crowdfunding platform provides most of the due diligence process that investors need to do all by themselves otherwise. For example, before a startup is posted on the platform, it has to pass the following process to be approved: 1) The entrepreneur needs to submit all the business information (e.g. executive summary, business plan, financial information). 2) The application is then reviewed and the crowdfunding site's team will decide if the venture makes sense to be moved forward. (Prive, 2013)

Crowdfunding exists in three main forms: rewarding crowdfunding, debt crowdfunding, equity crowdfunding. Reward crowdfunding is the most popular type of crowdfunding, especially through the platform like Kickstarter. Based on the amount contributed to the project, supporters are promised with rewards, which often includes a prototype of the product before they are marketed for sale. The next kind of crowdfunding is debt crowdfunding. Its mechanism is considered similar to that of a loan and can be understood as peer-to-peer lending. The entrepreneurs are borrowers and the investors are lenders through the debt-based crowdfunding site. Every borrower has their credit worthiness rated and once the loan is approved, the borrower makes monthly payments back to lenders with interests. Equity crowdfunding, corresponding to its name, implies that investors make capital investments in exchange for ownership. Other than normal small investors, venture capitalists and angel investors are also big players on equity-based crowdfunding sites. An example is AngelList, where the main investors are accredited angel investors. (Kauffman, 2016)

#### 2.4 Angel investment

An angel investor refers to a high net worth individual who invests his or her own funds in a set of small businesses. According to the standard of US's

Securities Exchange Commission, an accredited angel investor must have at least \$1 million in assets and an annual income of \$200,000 (as cited in Investopedia). They are often wealthy, well-connected individuals who takes a personal interest in a product or idea. Angels can also work together and form syndicates to pool capital into a single investment.

The total size of the angel investment market is difficult to be measured precisely because many investments made on an individual basis are not subject to disclosure rules. However, surveys by the Centre for Venture Research at University of New Hampshire are able to indicate that the total investments made by angel investors were \$24.6 billion in the US as of 2015. The average angel deal size in 2015 was \$345,390 (Sohl, 2015). Even more dramatic is the rise in angel investing around the world – in Europe the total market doubled during the past five years and in Canada it tripled (Ortmans, 2016). Angel investors' top six most favourite industries are software, healthcare, biotech, industrial/energy, retail, and media (Sohl, 2015).

The structure of an angel investment usually involves a term sheet, which is a non-binding document that outlines the terms and conditions in which an investment is to be made. Some of these terms comprise vesting, governance principles, corporate structure, financing strategy, valuation and exit strategy. The most important part of deal structuring is to define the ownership. Ownership structures commonly used includes common stock, preferred stock, participating preferred stock, and convertible notes. At the end of the investment, angel investors receive their money back if the invested enterprise is sold off or goes public.

Since angel investors are usually individuals who have held executive positions at big corporations, they can provide great advice and mentorship to the entrepreneur. Angels frequently assist in building the strategy and take the company forward; therefore, angel funded startups often have a much higher chance to survive and grow until the follow-on funding, usually of venture capital, is reached (Kerr & Lerner & Schoar, 2010).

## 2.5 Venture capital

Venture capital is a category of financing by venture capital funds into young companies that are not listed on a stock market and have high growth potential. This definition is derived from the venture capital experience in a developed market like the United States. There is a total venture capital of US\$58.8 billion invested in startups across the United States in 2015, according to the report from PwC and the National Venture Capital Association (NVCA, 2016). The total aggregate value of 2015 venture capital deals around the world is US\$136 billion (Preqin, 2016).

However, the definition of venture capital is sometimes confused with that of private equity. For example, venture capital in Europe is understood more generally as private equity where investee companies include enterprises of a more mature stage of growth. Or in Asia, most of venture capital investments should be categorized as private equity (Naqi & Hettihewa, 2007). To start with, private equity is the capital invested in an unlisted company in exchange for its equity. Venture capital, in fact, is a subset of private equity. The distinguishing factor is that venture capital is aimed at a narrower target where the investees are young, usually hi-tech and show strong growth potential. In addition, venture capital investments usually require longer term commitments than general private equity investments. Venture capital investors are more involved in the management and direction of the company by playing an active role in the company's board of directors. Venture capitalists bring their technical and managerial skills to support the portfolio companies' development.

Venture capitalists managing a venture capital fund typically look for an annual return of 25-30% on their overall investment portfolios. The main principle of venture capital is "high risk, high profit". Since most ventures are expected to fail, they invest small amounts of money in a number of companies. As long as one investment can generate good returns, the entire fund can reach the required profitability. Though they target early-stage enterprises, venture capital funds usually do not want to participate in the seed financing of a business. Instead, they generally prefer to invest in



companies that have already received significant equity investments from seed investors like business angels and that are already somewhat profitable. The start-ups preferred by venture capital funds usually have business based on a disruptive innovation with an interesting business model and they usually belong to industries such as information technology, social media or biotechnology.

Venture capital is important to a country's economy. Firstly, an active venture capital market can boost the economic growth. In a Deutsche Bank's research about venture capital in 2010, it is indicated that an increase of 0.1% of GDP in venture capital investments is statistically associated with a 0.3% increase in GDP growth rate (Meyer, 2010). Secondly, the development of the venture capital industry can accelerate the growth of startups and create more jobs. In a research on the performance of companies receiving private equity and venture capital investments between 1995-2009, venture capital recipients experienced immediate increase in sales revenue and workforce as compared to the control group of non-backed companies of the same size and characteristics (Paglia & Harjoto, 2014). Thirdly, the thrive of tech scene and an effective startup ecosystem relies very much on the availability of venture capital. For many reasons, startups are better at being innovators and big corporations usually have a lot of difficult to come out with disruptive invention. The development of venture capital industry facilitates the startup ecosystem and the development of technology so the promotion of venture capital formation has become an important focus in most countries' policy. Fourthly, the development of a proper venture capital industry brings along a favourable environment for the development of other financial institutions and the whole financial market. The operation of venture capital investing is tied with a range of financial institutions so it cannot go separate from the financial market. Especially the exit stage of the investment usually involved IPO or merger and acquisition, it needs a regulated and functional stock exchange. Although only less than 5% of startup funding comes from venture capital, the statistics from a research conducted by the University of Florida show that 37% of IPOs completed in the US during the period of

1980-2015 are companies backed by venture capital (Ritter, 2016). A dynamic IPO market is also a precondition for a developed venture capital industry.

### 3 THE VENTURE CAPITAL PROCESS

The venture capital process includes all the activities VCs go through to make investments into startup companies. The venture capital process can be summarised in Figure 2.

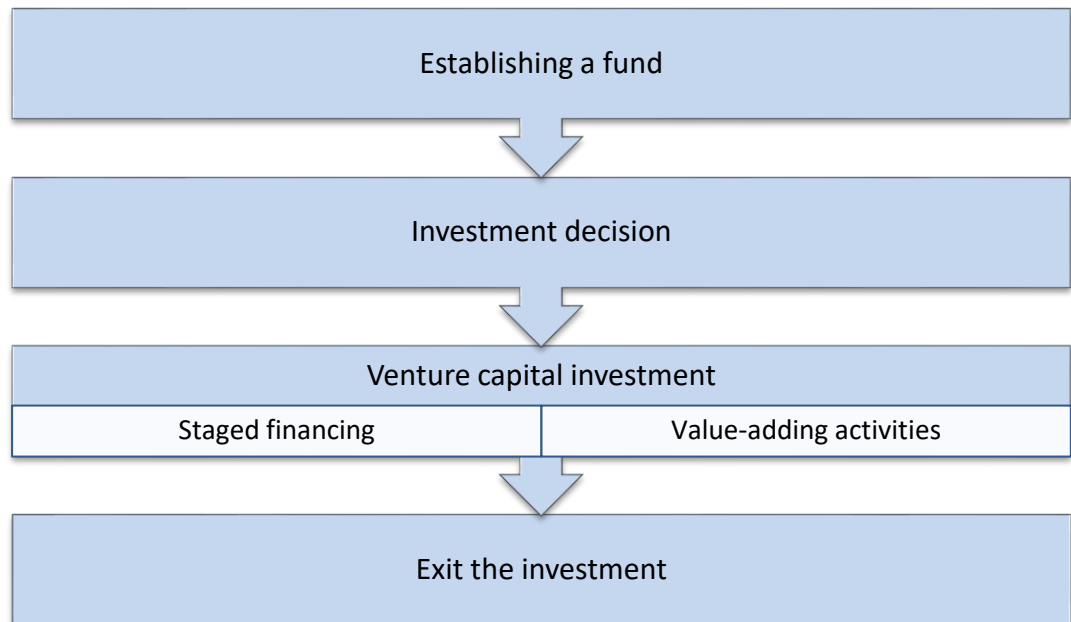


Figure 2. The venture capital process

It starts with the general partners of a venture capital firm pooling capital from investors and setting up a venture capital fund. With this fund, they make selection decisions on which startups to invest based on the fund's criteria. Once settling the paperwork with the investee companies, VCs provides capital funding plus their own skills and experience into the startups. The venture capital process ends with the exit of the venture capital firm from the investment through a liquidity event, such as IPO or trade sale. VCs return the capital to investors and may raise the next fund. (Gompers & Lerner, 2001)

#### 3.1 The participators of the process

Before going into the actual process, let's introduce the four main participators involved in the venture capital industry. They are: investors

who seek high returns; entrepreneurs who need funding; investment bankers who need companies to sell; and venture capitalists who make money for themselves by creating a market for the aforementioned three.

Firstly, entrepreneurs are the centre of the startup ecosystem and an indispensable part of the venture capital industry. The entrepreneurs are usually researchers, engineers, scientists who found their own business to realise their ideas into marketable products. To receive financing from the venture capital investors, the entrepreneurs should typically have their startups belonging to a high growth industry like high technology. They should possess not only an original idea but also a decent business plan. In addition to that, the entrepreneurs or the founding teams will also be selected based on their competence, a willingness to take risk and a match between them and the venture capital firms (Zider, 1998).

Secondly, the investors of venture capital funds are usually financial institutions (e.g. banks, pension funds, university endowments, insurance companies), and to a lesser extent non-financial institutions (e.g. foundations or any corporations with cash surplus to invest), and high-net-worth individuals (Zider, 1998).

Thirdly, investment bankers play an important role in an IPO, which is the most spectacular exit among different exit scenarios. The reputation and experience of an investment bank can influence the credibility of the IPOed company's stock price and it typically receives 7% of the money raised through an IPO as compensation (Ehrhardt & Brigham, 2011, 791 & 795).

Last but not least, the venture capitalists link the previous three industry players. They work with the other at different points of the venture capital process. As explained in the glossary, venture capitalists are professionals who have skills, experience and network, they are usually managing partners of a venture capital firms or its investment professionals (Ehrhardt & Brigham, 2011, 789). At the establishment of the funds, they are responsible for finding capital sources from investors to pool into the fund. At that same time, they also need to search deals and evaluate those

investment opportunities in order to convince the prospect of the fund to investors. When the fund is established, part of their responsibility is to design an investment strategy for the fund's portfolio. They also continue to select worthwhile startups to invest in on behalf of investors and use their skills to nurture the investee company until an exit.

### 3.2 Establishing a fund

In order to start their operations, venture capital firms need to source finances to make the investments. Depending on the structure of the venture capital firm, its fund can be raised in different methods.

Venture capital firms can be categorised into three types based on its structures: private independent venture capital firm, captive venture capital organization, public sector venture capital organization. Firstly, a private independent venture capital firm is the most common structure. It pools capital from investors (e.g. banks, pension funds, endowments and others as mentioned in section 3.2) to set up a venture capital fund. The investors are organised as limited partners and the venture capital firm's managers serve as the general partners. The investors are willing to commit their capital into venture capital funds in hope for a higher rate of return than that of other asset classes and regard it as a tool of investment diversification. Secondly, if the venture capital firm is financed by an established organization, it is called a captive venture capital organisation. The parent organisation is typically a financial institution (e.g. a bank or insurance company), but it can also be a non-financial company, where the captive venture capital organisation is then called a corporate venture capital organization. A captive venture capital organisation, especially the corporate venture capital type is different from private independent venture capital firms in its objectives because it usually has corporate strategic objectives instead of primarily financial goals. Lastly, public venture capital firms are organizations that are (entirely or partly) funded and controlled by government entities. They generally have a "higher" goal than making

profits, for instance, to facilitate the growth of small and medium enterprises or support the economic development of a certain region. (Isaksson, 2006)

In general, a typical venture capital fund has a life of 10 years. Fund providers are not directly involved in the investment decision and only realize returns from their investments at the end of the fund's life.

### 3.3 Investment decision

The returns of a venture capital fund depend entirely on the success of its portfolio companies so the selecting phase is outlined and followed through very carefully. Usually, the projects selected to be sponsored must show a strong business plan, its distinguished offering and the marketability. The investment decision also determines the financial instruments used for the investment, the percentage of ownership in the portfolio companies and other legal issues.

#### 3.3.1 Selecting criteria

Over the life of the fund, venture capitalists must review and evaluate hundreds of businesses so they often select their investees based on some predetermined criteria. The criteria often depend on the fund's investment strategy and are often stated clearly in the fund's mandate from the time of establishment. Though each fund established with different goals, the selecting decision revolves around those criteria:

- The growth prospect of the industry sector
- The scope of the market and its attractiveness
- The novelty of the product
- The competence of founders
- The development stage of the startup
- The inquired investment amount

Each fund will have different priority and weight on each criterion so a clear set of criteria will help to quickly flag the startups that fit in a preliminary

screening. Then, those startups continue to be assessed and evaluated based on its management team, its product's market potential, and the business model. In this stage, venture capitalists investing on behalf of the fund will be responsible for carrying out the due diligence and share it with other investors so that a decision can be reached. In reality, some funds will only review opportunities that come via a referral from a trusted source or in investor conferences and summits where founders have the opportunity to pitch directly to investor groups.

### 3.3.2 Valuation

An important step in the venture capital process is to determine the value of the firm and arrive at an acceptable price for the deal. It is more difficult to evaluate a private firm than a public firm for many reasons. For instance, while public firms are obliged to make a certain amount of information available to the public and present the financial statements according to standard accounting standards, private firms are not subject those strict legislations. Also, owners of a private firm are usually its managers so the differentiation between personal and business expenses can be blurred. (Isaksson, 2006)

Evidence suggests that venture capital projects are typically valued by applying one or more valuation techniques, which include multiples-based valuation technique, Discounted Cash Flow method (DCF) (Wright & Robbie, 1998). In addition to a formal valuation, VCs also relies on the use of a "common sense" or "pit of the stomach" valuation approach, which is based on VCs' personal experience, knowledge and intuition (Isaksson, 2006).

### 3.3.3 Deal structuring and contracting

Once VCs and the chosen company reach an agreement on the percentage of ownership and capital exchange, they need to discuss about the financing contracts. The outline of a financing contract is usually state-contingent. Yet, it cannot miss the fundamental issues such as the type of securities and

their resulting ownership and control rights. The type of securities are usually preferred stocks and convertible bonds. However, venture capital providers can also employ other kinds of equity and/or debt instruments. The selection of financial instruments also depends on the stage of financing (this will be discussed further in section 3.4.1). The contract also includes various covenants such as rights of first refusal, anti-dilution clause, liquidation rights, board rights, automatic conversion, non-compete clauses (Denis, 2004).

### 3.4 Making the investment

#### 3.4.1 Staged financing

A venture capital fund does not supply the entire amount of capital all at once. Along with the development progress of the investee company, if the investee company reaches the milestone of each financing stage as agreed, the fund will supply the next investment instalment. If not, they can stop the investment process. There are no clear divisions of financing stages and so financing stages can be seen relatively by the startup's development (Gompers & Lerner, 2004). Based on a study by Brander et al. (2002) and the "Guide on Private Equity and Venture Capital for Entrepreneurs" by the European Private Equity and Venture Capital Association (EVCA) in 2007, the author will discuss four main financing stages corresponding roughly to a business life cycle.

First of all, seed financing is the earliest round of financing. The investment is for early-stage companies. The receiver of this amount will use it to develop his initial concept, evaluate its worthiness and prepare a business plan. Though venture capital funds can participate since this round, they usually do not and seed financing usually comes from angel investors.

The second financing stage is start-up financing. The investment at this stage is made to companies with the objective of supporting product development and carry out preliminary marketing efforts. At this stage, the company has completed a market research and possesses a clear business



plan. Though the product is yet to be launched into the mass market, a prototype is developed and tested at a small scale. A management team is formed to run the startup. If the venture capital firm finances a company at this stage, a venture capitalist will be appointed by the venture capital firm to take a seat in the board of directors. The appointed venture capitalist monitors the operation of the startup and the management team from the board of directors.

The third venture round is called growth/expansion financing where funding flows to companies who lack capital to launch the product into the market and/or to increase production capacity. Series A is what the first institutional round refers to. Subsequent investment rounds are called Series B, Series C and so on... This is the stage where venture capital funds usually come in. At this juncture, the startup are already selling the products but not gain profits yet. The venture capitalists monitor the competence of the management team, especially in how it manages the manufacturing development and reacts to competition. Depending on the performance of the startup, the venture capital firm will decide whether or not to move forward to the next investment round. They may prolong the stage if the management has not reached the required development level. If need be, venture capitalists can suggest replacing the management team or cut funding totally.

Fourthly, in a pre-exit stage, mezzanine is used as bridge finance to cover the gap between expanding the company and a liquidity event like an IPO. Prior to this point, the venture has achieved a certain amount of market share. As a company garners its strength, the founders and VCs may begin preparing for exit options, usually through an IPO or a strategic sale to third party. For the startup, it often plans this additional finances three to 18 months before its IPO, mainly to ensure a good 'operating position' before going to the market. In other words, it will use the money to improve the company's balance sheet, boost its financial indicators and sometimes restructure the company's ownership. From the VC side, mezzanine financing is granted to receive preferred stock and or convertible bonds, giving the advantages of both debt and equity. VCs may also require some

type of warrants, giving them the right to purchase more equity at a set price within a particular time frame. This is a great way for a venture capital firm to protect itself because it wants to ensure that all previous venture capital will not be lost if the IPO is not successful. On the other hand, a successful IPO will likely lead to significant gains to the venture capital firm, which will liquidate their stake in the company soon thereafter.

In short, the venture capital investment can start at the seed financing round or at any later stage and finish at the exit to recollect the capital. Each stage has different risk-return relationship. Staged financing is an important method to minimise the investment risk. The more detailed the breakdown of the investment is, the more the risk might be minimised. However, the division of stages and how to break down the investments rest on the decision of each venture capital firm.

#### 3.4.2 Value-adding activities

An early-stage company does not only lack capital to grow, it is also often inexperienced in most business functions such as finance, human resource, marketing. Venture capital investment can address both problems. Apart from supporting financially, a prominent characteristic distinguishing venture capital from other kind of investments is the active participation of venture capitalists in the portfolio company's operation. By their involvement, VCs have the opportunity to transfer their resources and competencies (e.g. skills, networks, reputation) to the firm in which they have invested (Isaksson, 2006). This allows the companies to focus solely on its core business. Those are the added values VCs bring to its portfolio companies. The level of involvement also differs per the stage of the investment. For VCs, the active governance from the board of directors is also a way for them to minimise the inherent risk of venture capital investment.

However, the active participation of the VCs can also adverse effect for founders. Since the primary goal of VCs is high returns, it can often clash with the long-term vision of founders for their firm. On top of that, VCs

continue to provide funding only when a milestone has been reached at each stage. If not, VCs can suggest restructuring the management team or decide to stop funding. The same VCs who provide huge help to grow the company are also the one who do not hesitate from firing the founders if they see the founders are not competent enough to take the startup forward.

### 3.5 Exit the investment

The exit stage is an integral part of the venture capital process. After several years of investment, the venture capitalists will want to cut ties of their engagement with the investee by selling their shares and, hopefully, gain returns. Each venture capital fund has a limited time frame of about 7-10 years. By the end of the fund life, venture capitalists need to divest and liquidate all the investments, reimburse the investors and other affiliated parties. However, there are also many cases where venture capital firms choose to exit their investments earlier than a liquidity event. For example, early-stage venture capital providers may exit in later rounds by selling their stakes to new investors. In general, the venture capital process usually ends with one of the following five exit routes (Cumming & MacIntosh, 2002):

- Initial Public Offering (IPO)
- Trade sale (or Mergers & Acquisition)
- Secondary sale
- Buyback
- Write-off

In an IPO or initial public offering, the investee company's shares are offered in a public sale for the first time. This is a spectacular exit scenario for both the fund and the startup but it is not the most common case. IPO will cost a certain amount of money such as administrative fees resulting from constant publishing of information for the market and responsible authority, fees paid for legal procedures, audit and underwriting, and indirect costs of time and effort spent in the preparation for the offering. The costs total up to a 10-12% of the total amount offered on the market. (EVCA, 2007)

Trade sale is also a very popular means to exit the investment, especially in Europe where financial markets revolve around banks. A trade sale can also be referred to as M&A or Mergers and Acquisitions. This means the shares of a company is sold to another company. The buyer is usually a larger firm who can notice the strategic advantage or the complementary effect the startup can bring into its own business. A trade sale negotiation is often occurred in private because it is often negatively interpreted by clients, suppliers and employees. (EVCA, 2007)

Secondary sale is an alternative exiting channel. Even when a fund life is not ending and its investee company is not facing a liquidity event like IPO or trade sale, VCs can choose to sell their stakes to another investor. This occurs when the company has reached a desired value for venture capitalists or when the fund restructures the portfolio and the startup does not match its investment criteria anymore. (EVCA, 2007; Cumming & MacIntosh, 2002)

Buyback is where the venture's owner or management team buys back the venture capital firm's holding shares. This allows the venture to gain back the control after a period subject to the governing of VCs. This is an attractive exit if the startup has regular cash flow and can mobilise sufficient loans. To buy back the shares, the owner can actually loan from the venture capital firm pay off the debt gradually from the its positive cash flow. (EVCA, 2007; Cumming & MacIntosh, 2002)

A write-off exit happens when the venture fails despite all the previous saving efforts of the startup's managers and venture capitalists. VCs then chooses to walk away from the investment by liquidating their holdings. In fact, write-offs lead to bankruptcy and the disappearance of many startup. (Cumming & MacIntosh, 2002)

Exit is very important and an exit route is contemplated by VCs since the time of making the investment. The experience and competence of venture capitalists and the use of their networks are employed to achieve the best possible exit for the investment. For VCs, the success rate of portfolio

companies and the returns will be the main instrument to sell themselves when they raise the next fund. On the other hand, the investors need a means to evaluate the skills of the venture capitalists so as to be able to decide whether or not to commit future assets in the hand of those fund managers. In addition to that, the investors need to assess ROI and the profitability of venture capital investment juxtaposition with that of other asset class to draw a conclusion whether or not to invest in venture capital and to which amount.

## 4 THE VENTURE CAPITAL INDUSTRY IN VIETNAM

The venture capital industry in Vietnam is an indispensable part of its startup scene. As mentioned earlier, the concept of venture capital and private equity in Asia including Vietnam is sometimes understood interchangeably so many deals and funds were categorised as venture capital when they actually belong to private equity; therefore, the precise data is sometimes difficult to find. The Asian Venture Capital Journal reported the value of venture capital in Vietnam reaches around US\$ 525 million in 2007, the peak point in the period of 2007-2010 (as cited in Nguyen Bao, 2014).

### 4.1 The development of the venture capital industry in Vietnam

Vietnam experienced a first wave of startups a little more than ten years ago. One of the first true venture capital firm is IDG Ventures Vietnam, which is established in 2004. It funded a host of startups between 2004 to 2006 with an early fund of US\$100 million. While many of that first batch have failed, some have become huge like VNG, VC Corp, and Vat Gia. Thanks to the entrance of CyberAgent Ventures in 2008 who is willing to invest in smaller and earlier-stage startups, a second wave of startups rose. Successful startups of this wave include Nhac Cua Tui, Tiki.vn, nhommua.

Since the beginning of 2014, the startup phenomenon has been going viral again and Vietnam is becoming home to a burgeoning startup ecosystem in both Ho Chi Minh City and Hanoi. The main reason behind the startup wave is a huge and young population with an enthusiasm for technology and entrepreneurship. As of the end of 2015, the population is 92 million people with 70% in the age group 15-64, this is a driving force for both the demand and supply for the Internet Technology and Communications (ITC) industry (World Bank data, 2016). On the demand side, the economy is growing on average at 6 per cent annually, which leads to the rise of middle class. There are 47 million active internet users and 122 million mobile subscription (World Bank data, 2016; Internet live stats, 2016). The rate of 51% Internet subscription and 133% Mobile subscription implies a huge market for internet and mobile products and services. On the supply side, Vietnam is

a provider of technology talents for the region. While its digital economy is currently centred around manufacturing, there is a growing amount of innovation and entrepreneurship in the technology sector.

The startup investment scene in Vietnam has seen a growing number of investors. Biggest names of the venture capital industry include IDG Ventures, VinaCapital DFJ, Cyberagent Ventures as well as the recent launch of 500 Startups Vietnam. Financing of Vietnamese startups also come from a spate of other regional venture capital firms such as Expara Ventures, Golden Gate Ventures, and Gobi Partners. Later-stage venture capitalists like NSI Ventures, Vertex Ventures and Monks' Hill Ventures have also been looking for deals in this market.

To give an overview of the venture capital industry in Vietnam, those below are five prominent and most active firms that have offices or local heads in Vietnam.

- IDG Ventures Vietnam is a pioneer venture capital firm in the country with a total of US\$100 million under management. The firm is currently managing investments in over 40 companies in the technology, media, telecommunications sectors. Established in 2004, it embraced in the first wave of startups in Vietnam. Some of its most successful investees are VNG, VC Corp, Vat Gia. (IDG Ventures, 2016)
- DFJ VinaCapital L.P., set up in 2006, is an US\$35 million venture capital fund. It is a partnership between asset management firm - VinaCapital Group and the global Draper Fisher Jurvetson venture capital network. It generally invests in later stage startups of the media and technology sector, e.g. taxonline, Yeah1 TV, Vietnam Online Network. (VinaCapital, 2016)
- CyberAgent Ventures comes from Japan and is one of the most active investors in Vietnam. It has a venture capital fund dedicated to internet startups in South East Asia with a value reaching US\$ 20.1 million in 2011. It has joined the market since 2008 and the investment policy focuses more on making seed and early-stage

investments. Some most noted investments are infused into popular startup companies like Nhaccuatui.com, VeXeRe, Tiki.vn, Foody.vn. (CyberAgent Ventures, 2016)

- 500 Startups has recently launched an US\$10 million venture capital fund which will aim to make 100-150 investments into Vietnam-connected startups with a check of typically from US\$100,000 to US\$250,000. Its ambition is to be the most active Silicon Valley seed stage venture capital firm in Vietnam. (500 Startups, 2016)
- FPT Ventures is a US\$3 million seed fund launched in 2015. It is the funding arm of Vietnam's leading tech company - FPT Corporation and has so far invested in seven startups, all of which are spinoffs of FPT Corporation. (FPT Ventures, 2016)

Vietnam had about 28 investment deals in 2014. In 2015, the number of deals doubled and hit 67, reported by Tapioca Founder Institute (Tapioca Founder's Institute, 2016). According to the head of the institute, a deal is counted as successful when it satisfies one of these criteria: be valued at over US\$10 million; or have a revenue of over US\$2 million; or have 100 employees; or have received at least series B investment round; or exit through trade sale (Kieu Chau, 2015).

When mentioning Vietnamese startups, two most famous names are Flappy Bird and VNG (also known as VinaGame). Flappy Bird is a mobile game app which topped the App Store in 2013 when it achieved 50 million downloads. It claims to have earned US\$ 50000 a day at peak points. Since the success of Flappy Bird app, a 'get-rich-quick' mentality through startups has begun to develop and causes the most recent startup wave in 2014. On the other hand, VNG is one of the first startups of the country and has turned itself into a unicorn since 2014 when it was valued at US\$1 billion by the World startup report (The Economist, 2014). It is a provider of music download service, online and mobile games, and a chat app Zalo whose number of users ranks only second behind that of Viber. Currently, the top invested industries are edtech, fintech, media, ecommerce. Some most



recent prominently successful Vietnamese venture capital investment deals are listed in Table 1 below.

Table 1. Recent major deals in Vietnam (collected from TechnAsia and Crunchbase)

Name	Description	Latest stage	Investor	Time
Appota	Website content provider	Undisclosed (acquired)	Applancer	2015
Big Cat	Making video online, owner of Youtube channels	Undisclosed – 7 figure (acquired)	Asia Innovations Group	2016
Coc coc	Browser and search engine	US\$14 million	Hubert Burda Media	2015
Foody.vn	Vietnam's Yelp	Undisclosed (Series B and C)	Tiger Global Management and others	7/2015
iCare Benefit (Mobivi)	Financial service	US\$20 million	Experian, Kusto, Unitus Impact, Sumitomo Mitsui	2013
The Kafe	A fusion café-restaurant chain	US\$5.5 million	Cassia Investments and others	10/2015

Momo	E-wallet and payment app	US\$28 million (series B)	Standard Chartered Private Equity, Goldman Sachs	3/2016
Tappy	Social networking app	Undisclosed – 7 figure (acquired)	Weeby	2015
The Gioi Di Dong	Vietnam's Bestbuy - Reseller chain of tech devices and electronic	US\$250 million (IPO)	Public investors	2015
Tiki.vn	Vietnam's Amazon	US\$16.7 million (38% stake)	VNG Corporation	2016
Vexere.com	Online bus ticket selling system	Undisclosed (seed funding)	CyberAgent Ventures and Pix Cine Capital	6/2015

#### 4.2 The difficulties in the venture capital process

Although Vietnam has a burgeoning startup scene, the country is yet to establish a proper startup ecosystem. This is mainly due to lack of a legal framework where there is currently no legal mentioning of venture capital funds and the complicated procedures that investors and startups have to go through. In addition, the cultural tendency of Vietnamese business to be secretive impedes entrepreneurship. The investment environment is also

unattractive because the financial market is underdeveloped with a stock market which is yet to fully emerge.

Firstly, there are lack of laws and legislation governing the venture capital funds. At present, there are no official law text that specifically regulate the establishment and operation of those funds. The laws about fund establishment currently exist in Laws on Stock where the conditions to establish a fund are too high for smaller investors, according to the empirical evidence from surveys of the Ministry of Planning and Investment. For instance, a public fund needs to have at least 100 investors and the total sold fund certificates need to reach at least 50 billion VND (around US\$ 2 million); a limited partner fund needs the minimum capital of 50 billion VND with maximum of 30 limited partners who are legal entities; to establish a security company the capital must start from 50 billion VND (Ministry of Planning and Investment, 2016). Existing local venture capital investors have established themselves as companies instead of structuring themselves as funds.

The overriding characteristic of the VC funds operating in Vietnam is that they are usually established abroad. However, venture capital funds that do not have office in Vietnam must encounter time-consuming and inefficient paperwork. According to Mr. Dzung Nguyen, the managing director of CyberAgent Ventures, the time between finishing the investment agreement and have appropriate and adequate papers to process the capital transfer usually takes 6 months to a year. It will be much more if there are many investors invest in one company at the same time (Hai Dang, 2016). Furthermore, laws and regulations are also slow to be updated and prone to changing so foreign investors do not have confidence in Vietnamese investment environment (Tuyet Nhung, 2016). While a new policy on investment has been launched since 1/7/2015, which strives to create a more favourable environment and offer more latitude for foreign investors, the situation only slightly improves. Many foreign funds wanting to invest in Vietnamese startups even require the startups to be registered in Singapore, so that the financing process will be easier (Hai Dang, 2016).

Secondly, some cultural traits might impede the entrepreneurial spirit and the venture capital process. For instance, the society frowns upon failures. Though Vietnamese people are entrepreneurial, they are afraid of failures harming their reputations. Thus, young people often go for safe jobs in the government, schools, and established companies. In addition to that, Vietnamese SMEs are predominantly family-managed. The issue of control is important, leading to preference for debt rather than equity. Firms also tend to protect their interests by being secretive so they are not willing to share the company's information. Firms do not usually comply with international accounting standards or statutory audit requirements so it is hard for venture capitalist to evaluate. Venture capitalists have to rely heavily on pre-investment due diligence, in particular by collecting references on business owners through personal networks and contacts.

Thirdly, the inefficient and nascent state of the capital market is also a major setback. Vietnam's finance sector is overwhelmingly based on banks, not the capital market (Klingler-Vidra, 2014). Due to the bank-centric character of the economy, bank loans are the primary source for companies to raise funds. An undeveloped capital market makes it difficult for venture capital firms not only to raise money for a fund's establishment, but also to find exit alternatives for their investments. Unable to grow the stock and bond market, Vietnam will struggle to build a robust startup ecosystem, which requires easy access to funds and profitable exit routes for investors (Nguyen, 2016).

#### 4.3 Government efforts

Vietnamese government has been working continuously to improve the startup ecosystem and the investment environment including that of the venture capital industry. To be more specific, the authority is working on laws for the operation of both startups and venture capital firms; proposing tax incentives for investors; facilitating the organisation of tech conferences; establishing governmental funds and projects to support the startup ecosystem.

The Vietnamese government shows a lot of effort to stimulate the Vietnamese start-up scene, including encouraging the operation and establishment of investment funds to increase the availability of financing sources for startups. As mentioned in previous section, foreign investors are stuck at many steps from the time of establishing the venture capital firm to the exit stage. Not only venture capital firms, startups also have to navigate through the ordeals of paperwork. Recognizing those hurdles coming from complicated bureaucratic procedures and unclear regulations on venture capital, a multitude of incentives, proposals and decrees are passed in order to boost the startup ecosystem and the development of venture capital industry.

For instance, Law on support for small and medium enterprises (SME) (“Luật Hỗ trợ doanh nghiệp nhỏ và vừa”) is finalised its fourth edition draft in May 2016 and expects to be passed in the next parliamentary session this year (Ministry of Planning and Investment, 2016). In this upcoming law, there will be the legalisation of venture capital funds and crowdfunding. The Ministry of Planning and Investment is also building on a 31-page decree explaining detailedly the norms on establishing and running venture capital funds (Dự thảo “Thông tư về Quỹ Đầu tư mạo hiểm cho khởi nghiệp sáng tạo”).

New laws to improve the startup ecosystem also affect the development of venture capital industry. For instance, after the National Startup Initiative Workshop took place in March 2016, a decree of passing the project “Supporting the Startup Ecosystem Until 2025” (“Hỗ trợ hệ sinh thái khởi nghiệp đổi mới sáng tạo quốc gia đến năm 2025”) followed and was signed by the Deputy Prime Minister in May 2016. Some highlights from the content of the decree include:

- An entire section on [chinhphu.vn](http://chinhphu.vn), a governmental portal, dedicated to guide the legal and business practices of startups.
- Building a dedicated portal “Cổng thông tin khởi nghiệp đổi mới sáng tạo quốc gia” which is dedicated to provide information about

startups, technology, innovation, patents, Intellectual Property, business model, funding sources and investment deals...

- Regulations that are favourable to Vietnamese startups and starting a company
- Regulations that are conducive to the operation of Vietnamese and foreign investors
- Simplifying of administrative procedures
- Tax incentives for parties involved in startups
- Promote the creation of associations of angel investors and venture capital investors
- Improve the facility and infrastructure of research and development centres and incubators

This decree also mentions setting up more national own fund of venture capital to invest and guide startups. Some major current governmental investment funds and programs to support startups are introduced below.

- Silicon Valley Project is created in 2013 by the Ministry of Science and Technology with a US\$110 million fund. The startups participating this program will go through four months of incubation with the mentoring of experts from across the ecosystem and abroad. (Vietnam Silicon Valley, 2013)
- FIRST, the abbreviated form of "Fostering Innovation through Research, Science and Technology", is a project by the Ministry of Science and Technology in partnership with World Bank with a total amount of funding of US\$110 million. The project seeks to support four main areas including, biotechnology, materials science, robotics, and IT. It also has main responsibility such as launching incubation programs; designing and piloting new policies to improve the national policy framework for science and technology development. (FIRST, 2016)
- Ho Chi Minh City's Innovation and Startup Fund (HISF) is established by Ho Chi Minh City's Science and Technology Department in May

2016. The fund is set up with aims to support as many as 2,000 startup companies by 2020 and has received funding requests from 200 projects so far. The support fund of VND1 trillion (US\$44.8 million) is managed and governed by Ho Chi Minh City's Business Startup Support Centre (BSSC). (BSSC, 2016)

In addition to building on legal framework and increasing supporting financing sources, the technology conferences and events are also encouraged. One eminent event is Techfest, one of the biggest annual event for the startup community organised by the Ministry of Science and Technology. The first Techfest in 2015 attracts the participation of 1000 delegates, including 50 representatives of national and foreign investment funds and 50 from startups. It is estimated to facilitate the connection between investors and entrepreneurs and a total of US\$1 million is made thanks to the event (Techfest, 2016). This year, there are 2,000 attendees among which were around 200 startups and investors.

Those actions indicate the great concern of the government to this area and are considered a major improvement for the Vietnamese investment environment. A tight and well thought-out legal framework will ensure the rights of investors and regulate strictly the startups' and venture capital funds' operation.

#### 4.4 Comparison to other ASEAN countries

Southeast Asian countries include Brunei, Burma (Myanmar), Cambodia, East Timor, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam. All the states, with the exception East Timor, are official member of a regional economic community - ASEAN, referring to the Association of Southeast Asian Nations. ASEAN has 629 million people with a combined GDP of US\$2.43 trillion as of 2015 (ASEAN Stats, 2016). Private equity or venture capital investing is a fairly recent but rapidly increasing phenomenon in the emerging markets of Southeast Asia. With the rise of middle class in South East Asian countries, the startup community here is growing and so is the attractiveness of its investment environment. As

shown in the table below, a record 318 venture capital deals worth a total value of US\$1.28 billion took place in 2015. The number of deals has increased more than 1.5 times the figure of the previous year of 2014.

Table 2. Number and Aggregate Value of Venture Capital Deals in the ASEAN region (Preqin, 2016)

Year	No. of Deals	Aggregate Deal Value (US\$ million)
2010	44	187
2011	58	161
2012	104	296
2013	191	1002
2014	191	928
2015	318	1280

According to Table 2., extracted from Preqin and SVCA Special Report: Singapore and ASEAN Private Equity in April 2014 (the latest analysis available), deals are distributed mainly into six countries: Singapore, Indonesia, the Philippines, Thailand, Malaysia, Brunei and Vietnam during the years. Singapore has been taking the lead, usually followed by a distant second - Indonesia. The remaining deals occur in Malaysia, Philippines, Thailand, Brunei and Vietnam.



Table 3. The proportion of the number of venture capital deals in Southeast Asia by country (Preqin & SVCA, 2014)

Country	2009	2010	2011	2012	2013
Singapore	78%	71%	75%	67%	72%
Indonesia	-	7%	9%	13%	11%
Thailand	-	4%	-	-	4%
Philippines	-	7%	5%	10%	5%
Vietnam	18%	-	3%	3%	2%
Malaysia	4%	11%	5%	7%	6%
Brunei	-	-	3%	-	-

The venture capital amount invested in Singapore tops the South East Asian region. In 2015, more than 30% of venture capital/private equity (VC/PE) investments into Southeast Asia are targeted into Singapore-based companies (Preqin, 2016). Not settling for being the hub of ASEAN, the country has ambition to become the startup hub of Asia (Purnell, 2014). The advantages of Singapore are good infrastructure, rule of law, and easy access to major markets. In fact, per the VC/PE Country Attractiveness Ranking conducted by IESE (Table 4), Singapore also have a highest score for its investment environment in the region. Malaysia and Thailand follow and Vietnam has the lowest score among the six listed ASEAN countries. The index takes into account: total economic growth and growth rate, size of the stock market, trading volume, IPOs & public issuing activity and other conditions of the financial market.

Table 4. The VC/PE Country Attractiveness Ranking (Groh et al., 2016)

Country	Singapore	Indonesia	Malaysia	Thailand	The Philippines	Vietnam
VC/PE Country Attractiveness Ranking	93.3	64.9	85.6	71.5	63.4	59.5

In the region, some most active venture capital firms count 500 Startups, East Ventures, Golden Gate Ventures, Sequoia Capital, Monk's Hill Ventures, Softbank Capital (Balea, 2016). The 5 top funded industries in Asia: Ecommerce, Logistics & Transportation, Fintech, Marketplaces & Platforms, Music & Entertainment (Lie, 2016). Some startups with the biggest valuation are indicated below in Table 5.

Table 5. Most valuable startups in South East Asia (collected from the database of TechnAsia, Crunchbase)

Name	Description	Value	Latest stage	Notable Investors	Country, Year founded
Garena	Gaming	US\$2.5 billion	Pre-IPO stage - undisclosed	General Atlantic, Tencent	Singapore, 2009
GrabTaxi	SEA's Uber	US\$1.8 billion	Series E US\$350 million	GGV Capital, Vertex Venture Holdings, SoftBank Capital	Malaysia 2011

Lazada	Ecommerce site	US\$1.25 billion	US\$250 million Series F	Rocket Internet, Temasek Holdings	Singapore 2011
Razer	Gaming Hardware	US\$1 billion	Pre-IPO Stage	Accel Partners, Intel Capital	Singapore, U.S, 2005
Tokopedia	C2C Marketplace	US\$1 billion	US\$100 million Series E	Sequoia Capital, SoftBank Capital, East Ventures	Indonesia 2009
Traveloka	Flight and booking site	US\$1 billion	Growth Stage - undisclosed	Global Founders Capital (GFC), East Ventures	Indonesia 2012
VNG	Music download service, chat app, mobile games	US\$1 billion	Growth Stage	CyberAgent Ventures, IDG Ventures Vietnam	Vietnam 2004

Among those unicorns, there is one from Vietnam, the others are mainly from Singapore, Indonesia and Malaysia. Though Vietnam has an advantage in the availability of tech engineering workforce and a market growth potential (Eddie, 2016; Do, 2016) the attractiveness of the investment lags behind. The legal system is still opaque (as discussed in section 5.2). In addition, the private equity market is small and relatively underdeveloped and the monetary policy, interest rates and currency

movements are not stable as neighbouring countries (Boston Consulting Group, 2012). That results in Vietnam's venture capital industry being smaller in size than its neighbour countries like Singapore, Indonesia, Malaysia.

#### 4.5 Interviews

The interviews with professionals working in Vietnamese investment scene were conducted to gain further insight on the topic of the thesis. Three interviews were conducted, the interviewees are: Huynh Nguyen is the Chief Investment Officer of Bros Partners Investment Ltd., Khanh Phan is Head of Investment Advisory working at Maybank Kim Eng and Tin Ta is Head of Investment Analysis at Au Viet Securities Corporation. The questions can be seen in the appendix.

The three have worked in their respective companies for at least 4 years. The investments of their companies have an expected internal rate of return 15-25%, Phan's company can even generate profits several times the capital invested. About the duration of the investment, Ta answers that the capital gains are the major concern so he exits an investment as soon as the expected profit rate is reached, no matter how many years. Phan and Nguyen both states that venture capital investments in their experience can only exit at least from the third year. The most popular exit channel in Vietnam is trade sale.

When being asked about the venture capital industry in Vietnam, according to their answers, the most targeted industries are high-growth and high profit potential like IT, Online Service and Food & Beverage, especially with the major investment deals like that of VNG, Tiki, the Kafe. They all agree unanimously that there are enough venture capital funds to meet the financing demand of Vietnamese startups.

About the importance of the venture capital industry, Phan says that venture capital is an indispensable support for the startup community. It can encourage creativity and disruption in technology. A successful project can

become world famous and bring attention to not only the company but also the country. Nguyen also adds that the finances brought by venture capital can encourage young people following their dreams, though it is not easy to obtain.

To compare the venture capital industry of Vietnam to neighbouring countries, Ta and Phan without hesitating answer that the domestic one still lags behind but is improving fast. Ta states that the shortcomings lie within the lack of mature legal environment for this industry and lack of facilitating policies. In addition, the education is still outdated and there is missing of a culture of business owners. While as, Nguyen says that Vietnamese startups do not have the quality to go global yet. Discussing the role of the government in developing the venture capital industry, Ta says that the government has shown a lot of concern but is slow on taking radical and progressive measures. However, Ta and the other two credit the government on currently making a lot of efforts to improve the investment environment. Phan advises the policymakers to improve the investment policies faster and present a more favourable environment for investors. Also, it should issue comprehensive guidelines for enterprises on how to attract investors, apply for grants, effectively deliver their ideas, and create occasions so that investors and entrepreneurs can connect each other easily. In addition to that, Ta says that a reform in investment laws is needed and the government has to create a more liberal environment for creativity to flourish.

Lastly, they offer some insights on how they select the investee and provide some advice for entrepreneurs on how to apply for funding from their companies. Phan says the criteria for him is the market growth potential of the product and the determination of the leader while revenue and profit is only second after that. For Ta, the most important criterion is the profit growth potential of the product and its industry. Nguyen agrees with Ta on selecting high growth industry sector and stresses on the quality of the idea and the skills and competence of the founding team to scale it up. For an entrepreneur looking for financing, they advise him or her to understand the idea in depth and the industry of his product. He also needs to show strong

commitment with good leadership and management skills, a good team is also an advantage.

## 4.6 Conclusion

### 4.6.1 Answer to the main research question

“How has the venture capital industry progressed in Vietnam?”

Vietnam has a huge market potential and its startup scene is growing and so is the need for financing. In the past 2 years, many startups have been receiving millions of dollars of investment infusion from domestic and regional venture capital firms. Some of the biggest players in Vietnamese venture capital industry are IDG Ventures and CyberAgent Ventures, both of which have made investments in the only unicorn so far VNG, among others.

Though promising, the investment environment and startup ecosystem is in a nascent stage. The most concerning problems are bureaucracy and the incomplete legal framework, which make Vietnam a less attractive destination for investors. Since there is not yet legal mention of venture capital firms in current laws, most of the active venture capital firms are established abroad. Moreover, the stock and other financial markets are yet to fully emerge and operate efficiently so there is a lack of alternative routes for exiting the investment.

Recognising the hurdles that venture capital firms and startups have to encounter, the Vietnamese government is showing strong effort to make legal reforms and improvements, e.g. recently issuing guidelines on the establishment and running of venture capital firms, simplifying the complicated procedures of paperwork, proposing tax incentives for investors and startup-affiliated parties. Despite many progresses, Vietnam’s venture capital industry is still lagging behind neighbouring countries like Singapore, Indonesia, Malaysia both in terms of size and the attractiveness of the investment environment.

To draw higher interest from venture capitalists, it is urgent on the part of the government to finalise laws on the legal existence of venture capital firms, on investment governing and make the process of registering of firms and investment more transparent and efficient. In addition, the capital market also needs to be improved by offering more financial tools such as derivatives and investment indices. Any slowness in this process can cause loss of business opportunities for both entrepreneurs and investors. In addition, it is important that the government can foster scientific research and education relating to engineering and technology so that technopreneurship can continue to flourish in the future.

#### 4.6.2 Reliability and validity

Reliability means the extent to which a research will yield consistent results; in other words, it should be considered whether the same findings would be the same in other occasions and with other observers (Saunders et al., 2012, 156). Considering the participants, they are free from participant bias because the interviewees answer on their own account, not on any others' behalf. Though the answers are based on their personal experiences and knowledge, the respondents are the specialists in their fields and their opinions can be regarded with high credibility. Regarding the observer, there is a risk of presenting the information in a positive perspective as Vietnam is the author's native country. The author acknowledged this possibility and proceeded the study with caution. The author collected data from multiple sources to avoid looking at the phenomenon from only one point of view. Also, the data in this research was analysed from a more critical approach to provide an objective view of Vietnamese venture capital industry.

Validity includes external and internal validity. Internal validity is examined to which extent the results actually measure what they are supposed to measure. On the other hand, external validity deals with the generalizability of the results, which means whether the findings are equally applicable in other settings and other times. (Saunders et al., 2012, 157-158). The information about different financing sources for

startup and the venture capital process is discussed in a general approach and can be useful for the general public. The venture capital market in Vietnam is delineated with very recent data and can hold true for a next few years.

#### 4.6.3 Recommendation for further research

To create a more favourable environment for investors and achieve a more developed venture capital market, further research on which specific policies and laws should be apply in Vietnam should be carried out. The venture capital policies in leading markets such as the US and Europe and other Asian peers should be examined in order to determine which are suitable for the stage of economic development and political situation in Vietnam.



## 5 SUMMARY

The thesis is a study on venture capital as an important source of financing for startup and how well the venture capital industry in Vietnam has developed, especially in comparison to other ASEAN emerging economies.

The first theoretical chapter covers all the main kinds of financing sources a startup founder can tap on to kick off his or her business. The most traditional and common financing sources are personal savings, borrowings from friends and family, bank loans. Crowdfunding, angel investment and venture capital are relatively less employed because they usually apply for startups in more trendy industries such as technology. Nevertheless, they are important, especially venture capital who can fill the gap of finances for companies with ambition and ability to offer disruptive technology to the market.

The second theoretical chapter digs deeper into the venture capital investment. It provides an overview of the venture capital process: VCs starts the process by raising a venture capital fund from various investors. They then select startups to make investments in, based on the fund's selection criteria. Other related issues like valuation and deal structuring is also briefed in the section. Once the negotiation and the paperwork is settled, VCs provide both financial support and non-financial support, i.e. VC skills, competence and network to nurture the portfolio companies. The venture capital process ends when the venture capital firm liquidates their holdings through an exit route. VCs return the capital to investors and may raise the next fund.

The theoretical chapters are followed by an empirical part, where the Vietnamese venture capital industry is analysed. In addition to secondary data like news, statistics, databases, official websites, three email interviews are carried out to provide more insights into the situation. In general, the major difficulty is the lack of a mature legal framework and the complexity of paperwork. However, the government is paying great attention to facilitate the startup ecosystem by encouraging the development of the venture

capital industry. Despite still lagging behind Singapore, Indonesia, Malaysia, Thailand, the venture capital industry of Vietnam is auspicious. Further research on which specific policies and laws should be applied in Vietnam should be carried out.

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### **Interviews**

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## APPENDIX 1: Interview questions

- I. Introduction about the interviewee:
  1. Which venture capital fund/ investment fund/ security company are you working for?
  2. What is your position in the company?
  3. How many years have you worked there?
- II. The investment framework:
  1. How many funded companies in the portfolio?
  2. What is usually the selection criteria?
  3. How many years would it be expected since the investment in a firm until the point of exiting from that firm?
  4. What is the aimed annual rate of returns of your fund?
- III. The landscape of venture capital industry in Vietnam
  1. Are there enough venture capital funds to meet the funding demand of Vietnamese startups?
  2. How is the quality of startups in Vietnam: the innovativeness of ideas and the founder's skills and competence?
  3. What is the industries that venture capital funds in Vietnam usually invest in?
  4. What is the biggest venture capital deal you have heard of in recent years?
  5. Can you list some most famous and valuable venture-backed startups in Vietnam?
  6. How do funds usually exit the investment in Vietnam?
  7. What can you advise to a founder on what he/she needs to prepare before approaching venture capital sources?
- IV. The level of development of venture capital industry in Vietnam:
  1. How is the level of development of venture capital industry of Vietnam comparing to that of Singapore, Thailand, Malaysia, Indonesia: more or less developed?
  2. How can the venture capital industry impact on the economy of Vietnam?



3. What is impeding the development of the venture capital industry in Vietnam?
4. Does the government concern about the startups and the venture capital industry?
5. What should the government do more to develop it in your opinion?