PLAYING THE GAME

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BY **JACQUELYN CHEOK**

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VENTURE capital, to some degree, is like a game of poker. A bunch of shrewd players with inscrutable faces – venture capital firms in this case – compete for the best combination of cards – or portfolio of companies – to make the most returns on their investments.

Betting is an intrinsic part of play of course – a result of calculated risks, dynamic judgment and sometimes politicking. Players may even put their money on the same card, and then split the pot later if that card turns out to be a winner.

Essentially, venture capital is risk capital, provided by individuals or private institutional investors to startups or new and growing companies in exchange for limited company ownership.

RISK CAPITAL

"Such external injection of capital allows the companies – usually technology-based – to achieve certain business goals which would increase their valuation and hence provide a return on investment for their shareholders," says Isaac Ho, founder and chief executive of Venturecraft, which has over S$350 million in funds to help companies expand into high-growth markets such as China. It is a complex business, notes Hian Goh of NSI Ventures, which is actively investing from its S$90 million fund that was closed last year.

"A form of tiered risk-taking," is what he calls it, in which the initial seed or angel round carries the most risk as investors are fundamentally betting on an "idea". The next round of financing, known as Series A, helps to "build" the business and is thus the most critical, Mr Goh believes. After that, there is Series B – which helps the business "expand" – and so on.

Venture capital is ultimately about venture, says Chua Kee Lock, president and chief executive officer of Temasek-owned Vertex Ventures, South-east Asia's largest venture capital firm. "It's about investing in companies that are truly innovative, disruptive and that are really making a huge difference," he says.

SPOTTING WINNERS

How do venture capitalists recognise a promising startup when they see one? Lim Kuo-Yi, managing director of Monk's Hill Ventures, which has invested in Singapore-based Ninjavan out of its S$80 million fund, reckons that it is instinct. He explains: "We are guided by our own DNA as operators and entrepreneurs, and look to work with stellar entrepreneurs."

Competent founders, according to the former head of Infocomm Investments, already have a foot in the door. Says Mr Lim: "Adaptive, smart and resilient leaders at the head of startups is a necessary and critical condition for any chance of success."

For Golden Gate Ventures (GGV), a South-east Asia-focused fund with about 34 portfolio companies including Singapore property portal 99.co and mobile marketplace Carousell, it is all about buying into companies that can solve the problems and provide value unique to the countries in the region.

Founding partner Vinnie Lauria says: "There is so much upside potential in South-east Asia, but much of that value still needs to be unlocked by products and services that are almost taken for granted in other developed markets, such as payments, e-commerce and logistics."

When these particular industries flourish, not only will the region see an "explosion in value creation" but the development of larger, more valuable industries on top of these fundamental technologies, Mr Lauria affirms.

CATEGORY LEADERS

Mr Chua of Vertex Ventures is adamant about one thing. If venture capital firms are not investing in category leaders only, they are doing it wrong. "It shows lack of understanding of the venture capital business," he says.

Recently, some funds, including corporate venture funds, have started betting on more than one company in a sector, with the hope that these similar-industry portfolio companies will outperform one another, and only the best will come out on top and score an exit – either a trade sale or an initial public offering (IPO).

"This is a very short-term view. It signals that the investor is not sure of the winner. Venture capital is like gambling. You have to choose a winner. If you choose wrongly, that's too bad," says Mr Chua.

Moreover, there is the matter of resource allocation. Venture capital firms liable of putting all eggs in one basket are bound to cause "unnecessary misunderstanding", he points out.

"Some firms are seen as stealing information from one portfolio company for the other, even though they haven't. They have to allocate resources; there's no such thing as half-half."

It is a form of discipline this way, adds Mr Chua. "If you're not sure, don't choose, don't invest."

Category leaders, at least to Vertex Ventures,

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are companies such as Grab (formerly GrabTaxi; ride-sharing), Reebonz (e-commerce), HappyFresh (e-grocer) and Paktor (mobile dating).

EVOLVING MODEL

Interestingly, and perhaps fittingly too, more venture capital firms are becoming venture builders themselves. Says Venturecraft's Mr Ho: "Venture builders are changing the startup model for venture capitalists – which traditionally operate as investment managers or limited partners – by becoming more operational and hands-on in management than investment-holding companies."

This, according to him, entails going beyond managing the balance sheets to raising capital, managing resources, designing business models, working with regulatory and public policy teams, hiring business development managers and running marketing campaigns at the startup phase.

Even so, the venture capital model has been essentially unchanged – a fact that is especially true in Singapore where the startup ecosystem took off only fairly recently, says GGV's Mr Lauria.

"The Singapore model is unique in so far that it hews closely to the Israeli model. In contrast to Silicon Valley, where the venture capital industry was a product of private, public and educational collaboration and grew organically since the 1960s, Singapore and Israel had to deliberately catalyse the industry's creation through public policy and reforms."

If anything, Mr Lauria adds, venture capital in Singapore has become much more privatised, as more and more privately raised funds have launched and become active.

BACK IN THE DOTCOM DAYS

Mr Chua of Vertex Ventures recalls the fateful dotcom days. "Back then, everyone was chasing after unreasonable valuations. People tended to follow what they thought other people had done well in – copying what they had done and thinking they were different and better. Say you created LinkedIn. The next moment, there would have been 10,000 LinkedIns."

The biggest lesson is that if one pays for something that turns out to not be worth that amount, one will be hurt, says Mr Chua. "Ultimately, it's about disruption and innovation. Since the dotcom bubble, for a period of time, venture capital firms were more disciplined in terms of their valuations."

But of course, everyone has a short memory, he notes, citing a "golden year in investment" just last year when investors, in China and India in particular, "went crazy". The overzealous mood has subsided since, after most venture capital firms in the region started the new year on a more cautious note, says Mr Chua.

Amit Anand, founder and managing partner of Jungle Ventures (of which Indian business veteran Ratan Tata is a special adviser), has another take on things. He says: "The key difference between dotcom days and today is the explosion of smartphone penetration across the region."

At present, the Asia-Pacific boasts over one billion smartphone users, he says. Inexpensive smartphones are creating new opportunities for segments such as e-commerce and payments, as well as new business models in emerging markets where many consumers previously had no access to the Internet.

Says Mr Anand: "This, coupled with favourable demographics, rising incomes and urbanisation, is driving investments in the region."

CHALLENGING TIMES

Despite their differences, venture capital firms agree that there will be challenging times ahead for under-performing startups, though the overall ecosystem will stay robust. "We expect to continue to see a robust pipeline of deals across Asia in 2016. However, the hype surrounding markets like India should cool down and rationalise," says Mr Anand, echoing Vertex Ventures' Mr Chua's views on a bullish India in 2015.

While Mr Lim at Monk's Hill expects to mentor a pipeline of "very good" entrepreneurs in 2016, his firm will remain disciplined in approach. He says: "Startups will find it harder and will take a longer time to raise funds this year, especially for the subsequent rounds post Series A. Going back to basics will be the theme – you will hear words like 'viable and sustainable business models' a lot."

Companies with weak fundamentals that have been "buying growth" – and there are many of them – will either be subject to a fire-sale or shut down, adds Mr Goh of NSI Ventures. "This is healthy for the venture capital ecosystem, because the blood-letting will mean the fight for talent will ease and competition will ameliorate."

Amid the turbulence, Venturecraft's Mr Ho sees opportunities for venture capital firms, especially since "entrepreneurial activities tend to bloom and valuations tend to be suppressed" during economic downturns. He shares: "In such a risk-averse funding environment, bad ideas will get weeded out more quickly while the good ideas that emerge will receive more attention. Valuations might also be revised."

This, he says, is likely to result in more syndicated deals this year as investors compete for a limited pool of good deals, or venture capital firms opt for more recession-proof sectors such as health care and education. ■

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– Lim Kuo-Yi** (right), **managing director of Monk's Hill Ventures