SUSTAINABLE ENTREPRENEURSHIP PROJECT

Finance: A Global Survey of Theory and Research

SUSTAINABLE ENTREPRENEURSHIP PROJECT
RESEARCH PAPER SERIES

Dr. Alan S. Gutterman
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About the Project

The Sustainable Entrepreneurship Project (www.seproject.org) engages in and promotes research, education and training activities relating to entrepreneurial ventures launched with the aspiration to create sustainable enterprises that achieve significant growth in scale and value creation through the development of innovative products or services which form the basis for a successful international business. In furtherance of its mission the Project is involved in the preparation and distribution of Libraries of Resources for Sustainable Entrepreneurs covering Entrepreneurship, Leadership, Management, Organizational Design, Organizational Culture, Strategic Planning, Governance, Corpoorate Social Responsibility, Compliance and Risk Management, Finance, Human Resources, Product Development and Commercialization, Technology Management, Globalization, and Managing Growth and Change.

About the Author

Dr. Alan S. Gutterman is the Founding Director of the Sustainable Entrepreneurship Project and the Founding Director of the Business Counselor Institute (www.businesscounselorinstitute.org), which distributes Dr. Gutterman's widely-recognized portfolio of timely and practical legal and business information for attorneys, other professionals and executives in the form of books, online content, webinars, videos, podcasts, newsletters and training programs. Dr. Gutterman has over three decades of experience as a partner and senior counsel with internationally recognized law firms counseling small and large business enterprises in the areas of general corporate and securities matters, venture capital, mergers and acquisitions, international law and transactions, strategic business alliances, technology transfers and intellectual property, and has also held senior management positions with several technology-based businesses including service as the chief legal officer of a leading international distributor of IT products headquartered in Silicon Valley and as the chief operating officer of an emerging broadband media company. He received his A.B., M.B.A., and J.D. from the University of California at Berkeley, a D.B.A. from Golden Gate University, and a Ph. D. from the University of Cambridge. For more information about Dr. Gutterman, his publications, the Sustainable Entrepreneurship Project or the Business Counselor Institute, please contact him directly at alangutterman@gmail.com.

Finance:
A Library of Resources for Sustainable Entrepreneurs
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The Sustainable Entrepreneurship Project (www.seproject.org) also prepares and distributes other Libraries of Resources for Sustainable Entrepreneurs covering Entrepreneurship, Management, Organizational Design, Organizational Culture, Strategic Planning, Governance, Corporate Social Responsibility, Compliance and Risk Management, Finance, Human Resources, Product Development and Commercialization, Technology Management, Globalization, and Managing Growth and Change.

§1:1 Introduction

Financing is an essential element for establishing a new business, launching a new product or service, or expanding an existing business through internal growth or acquisition. For example, cash is necessary in order for a company to continue operations while awaiting payment from customers and anticipated increases in sales; expand the volume of sales of existing products through increased advertising and promotion; develop or acquire new technical skills and assets, including acquisitions of other firms; enter specified new markets, including new facilities and recruitment of personnel; create new products that address a specified market need, including research and development; replace or upgrade aging or obsolete facilities or equipment; or comply with regulatory requirements, such as health standards or environmental laws.[1]

It is likely that entrepreneurs and managers will, regardless of the size of their businesses, need to venture into the world of finance several times over the life cycle of the enterprise. In that world they will encounter a wide range of participants, including banks, venture capitalists, investment bankers, government agencies, and business advisors, each of which will provide unique resources and experience. In addition, they will be exposed to the legal requirements and institutions of their own domestic "financial systems", which are the processes that have emerged for channeling funds from agents with surpluses of capital to agents with capital deficits, as well as the requirements and institutions of financial systems in other countries where they might be seeking capital and/or otherwise conducting business.

Researchers looking to analyze and compare financial systems have generally paid attention to how agents (i.e., those with funds surpluses and deficits) interact directly with one another through financial markets and to identifying the role of various financial intermediaries such as banks and insurance companies.[2] In the 1950s, for example, the typical situation in the US was that wealthier households offered their surplus funds to larger firms in need of capital through equity and bond markets while less wealthy households entrusted their surplus funds to intermediaries such as banks, insurance companies and other financial institutions that loaned those funds to small and medium-sized firms needing capital. However, by 2000 things had changed substantially and the percentage of direct ownership of corporations by households had dropped to less than 40% from over 90% in 1950. At the same time, non-bank intermediaries such as pension and mutual funds had gradually become significant players in corporate ownership, owning more than 40% by 2000 using funds that had been collected from households. Accordingly, by 2000 the analysis of the financial system in the US, as well as the financial systems of other developed countries that had experienced the same types of

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[1] For further discussion of finance, see "Finance: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

[2] The discussion in this section is based on F. Allen and D. Gale, Comparative Financial Systems: A Survey, http://www.econ.nyu.edu/user/galed/papers/paper01-04-01.pdf, 1-2. The article also appears as F. Allen and D. Gale, "Comparative Financial Systems: A Survey" in A. Boot, S. Bhattacharya and A. Thakor (Eds.), Credit, Intermediation and the Macroeconomy (Oxford: Oxford University Press, 2004), 699-770.

changes, needed to take into account these non-bank financial institutions that not only intermediated between households and markets but also between firms and markets.

Another important player in any financial system is, of course, the government. Governments play a variety of roles in the financial system. For example, governments are both borrowers and savers: borrowers in times when funds are needed to fight wars, overcome recessions or underwrite major investment projects; and savers when state-owned assets, such as natural resources like oil, generate significant amounts of money that the state can set aside and hold on behalf of the citizens of the country. Other important roles for the government in the financial system include setting and conducting monetary policy and regulating banks and other financial intermediaries (e.g., insurance companies). The type and scope of regulation is determined by a variety of influences including still another important institutional factor in the financial system: the political system that determines the structure of the government and its policies.

When considering the financial system in a given country consideration must also be given to the legal system, notably the law surrounding formation and enforcement of contracts, property rights, corporate governance mechanisms and terms and restrictions of securities. In addition, the exchange of capital that occurs in any financial system requires agreement on accounting systems and standards and disclosure rules and norms that facilitate transfer of information by those in need of capital to those willing to provide capital to allow the capital providers to make informed decisions about whether to invest or lend. Finally, the quality and performance of a financial system is influenced by the availability of skilled human capital including lawyers, accountants, commercial bankers, investment bankers and economists.

According to Allen and Gale, researchers involved in comparing and contrasting financial systems have focused primarily on two sets of issues.[3] The first set is concerned with how effective different types of financial systems are at various functions such as investment and saving, growth, risk sharing, information provision and corporate governance. The second set of issues is concerned with identifying and understanding what drives evolution of financial systems and includes analysis of the influence of law and politics on financial systems and the impact of financial crises as accelerators of changes in financial systems. Each of these issues, while important, do not fully explain the interests of researchers in comparative financial systems and work is also being undertaken to study and understand the activities of specific actors, such as banks and other depository financial intermediaries, and the relationship between regulation and structure of the financial markets and the commercial banking sector.[4]

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[3] For surveys of early research on comparative financial systems, see, e.g., F. Allen, "Stock Markets and Resource Allocation" in C. Mayer and X. Vives (Eds.), Capital Markets and Financial Intermediation (Cambridge: Cambridge University Press, 1993); F. Allen, D. Gale, "A Welfare Comparison of Intermediaries and Financial Markets in Germany and the U.S.", European Economic Review, 39 (1995), 179-209; and A. Thakor, "The Design of Financial Systems: An Overview", Journal of Banking and Finance, 20 (1996), 917-948.

[4] See, e.g., A. Thakor, "The Design of Financial Systems: An Overview", Journal of Banking and Finance, 20 (1996), 917-948.

One source of financing for businesses is raising capital through offerings of their securities in the public capital markets. While the public securities markets in the US remain the largest and deepest in the world, there is clearly competition from other markets that are achieving extremely high levels of growth including capital markets in the Eurozone and in emerging markets such as China and India. Globalization of public securities markets has also been facilitated by advances in technology and financial services that have enabled the desire of companies to tap into capital markets in foreign markets that might be offering more attractive terms and/or reduced investment and regulatory costs. In fact, there is clearly robust competition among regulators around the world to attract both prospective investors and companies willing to list their securities on local exchanges. Finally, the competitiveness of securities markets around the world depend a good deal on internal, or domestic, factors such as tax rates on capital gains and dividends; litigation and shareholder activism; and politically driven regulatory requirements such as those imposed on companies listed on US securities exchanges in response to a series of financial miscues and crises beginning in the late 1990s and running through the next decade. A great deal of research has been conducted on comparative aspects of public securities markets, particularly in relation to regulatory practices and corporate governance issues.

Commercial loan financing, particularly lending involving banks and similar financial institutions, is invariably one of the important components of any company's capital structure. In many cases, the first funding that the company receives will come from a commercial bank that is induced to provide a loan on the basis of the company's business and financial plans and the financial guarantees of one or more of the founders and/or their associates. As the company grows, its lending relationships will become increasingly important and the business may find itself using a wide range of lending tools on varying terms and with repayment dates which may range from a few months to several years in the future. The managers of the company need to carefully analyze each of the alternatives and take into account the capital requirements of the business and the philosophy of each of the potential lenders. In many cases, outside investors and business partners can provide recommendations to management about an appropriate type of commercial lending relationship.

There are a number of different commercial lenders offering a wide variety of financing arrangements. For example, full-service banks can provide short-term working capital loans, long-term lending, real estate and mortgage lending, inventory and accounts receivable financing, equipment leasing and other specialized forms of debt financing. Banks, finance companies, and thrift institutions can often provide other financing packages, including bankers' acceptance financing, factoring, and leasing. Some lenders can be a valuable source of information regarding financial and credit matters in general and provide companies with advice regarding cash management and establishing internal procedures for handling cash and making short-term investment decisions. Banks and other financial institutions also prepare and disseminate reports on general economic and business conditions. When a business receives debt financing from banks and other lenders, or loans from governmental lending agencies, the arrangement will be subject to a variety of commercial laws relating to the form and content of the terms of the loan and the company's promise to repay and the rights of the lender with respect to specified assets of the borrower and its principals in the event that the borrower defaults in its obligations under the loan. Specific areas of law that might come into play include laws governing negotiable instruments, secured transactions, guarantees, and bankruptcies.

Research has established that there is a crucial and significant link between development of financial systems and overall economic development of countries and there is no doubt that banking systems play a crucial role in the financial system of all countries even if the influence differs in countries due to historical reasons and/or the stage of economic development. Banks and their regulators serve a variety of roles including sources of credit and administrators of the payments system and central banks are generally oversee formulation and execution of monetary policies. Kagwe noted that a banking system in any country can perform a number of important functions, including acceptance of deposits from individuals, businesses, and other institutions for safekeeping; investing the deposits by making loans in return for interest, with the risk of default being borne by the banks; compensating depositors through interest payments on deposits; facilitating the system of payments and transfers of funds for goods and services transferred between different economic units in the economy; and regulation and supervision of the banking system.[5] The banking system has been a central factor in research regarding the impact of financial sector development on economic growth and researchers have, for example, found evidence of a positive relationship between the total credit extended to the private sector by banks and economic growth and a positive association between financial intermediation and economic growth.[6]

A working prepared by Barth et al. in the early 2000s provided a model that could be used as a comprehensive and practical method for comparison of the characteristics of banking systems across a wide range of countries.[7] They focused their efforts on several fundamental aspects of international banking including the structure of banking, with emphasis on the connection between the development of the banking system and economic growth; banking industry performance; and banking regulation, supervision, and corporate governance. Embedded within these general topics are a number of specific issues of interest from a comparative perspective such as the relative size of banking industries in various countries; the degree of government and foreign ownership in banking; the degree of market power in banking systems; the range of activities in

[5] J. Kagwe, "African Banking Systems" in J. Waiguchu, E. Tiagha and M. Mwaura, Management of Organizations in Africa (Westport, CT: Quorum Books, 1999), 331-346, 331.
[6] J. Barth, G. Caprio and D. Nolle, Comparative International Characteristics of Banking (Washington, DC: Office of the Comptroller of the Currency, Economic and Policy Analysis Working Paper 2004-1, January 2004), 5 (citing R. King and R. Levine, "Finance and Growth: Schumpeter Might Be Right", Quarterly Journal of Economics, 108(3) (1993), 717-737; R. Levine, N. Loayza and T. Beck, "Financial Intermediation and Growth: Causality and Causes", Journal of Monetary Economics, 46(1) (2000), 31-77).
[7] J. Barth, G. Caprio and D. Nolle, Comparative International Characteristics of Banking (Washington, DC: Office of the Comptroller of the Currency, Economic and Policy Analysis Working Paper 2004-1, January 2004).

which banks are permitted to engage; the structure, scope and independence of the supervisory system; the implementation of supervision; and deposit insurance schemes.[8]

Finally, many companies seek funding for their activities from "private investors" in transactions done outside of the formalities of public securities markets. In the US and other developed countries these transactions are often referred to as "private placements" and include offers and sales of equity and debt securities to various investors, including wealthy individuals and angel investors, venture capitalists and institutional investors (e.g., pension funds, insurance companies, etc.). Each of these investors have their own specific requirements for making funding decisions and a great deal of attention has been paid to "venture capital", which can be distinguished from many other investment capital sources by the emphasis on selecting start-up and emerging companies and working with managers to build the business to the point where the venture capitalists can realize extraordinary returns on investment through a public offering or the sale of the company to a larger firm. Put another way, venture capitalists provide a commitment beyond mere money to the development of the firm.[9]

§1:2 Japan

Since the end of World War II, Japan's macroeconomic policies, as well as the organization and regulation of Japan's financial and credit institutions at the microeconomic level, have been dedicated to achieving growth in specific target industries.[10] The underlying theory of these policies was that growth could be accomplished by ensuring that firms had access to reliable sources of funds at interest rate costs below those being borne by their international competitors. To achieve these objectives, the government took an active role in not only the regulation but also the operation of the nation's banking institutions. Moreover, an effort has been made to develop the nation's capital markets and to provide other outlets for the funds accumulated through the propensity of the citizenry and its businesses to save and invest.

The pattern of financing for Japanese firms has been such that equity has been a relatively unpopular and unattractive means of financing and investment. Japanese firms have tended to focus on such long-term objectives as market share and reliable cash flow for new investment rather than on the value of share prices. Thus, the ability of firms to deliver attractive returns to their investors has been of relatively minor concern until recent years. Nonetheless, formal equity markets have been in place in Japan for a number of years. Domestic stock offerings are regulated by Ministry of Finance ("MOF"); however, listing requirements and market regulation remain immature in

[8] Id. at 3. The authors also recommended the following as a useful source regarding international comparative banking studies: K. Brown and M. Skully, "International Studies in Comparative Banking: A Survey of Recent Developments," SSRN Working Paper No. 365920, January 2003.

[9] For extensive discussion of venture capital financing in the US, see "Finance: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

[10] Portions of the discussion of securities regulation in Japan in this section are adapted from A. Gutterman and R. Brown, Going Global: A Guide to Building an International Business (2012 Edition) (Eagan: MN: West, 2012) §§ 37:21-37:29.

relation to the US and other Western capital markets. On balance, Japan's capital market strategies through the 1980s were extremely successful in facilitating the economic growth of the nation and its firms and the 1990s started with a tremendous upswing in the Japanese stock markets; however, when monetary policy was tightened, a collapse followed—one that has lingered for nearly twenty years.

In 2008, the name of the Securities and Exchange Law, which had regulated stocks and securities in Japan, was amended to the Financial Instruments and Exchange Law ("FIEL"). In addition, the following four laws were abolished and consolidated into the Financial Instruments and Exchange Law: Financial Futures Trading Law; Law Concerning Foreign Securities Firms; Law Concerning the Regulation of Investment Advisory Services Relating to Securities; and Law Concerning the Regulation of Mortgage Business. The scope of "securities" was expanded under the FIEL. For example, all interests in trusts are deemed securities, and interests in collective investment schemes are treated as securities. The prior Securities and Exchange Law, in contrast, only listed government bonds, local government bonds, corporate bonds, stocks, investment trusts, and the like, as "securities." Some financial instruments, such as bank deposits and insurance, continue to be regulated under the Banking Law and the Insurance Business Law, respectively, and thus are not subject to direct regulation under the provisions of the FIEL.

The FIEL requires registration for "sales and solicitation" operations of securities and derivative transactions, as well as "investment advisory," "investment management" and "customer asset administration" services for cross-sectional regulation. Under FIEL, financial instrument firms must comply with specified rules of conduct in carrying out sale1s or solicitations of securities or derivative transactions firms engaged in the conduct of securities business are required to deliver documents to customer, other than customers classified as "professional investors", before making a contract. Other provisions in the FIEL establish certified investor protection organizations; mandate "quarterly reporting" for listed companies, who are subject to audits by certified public accountants or auditing firms and subject to criminal or civil penalties for submitting false quarterly reports; mandate "internal control reports" to ensure appropriate disclosure of financial and corporate information; and require submissions of "certifications" by management of listed companies stating that the descriptions in their financial statements are appropriate and in compliance with laws and regulations. Finally, the FIEL includes serious sanctions against violations of disclosures requirements, unfair trading and market manipulation and insider trading.

§1:3 United Kingdom

Many aspects of securities regulation in the UK are overseen by the Financial Services Authority ("FSA"), an independent non-governmental body given statutory powers by the Financial Services and Markets Act 2000 ("FMSA").[11] The FMSA sets out four statutory objectives for the FSA: market confidence—maintaining confidence in the UK

[11] Portions of the discussion of the Financial Services Authority in this section are adapted from material found at http://www.fsa.gov.uk/.

financial system; financial stability—contributing to the protection and enhancement of stability of the UK financial system; consumer protection—securing the appropriate degree of protection for consumers; and, finally, the reduction of financial crime, which means the extent to which it is possible for a regulated business to be used for a purpose connected with financial crime. The FSA also attempts to provide political and public accountability; effectively perform its activities with regard to rulemaking, giving advice and guidance and determining our general policy and principles and assist in providing legal accountability.

In discharging its functions under the FMSA the FSA is required to follow what it refers to as "principles of good regulations", which include the following:

- Efficiency and economy: The need to use FSA resources in the most efficient and economical ways.
- Responsibilities and roles of management: This principle is designed to secure an adequate but proportionate level of regulatory intervention by holding senior management responsible for risk management and controls within firms.
- Proportionality: The burdens or restrictions imposed on the industry should be proportionate to the benefits that are expected to result from those burdens or restrictions.
- Innovation: The desirability of facilitating innovation in connection with regulated activities.
- International character: The international character of financial services and markets and the desirability of maintaining the competitive position of the UK.
- Competition: The need to minimize the adverse effects on competition that may arise from FSA activities and the desirability of facilitating competition between the firms regulated by the FCA.
- Public awareness: The desirability of enhancing the understanding and knowledge of members of the public of financial matters (including the UK financial system).

The FSA has powers over unregulated firms and persons regarding market abuse, breaches of money laundering regulations and short selling and also performs significant functions under non-FSMA legislation such as acting as consumer enforcer under the Enterprise Act 2002, acting as an accredited financial investigator for confiscations investigations and restraining order under the Proceeds of Crime Act 2002, acting as a monitor of credit and financial institutions relating to compliance with the Money Laundering Regulations 2007 and acting as the body responsible for registering and authorizing payment and e-money institutions.

§1:4 Germany

Securities markets in Germany are separated by law into two different markets that differ in terms of their approach to regulation of trading, listing and ongoing obligations.[12] The

[12] Portions of the discussion of the discussion of securities regulation in Germany in this section are adapted from M. Kurth and O. Rothley, "Securities Law in Germany" in International Securities Law Handbook (3rd Edition) (The Netherlands: Kluwer Law International, 2010).

first market is the "Regulated Market", which is the most regulated market in terms of listing requirements and ongoing obligations, and the second market is the "Regulated Unofficial Market". The segmentation into two markets applies to all of the stock exchanges in Germany, which include multiple stock exchanges based in various financial centers (the Frankfurt Stock Exchange is the main stock exchange in Germany), the electronic stock exchange "Eurex" for futures transactions, a commodities exchange in Hannover and energy exchanges in Frankfurt and Leipzig. Each stock exchange is regulated and supervised by an exchange supervisory authority in the federal state where the stock exchange is located and such authorities carry out their supervisorial obligations in accordance with the provisions of the federal Stock Exchange Act, which calls for authorities to regulate and oversee the internal organization of stock exchanges, the admission of banks and other financial institutions, the listing of securities and the proper conduct of trading and settlement of securities transactions.

National oversight of all German securities markets and providers of financial and securities trading services is provided by the Federal Financial Supervisory Authority ("BaFin"). BaFin itself is not a listing authority; however, it has the regulatory power to approve the prospectuses that are required in order for listings to occur and also supervises trading activities on the various stock exchanges. In addition, BaFin has responsibility for ensuring that German securities markets, and the participants in those markets, abide by applicable legal provisions relating to matters such as prohibitions on insider trading, prospectus requirements, disclosure of financial and price sensitive information and public takeover law. Befitting its role with respect to regulation and oversight, BaFin has been vested with authority to conduct investigations, require disclosure of documents and/or information, prescribe appropriate remedies in case of non-compliance and impose administrative fines in certain cases of non-compliance. In cases where misconduct raises issues of criminal sanctions BaFin is permitted to forward such cases to the appropriate prosecutorial authorities.

The operation of securities markets in Germany is subject to a wide range of laws and regulations including the following:

- The Stock Exchange Act sets out basic principles regarding the organizational of stock exchanges and other securities markets and the trading and list of securities.
- The Stock Exchange Admission Regulation sets out listing requirements, listing procedures and disclosure obligations for securities for which an application for admission to the Regulated Market has been filed or will be filed.
- The Rules of Exchange regulate the internal organization of the respective stock exchange including details regarding listing procedures, conduct of trades and publication of all information regarding prices and volumes. The Rules for Regulated Unofficial Markets serve the same purpose with respect to Regulated Unofficial Markets.
- The Investment Act regulates the distribution and sale of interests, participations and shares in domestic and foreign investment funds.

- The German Banking Act includes the statutory framework for the German banking and financial services systems and focuses on protection of creditors and bank depositors.
- The Securities Trading Act focuses on the regulation of trading with securities, financial instruments, futures, derivatives and similar financial products. The Act addresses a number of important areas such as disclosure of changes of interests in stock of listed corporations, preparation and distribution of annual and quarterly financial reports, proxy and voting procedures and insider trading.

Other statutes and regulations address prospectus requirements and procedural rules and publication requirements apply to acquisitions and public takeover offers.

§1:5 France

Securities regulation in France falls to the Autorite des Marches Financiers ("AMF"), which was established in 2003 under France's Financial Security Act of 1 August 2003.[13] The AMF is intended to be an independent public authority that is responsible for regulating and policing French financial markets in order to protect savings and investment. The AMF has statutory responsibility for safeguarding investment in financial products, ensuring that investors receive material information and maintaining orderly markets. While its primary responsibilities relate to securities regulation, the AMF also cooperates with other French authorities that have responsibility for overseeing banking, investment firms and credit institutions and insurance products. AMF responsibility extends to four general areas: regulation; approval of market participants and products ("authorizations") and corporate financing ("bid acceptability and filing reviews"); supervision and monitoring of markets and market participants; and punishment of regulatory infringements. The jurisdictional scope of the AMF extends to financial disclosures and corporate financing; financial markets and their infrastructures; investment services providers, financial investment advisors and direct sellers; and collective investment schemes. The AMF has been given inspection and investigative powers including the authority to conduct on-site and off-site audits of licensed investment services firms, financial instrument markets, the securities settlement system, clearing houses and financial investment advisers and direct sellers. The AMF has authority to launch investigations pertaining to possible market abuses such as insider trading, price manipulation and release of false information.

Corporate financing is an important area of responsibility for the AMF and all listed firms are required to inform the public regularly regarding their business activities and results and about major transactions such as capital increases and rights issues, tender and exchange offers and takeovers and mergers. The AMF oversees the preparation and disclosure of financial and other business information regarding listed firms to ensure that such information is accurate, true, fair and timely and properly disseminated throughout the entire financial community. The AMF is responsible for reviewing documents to be issued by listed companies, such as simplified and full prospectuses and offer documents.

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[13] Portions of the discussion of the Autorite des Marches Financiers in this section are adapted from material found at www.amf-france.org.

In many cases completion of the AMF review is a condition for distribution of such documents since the AMF must issue an official "visa" in order for the documents to be distributed; however, in some cases firms are only required to file the documents with the AMF and they may be examined after distribution. Other AMF activities relating to disclosures include enforcement of rules mandating disclosure of price-sensitive information through news releases to the general public at the earliest possible time and ensuring the companies prepare, file and publish annual financial statements, semi-annual results and quarterly revenue data.

§1:6 European Union

In the European Union ("EU") the Single European Act placed the free movement of capital on the same footing as that of goods and services and led to the adoption of Council Directive 88/361/EEC designed to give the single market its full financial dimension.[14] Based on the Directive, the European Commission has sought to abolish restrictions on movements of capital between persons in Member States. The EU also implemented the Market in Financial Instruments Directive (2004/39/EC) in November 2007 to strengthen the EU legislative framework for investment services and regulated markets and to protect investors and safeguard market integrity by establishing harmonized requirements governing the activities of authorized intermediaries and promoting fair, transparent, efficient and integrated financial markets. Specifically, Member States were required to set up an authorization system enabling investment firms to operate throughout the EU. These firms must be registered and the register must be accessible to the public. Each authorization must be notified to the European Securities and Markets Authority ("ESMA"), which was tasked with developing regulatory technical standards and assisting the Commission in its relations with third countries and in assessing their markets. The Directive was also intended to align national rules governing the provision of investment services and the operation of stock exchanges, with the ultimate aim of creating a single European "securities rule book" that would presumably benefit investors, issuers and other market stakeholders by promoting efficient and competitive markets.

One of the interesting elements of the Directive was the attempt to harmonize various rules applicable to proposed acquisitions of insurance companies including promulgation of assessment rules of procedure and a list of assessment criteria. The Directive states, in particular, that the competent authorities should judge the appropriateness of the proposed acquirer and the financial soundness of the envisaged acquisition on the basis of several factors including the reputation and experience of those who direct the business of the insurance company following the envisaged acquisition; the financial soundness of the proposed acquirer; and the existence of reasonable grounds to suspect an operation or attempt to launder money or finance terrorism.

[14] Portions of the discussion of securities regulation in the European Union in this section are adapted from A. Gutterman and R. Brown, Going Global: A Guide to Building an International Business (2012 Edition) (Eagan: MN: West, 2012) §34:24.

With respect to enhancement of investor protection, it was intended that the contribution of the Directive would be in setting business of conduct rules for providing investment services to clients and minimum standards for the mandate and powers that national competent authorities must have at their disposal. The Directive established mechanisms for real-time cooperation in investigating and prosecuting breaches of the rules. In addition, the Directive created obligations with respect to safeguarding market integrity, reporting transactions and maintaining records. Each Member State is responsible for establishing a list of regulated markets and communicating this to the other Member States and ESMA. Finally, the Directive attempts to establish a "fair market" for retail investors by preventing financial institutions from discriminating between such investors (e.g., by offering some of them improvements to publicly quoted prices).

The role of the ESMA was mentioned above and it should be noted that the ESMA was one of several organizations created to reform European System of Financial Supervision—others included the European Systemic Risk Board, the European Banking Authority and the European Insurance and Occupational Pensions Authority. The ESMA has been charged with safeguarding the stability and effectiveness of the financial system and acts mainly in the field of activities of firms offering investment services, corporate governance, auditing and financial reporting. In addition, the scope of ESMA action covers the Directive on settlement finality in payment and securities settlement systems; the Directive on financial collateral arrangements; the Directive on the prospectus to be published when securities are offered to the public; the Directive on the transparency of information about issuers of securities; and the Directive on Alternative Investment Fund Managers. Specific activities of the ESMA in furtherance of its objectives include developing draft regulatory and implementing technical standards, issuing guidelines and recommendations and providing a centrally accessible database of financial institutions in the area of its competence.

Boskovic et al. prepared a sophisticated and detailed comparison of EU and US securities regulations in light of the implementation of the Directive.[15] They noted that due to largely unforeseen and painful impact of the international financial crisis that began in the mid-2000s, regulators in both the US and the EU had taken steps to improve supervision of large and interconnected institutions, increase market transparency and enhance capital and liquidity requirements. They also noted that US and EU regulators had comparable objectives with regard to the outcomes they were looking for from the regulatory systems including maintaining fair and orderly markets, protecting investors and providing price transparency. All that said, however, there were differences between securities markets, and the regulation of those markets, in the US and the EU including the following[16]:

- EU regulators have more discretion in authorizing investment firms and intervening in their management since they can judge whether the managers of those firms are

[15] T. Boskovic, C. Cerruti and M. Noel, Comparing European and U.S. Securities Regulations: MiFID versus Corresponding U.S. Regulations (Washington DC: The World Bank, 2009).
[16] Id. at vii.

sufficient experienced and reputable, while US regulators can only control their reputation and competencies.

- Organizational requirements are broader in scope for exchanges in the US and focus on disciplinary power, which is explained by the self-regulatory role of exchanges in the US versus a more limited role in the EU.
- Capital requirements are risk-based in the EU while in the US they are based on the concept of maintaining a highly liquid core of capital.
- Investment firms in the EU are under a broad and general obligation to mitigate conflicts of interest while analogous rules in the US are focused on more specific situations.
- Investor protection rules in the EU are two-tiered: retail and professional investors; however, US regulators protect all investors with some special carve outs for institutional investors.
- The concept of "best execution" in the US covers a number of factors, with price being the most important, while in the EU price is one of just several factors considered when determining if the client has obtained the best result for the execution of its trade.
- In the US quotes and transaction data reported by national exchanges and associations is consolidated into a single system and disseminated to market participants while in the EU quotes and trade data is fragmented and no consolidation is required.

Boskovic et al. summarized their findings and arguments by observing that "[t]he U.S. framework is characterized by a powerful supervisor and important powers assigned to self-regulatory organizations . . . [while] [i]n the EU legislation is more recent and unified and characterized by the absence of a supra national supervisor; self-regulatory organizations have more limited powers".[17]

§1:7 Emerging markets

While much of the global securities market activities take place in the US and the European markets described above, securities regulation is becoming increasingly important in emerging markets. Lavelle argued that "certain characteristics of equity shares, as well as certain holding patterns of blocs of shares, leave anonymous shareholders bereft of any significant influence over the management of most large firms in emerging markets . . . [t]he price mechanism fails to operate for historical reasons associated with state strategies of engagement and disengagement from economic management . . . [and as] a result of these strategies, past and present, the state remains a stakeholder, and it retains control over several key functions and operations of some firms, even in cases where it has divested shares".[18]

Lavelle explained that there were two levels of often conflicting issues and objectives at work as efforts were being made to create and develop equity markets in developing countries and that states issuing shares on such markets were not strictly interested in

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[17] Id. at 1.
[18] K. Lavelle, The Politics of Equity Finance in Emerging Markets (2004), 16.

seeking revenues from the sale of such shares but also sought to retain a degree of control over the operations of economic enterprises in their territories and to preserve employment.[19] The first level of issues and objectives, referred to by Lavelle as "Level I", was based on the requirements of international financial institutions, such as the World Bank and the IMF, that privatization programs should be implemented in order for emerging markets to receive loans needed for development activities. Lavelle explained that international lending agencies believed that the "[d]ivestment of government shares leads to more efficient enterprises and deeper financial market institutions" and that "equity issues are mechanisms for the state to raise capital, enhance managerial efficiency in (former) parastatals, . . . reduce debt exposure . . . [and create equity markets that] . . . contribute to the state's future economic growth by making additional forms of capital available".[20] The second level of issues and objectives, which were referred to by Lavelle as "Level II", incorporated the "domestic political necessities of privatization" and the need of economic policymakers in emerging markets to "gain the endorsement of key political constituencies to sell off state shares" and the need for offerings to be structured in ways that "keep control of the firm's management within the territorial confines of the state or reserve a role for labor or local participation in management to the greatest extent possible".[21]

Obviously the pursuit of the Level II goals by domestic policymakers is at odds with the Level I vision of the international financial institutions seeking separation of the state from economic management at the firm level as well as the listing requirements of international exchanges based in developed countries that discourage issuance on non-voting shares and impose corporate governance and disclosure requirements that are unfamiliar to the leadership of emerging market enterprises. The result of this conflict was often offerings of shares by states that were strongly guided by domestic political circumstances and included shares divided into classes reserved for citizens of the state and foreign nationals, shares divided into voting and non-voting classes, sales of all of the shares to a local family group (or another domestic business group that is largely immune from markets for managerial control) or retention by the state of a sufficient number of shares to exercise ultimate control over management activities (i.e., a so-called "golden share").[22] Further complicating Level I progress in the eyes of international financial institutions was the failure of emerging markets to move quickly to establish mechanisms for recognizing and protecting rights of minority shareholders.

An article describing research conducted by Weber et al. on the 58 countries that created new stock exchanges between 1980 and 2005 provided valuable insight into the factors that motivated countries to establish exchanges and the conditions that contributed to whether or not those exchanges were successful—based on objective measures such as the number of companies trading on the exchange and the trading volume—once they

[19] Id. at 18.
[20] Id. at 191.
[21] Id. at 18.
[22] Id. at 22, 191.

had been established.[23] Not surprisingly the researchers found that a variety of factors led countries to establish stock exchanges including pressure from global financial institutions such as the World Bank and the IMF and the perceived need to follow the lead of neighboring countries that may have previously set up an exchange and thus were looked upon as competitors for capital that might be available from investors located all over the world. Interestingly, it appeared that countries were more successful in their efforts to establish an exchange when they did so to meet competition from neighboring countries than when they acted primarily to diffuse international pressure.

The researchers explained that when developing countries were pushed by the World Bank and the IMF to establish stock exchanges as part of a host of economic reforms mandated as a condition for inclusion in the aid programs of those institutions the results were often little more than "symbolic" efforts that rarely were successful over the long term. In those cases the exchange launch process was largely a "well-defined project" involving an initial evaluation by institutional experts to be sure that all the formalities had been completed. However, once all the boxes on the launch list had been checked there was little or no ongoing follow up and continuous exchange of resources and expertise. When, on the other hand, countries established their stock exchanges based primarily on what Weber et al. referred to as "peer influence" the exchanges tended to be more enduring since countries became involved in an ongoing learning process that allowed them to tap into the experiences of their neighbors to fix mistakes and strengthen the foundation for development of their exchanges. The results of their study led Weber et al. to recommend that the World Bank and the IMF replace their one-on-one initiatives with developing countries to establish stock exchanges with support for regional infrastructures that would facilitate and encourage communications and exchanges of ideas among countries that already have something in common and close ties.[24]

§1:8 --Brazil

Brazil has one of the most developed and sophisticated financial sectors in Latin America.[25] The country's banking system and capital markets are well differentiated, internationally competitive and aligned with international standards. There is also a functioning system of banking supervision. Capital markets are open to domestic and foreign capital. The financial sector is sophisticated and systemic risk is low. Access to banking services for the poor has increased, and loan availability for private households has been substantially extended in recent years, but credit is still very expensive, especially for individuals and small enterprises. The ratio of bank lending to GDP remains low (approximately 25% of GDP) compared to other countries. A significant portion of the country's financial activities are dedicated to financing the public sector

[23] The discussion in this section of the research of K. Weber, G. Davis and M. Lounsbury, referred to in the text as Weber et al., is based on an article titled "Developing Stock Exchanges in Developing Countries" available at
http://insight.kellogg.northwestern.edu/article/developing_stock_exchanges_in_developing_countries/

[24] For further discussion of the creation and development of stock exchanges in developing countries, see the chapter on "Financial Systems in Developing Countries" in this Library.

[25] The discussion in this paragraph is adapted from Bertelsmann Stiftung, BTI 2012—Brazil Country Report 13 (2012).

through bonds. While Brazil has a dynamic and growing financial sector, the challenge is to develop still greater competitiveness and efficiency and more effective risk management practices, while maintaining stability.

The legal basis for the regulation of Brazil's financial and banking sectors is set out in the Federal Constitution, which include rules for financial institutions, and in various laws that regulate capital markets and their development, provide for the establishment of securities markets and regulate foreign investment in Brazil and remittances of funds abroad. In addition to these laws, Brazilian monetary authorities issue normative rules in the form of Resolutions of the National Monetary Council, and Central Bank Circulars and Circular Letters. The national financial system is comprised of: National Monetary Council (Conselho Monetário Nacional or "CMN"); Central Bank of Brazil (Banco Central do Brasil or "BACEN"); Banco do Brasil S.A.; National Bank for Economic and Social Development (Banco Nacional de Desenvolvimento Econômico e Social or "BNDES"); and other private and public financial institutions. The CMN is the highest monetary authority and is responsible for establishing monetary and credit policies, including matters relating to foreign exchange, and regulation of the overall operations of financial institutions. BACEN, in turn, is responsible for complying and enforcing compliance with the normative rules issued by the CMN, and for implementing all provisions set by law including exercising credit control in all its forms; controlling foreign capital; effecting rediscounts and loan transactions to financial and banking institutions; acting as depository for the government's gold and foreign currency reserves and special drawing rights; supervising all financial institutions; imposing penalties prescribed by law; issuing operating licenses to financial institutions; and setting standards for the instatement into office and holding of management positions in private financial institutions.

The key law dealing with securities markets in Brazil is the Securities Law.[26] In addition, the Corporations Law[27] contains important provisions for regulating the securities market in Brazil. The Securities Law regulates the overall operation of the securities market in Brazil, including public distribution of securities, the listing of securities for trading in stock exchange and/or over-the-counter market (OTC), disclosure requirements, financial intermediation, brokerage, clearing, types of securities admitted for trading, and types of companies whose securities can be traded in the Brazilian securities market. The Securities Law has also created the Brazilian Securities Commission ("CVM"), granting it regulatory and police powers over the Brazilian securities market. Specifically, CVM is in charge of regulating the Securities Law and Corporations Act in accordance with the policy defined by the CMN and for inspecting, on a permanent basis, the disclosure of market-related information, their participants and values traded in the market. The CVM is also in charge of regulating and inspecting the issuance and distribution of securities in the securities market, negotiations and intermediations in the securities and derivatives markets, organization and operation of and transactions carried out by stock and commodity futures exchanges, management of portfolios and custody of securities, audit of publicly-held companies and services of securities advisors and analysts.

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[26] Securities Law, Law n. 6,385 of December 7, 1976, as amended.
[27] Corporations Law, Law n. 6,404 of December 15, 1976, as amended.

The Securities Law is supplemented by resolutions, circular letters, rulings, opinions, deliberations and other rules issued by the CMN, BACEN, CVM, stock exchanges and organized OTC market entities. According to the Securities Law, the CMN is in charge of defining the policy on the organization and operation of the securities market, regulating the use of credit in the securities market, setting general rules to be followed by CVM in exercising its functions, defining the activities CVM has to carry out jointly with the Central Bank, approving CVM's personnel and regulation applicable to CVM's personnel, and establishing the remuneration to be paid CVM´s employees, including its president, officers and key personnel. CVM is an independent government body linked to the Ministry of Finance. Self-regulatory entities, typically stock exchanges and organized OTC entities, are subject to CVM's oversight and are in charge of organizing, maintaining, registering and overseeing operations involving securities; inspecting their members and ensuring compliance with applicable rules and regulations. There are also purely self-regulatory entities, such as the Brazilian Financial and Capital Markets Association (Associação Brasileira das Entidades dos Mercados Financeiro e de Capitais, ANBIMA), which is a private regulatory agent that represents numerous institutions, including commercial, multiple and investment banks, asset managers, brokerage firms, securities underwriters and investment advisors, and which has approved a self-regulatory code that sets out certain disclosure standards to be followed by its members while coordinating public offerings of securities in the Brazilian market and which establishes operational standards similar to those established in more mature countries in terms of capital markets organization.

The major stock exchange in Brazil is Bolsa de Valores, Mercadorias & Futuros de São Paulo ("BM&FBOVESPA"), which is headquartered in São Paulo and formed through a 2008 merger of the São Paulo Stock Exchange ("Bovespa") and the Brazilian Mercantile and Futures Exchange ("BM&F").[28] As of December 31, 2011 it had a market capitalization of US$1.22 trillion, making it the eighth largest stock exchange in the world as of that date. Until the mid-1960s, Bovespa, BM&F and the other Brazilian stock markets were state-owned companies, tied with the Secretary of Finances of the states they belonged to, with brokers appointed by the government. After the reforms of the national financial system and the stock market implemented in 1965-1966, Brazilian stock markets assumed a more institutional role. Operating largely through self-regulation, Bovespa and BM&F operated under the supervision of the CVM. In 2007, the exchanges demutualized and became for-profit companies.

Since the 1960s, Brazilian stock exchanges have constantly evolved with the help of technology such as the introduction of computer-based systems, mobile phones and the Internet. In 1972, Bovespa was the first Brazilian stock market to implement an automated system for the dissemination of information online and in real-time, through an ample network of computer terminals. At the end of the 1970s, Bovespa also introduced a telephone trading system in Brazil – the Sistema Privado de Operações por Telefone, SPOT (Private System of Telephone Trading). At the same time, Bovespa

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[28] The discussion of BM&FBOVESPA in this section is adapted from https://en.wikipedia.org/wiki/BM%26F_Bovespa.

developed a system of fungible safekeeping and online services for brokerage firms. Beginning in 1990, Sistema de Negociação Electrônica, CATS (Computer Assisted Trading System) began operation, running simultaneously with the traditional system of Pregão Viva Voz (open outcry). In 1997, a new system of electronic trading, known as the Mega Bolsa, was implemented. The Mega Bolsa extended the potential volume of processing of information and allowed the exchanges to increase their overall volume of activities. Currently, BM&FBOVESPA is a fully electronic exchange.

In 2000, Bovespa created three new listing segments—the Novo Mercado ("New Market"), Level 1 and Level 2 of Corporate Governance Standards--thereby allowing companies to accede voluntarily to more demanding disclosure, governance and compliance obligations. The new listing segments mostly languished until 2004, when a growing number of newly public companies began to list on the Novo Mercado and other segments as part of a capital-raising effort. From 2004 to 2010, the vast majority of new listings on the Bovespa were made by Novo Mercado, Level 1 and Level 2 companies. The Novo Mercado, Level 1 and Level 2 segments are based on a contractual agreement of the listed company, its controlling shareholder and its management to comply with specified regulations. In addition, listed companies must submit to arbitration as a method of resolving disputes. The set of protections entailed by a Novo Mercado listing is apparently deemed by market participants to increase the attractiveness of companies. The stock market index of Novo Mercado listed companies has consistently outperformed the broader BM&FBOVESPA index since its launch.

The recent success of the Brazilian equity capital markets is attributed to a significant extent to the credibility engendered by the Novo Mercado regulations. In 2007, only the equity markets in the US and China had a greater number of initial public offerings. The availability of a market exit has also encouraged the development of a private equity industry, a growing Brazilian investment banking market and a thriving asset management industry. Another side benefit of a thriving equity market has been access to equity financing for the international expansion of Brazilian business. Brazilian multinational companies have used the proceeds of equity offerings to fund a growing number of international acquisitions. Vale, Embraer, Gerdau, Brazil Foods, Marfrig Alimentos and JBS have acquired businesses outside Brazil using the proceeds from equity offerings. Attractive valuations of Brazilian subsidiaries have led international companies to list their Brazilian subsidiaries, as was the case of Banco Santander Brasil.

A comparative survey conducted among North American and Brazilian CFOs by Benetti et al. revealed significant differences in their techniques and concerns.[29] For example, the researchers found that North American CFOs were more likely to use the traditional internal rate of return (IRR) and the net present value (NPV) criteria when making valuations, while Brazilian CFOs favored accounting-based criteria such as the accounting rate of return and the profitability index, as well as the discounted payback

[29] C. Benetti, R. Decourt and P. Soares Terra, The Practice of Corporate Finance in an Emerging Market: Preliminary Evidence from the Brazilian Survey, http://www.fep.up.pt/investigacao/cempre/actividades/sem_fin/sem_fin_01_05/PAPERS_PDF/paper_sem_fin_19abr07.pdf.

period. Benetti et al. suggested that this finding might be an indication that in less developed capital markets, where there is less liquidity and less active secondary markets, accounting becomes a more important source of information for valuation decisions. Brazilian CFOs also made relatively more frequent use of less common techniques as the value at risk (VaR) and the adjusted present value (APV) than their North American colleagues, which Benetti et al. noted might be interpreted as a consequence of a more instable economic environment. Benetti et al. conclude that the identified differences in the responses of North American and Brazilian CFOs could be traced to institutional characteristics of the financial environment in which their firms operate including differences in capital restrictions, liquidity and concentration of capital markets, corporate governance regulations, competitiveness of financial markets and restrictiveness of fiscal and monetary policies.

Institutionalized rules for maintenance of financial records (i.e., financial accounting standards) have not been widely accepted in Brazil and Eunni has reported that record keeping in Brazil is not in accordance with internationally accepted accounting standards. The problem is particularly acute among small businesses who generally do not both to maintain accurate financial records or understand and comply with professional and commercial conventions regarding accounting practices. While industry and trade associates do exist in Brazil, they are typically more concerned about lobbying for tax and other concessions as opposed to playing a significant role in establish professional standards in the financial area and pushing enterprises to comply. In addition, the fact that a large percentage of the economy is dominated by informal businesses tends to discourage entrepreneurs who are complying with the law from adopting professional standards with respect to their financial records since the process involves additional expense and brings them no perceived additional benefits in the marketplace.[30] According to Eunni, the byproduct of all of this is a decided tilt toward businesses that remain small and informal in order to take advantage of "institutional infirmities".[31]

§1:9 --China

Several well-known countries still considered by many to be developing or "emerging" have nonetheless achieved a size that makes its reasonable for them to be admitting to organizations such as the G-20. China is an interesting special case within the G-20 given that it is simultaneously a large "rapid-growth" economy and a country in which measurable economic development has been slow to arrive in many areas and for large parts of the population. Like other G-20 countries China has announced programs to assist employment creation in its SME sector; however, these initiatives have not targeted high growth companies and have generally been limited to attempts at creating independent self-employment opportunities for laid-off workers and rural-urban migrant

[30] J. Capp, H. Eistrodt and W. Jones, Jr., "Reining in Brazil's informal economy", McKinsey Quarterly (January 2005).

[31] R. Eunni, "Institutional Environment for Entrepreneurship in Emerging Economies: Brazil vs. Mexico", World Journal of Management, 2(1) (March 2010), 1-18, 6.

workers.[32] It is widely believed that SMEs have played, and are expected to play, an increasingly important role in promoting economic growth and development and increasing employment opportunities in China but, as with other countries, "SME financing difficulties [have become an important bottleneck . . . restricting the . . . development [of] Chinese SMEs".[33]

Numerous policy responses for China have been suggested including the following ideas from Xin-Li and Yi-Min: improving the legal system for SMEs, particularly creation and enforcement of laws and regulations relating to financing methods and safeguards of SME financing; establishing an effective national governmental administrative institution for SME financing, including provision of loan guarantees and financial assistance service; establishing an SME development fund within the governmental budget; promoting SME development in marketing and business strategies of major financial institutions; establishing and improving the credit and guarantee systems for SMEs; and developing and improving the intermediary service system, including managerial advisory programs for SMEs and establishment of credit rating mechanisms to provide support in independently evaluating SME projects.[34] Xin-Li and Yi-Min also argued for the development of a dedicated financing system for SMEs with innovative financial products, encouraging SMEs to seek out legitimate private financing, developing the capital market and expanding direct financing channels and creating SME venture capital companies similar to the "small business investment companies" recognized in the US.

The financial market in China is still dominated by commercial banks, and although institutional investors are on the rise, this segment is still in its infancy. The Chinese government has made efforts to improve the foundations of the country's banking system, and to introduce more market mechanisms.[35] Admittedly, privatization in the financial sector is not far advanced in China and most non-bank financial institutions such as life insurance, investment and securities companies remain state-owned or controlled by local governments. However, even though the quality of major commercial banks' assets, their profitability and their levels of service diversification remain insufficient, and though Chinese Communist Party (CCP) interference in state-owned commercial banks' business decisions is a daily routine, the Chinese banking system proved to be remarkably resilient during the financial crisis due in part to the country's closed capital account that shielded Chinese banks from exposure to risky Western financial instruments and relieved the government of any obligation to bailout those banks. On the other hand though, with new credit issuances amounting to US$1.4 trillion in 2009 and about US$1.1 trillion in 2010 as a result of country's anti-crisis measures, there is a high probability that the share of nonperforming loans—which were cut to 1.3% of GDP by 2010 in absolute terms—will rise dramatically.

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[32] Ernst & Young, Funding the future: Access to finance for entrepreneurs in the G20 (London: Ernst & Young Global Limited, 2012), 36.
[33] W. Xin-li and F. Yi-min, Comparison of Small and Medium-sized Enterprise (SME) Financing between China and United States, North China Electric Power University (Project Number 200711025), 1.
[34] Id. at 4-5.
[35] The discussion in this paragraph is adapted from Bertelsmann Stiftung, BTI 2012—China Country Report (2012).

Unlike the economies of most developed countries, China's financial system relies excessively on its banking system as the primary channel for allocating financing to investors and businesses. The banking system accounts for close to 80% of the funding to support the country's economic growth. In addition, banking assets represent 76% of the total value of financial assets in China (the equivalent number in the US is about 26%). Historically, China's banking system revolved exclusively around the People's Bank of China ("PBOC"). After the Communist victory in 1949, all existing banks were nationalized and incorporated into the PBOC, which remained the only bank in China until 1978. After that year, the commercial banking operations of the PBOC were gradually split off into four state-owned commercial banks, known as the "Big Four" and consisting of the following:

- Agriculture Bank of China: lends to the agricultural sector, which includes farmers, village enterprises, townships and other rural entities
- Bank of China (BOC): publicly listed on the Hong Kong Stock Exchange and specializing in foreign exchange transactions and international trade finance
- China Construction Bank: designated the primary lender for construction projects such as infrastructural projects or urban housing development. It became listed on the Hong Kong Stock Exchange of in October 2005 when its initial public offering (IPO) raised US$70 billion, the largest offering in the world since 2001
- Industrial and Commerce Bank of China (ICBC): largest bank in China in terms of assets. It also manages commercial banking functions formerly held by the PBOC and has become the primary financer for domestic industries

The PBOC was restructured in 1983 to act as the central bank with responsibilities similar to those of the US Federal Reserve and in 2003 the China Banking Regulatory Commission (CBRC) was spun off from the PBOC. The PBOC handles the macroeconomic functions of a central bank such as regulating the country's monetary policies, issuing currency, setting reserve requirements for all subsidiary banks, setting interest rates, managing foreign exchange and managing the State Treasury. The CBRC is responsible for the supervisory duties of a central bank, such as regulating and monitoring the country's banks, trust and investment companies, asset management companies, and credit and savings cooperatives.

In addition, several policy banks were established in 1994 to assume the government-directed lending functions of the four state-owned commercial banks. Policy banks include the Agricultural Development Bank of China (ADBC), which is responsible for financing government-directed agricultural development projects; the China Development Bank (CDB), which is responsible for financing government-directed construction and infrastructure-related projects; and the Export-Import Bank of China (EIBC), which is responsible for financing government-directed trade and foreign exchange activities. There are also several national and regional commercial banks that are smaller than the state-owned commercial banks and serve the private sector. These banks are independent of the government and face fewer of the inefficiencies and corruption prone to state-owned commercial banks. They generally have lower non-performing-loan ratios, higher profit rates and higher quality assets. Foreign banks do operating in China; however, they play a largely insignificant role in China's banking sector, controlling less than 2% of all total banking assets in China as of 2010, and have been hampered by regulatory hurdles that have made it cost-prohibitive for them to do business in China. Those foreign banks that do operate in China generally focus on commercial and institutional banking and are most attractive to large corporate companies and high net worth individuals who value the more personalized and custom services that these banks offer.

China's stock market is comprised of two stock exchanges, the Shanghai Securities Exchange (“SHSE”), established in 1990, and the Shenzhen Securities Exchange (“SZSE”), established in 1991. The structure of China's stock market is unique in that 90% of listed companies are state-owned. Moreover, approximately two-thirds of the shares of listed companies are non-tradable, effectively barring foreign investors from obtaining more than a 33% stake. The stock market is divided into three boards: the Main Board, which includes shares of 1,300 larger enterprises on the SHSE or the SZSE; the Small and Medium Enterprises (SME) board, which includes shares of about 50 companies and is scheduled to grow into an independent growth enterprise market; and the Third board, which includes shares of 35 companies that are de-listed or not qualified to be listed on the other boards. Another aspect of China's stock market is the classification of shares. Stocks are divided into three main categories:

- A-shares: denominated in RMB, these shares were previously available for trading only to mainland investors. The qualified foreign institutional investor (QFII) program allows foreigners with QFII status to buy and sell A-shares. A-share companies represent over 85% of the stock market's listed companies. Close to 1,300 companies are classified as A-share companies. The turnover for these shares is very high, as local investors often prefer to invest their savings in these equities as opposed to accruing low-yielding interest rates from state-owned banks.
- B-shares: stocks listed domestically in China but denominated in US or Hong Kong dollars. These shares are available to all foreign investors to purchase and sell. Until 2001, the B-share market was closed to mainland investors, but it is now open to all domestic, non-institutional investors. Overall, this market is small with a market capitalization of approximately US$10 billion and a listing of less than 100 companies. Unfortunately, these shares suffer from chronic illiquidity.
- H-shares: stocks issued by Chinese enterprises but listed on Hong Kong's stock exchange. Companies that privatized and choose to seek foreign capital tend to list as H-share companies. The government restricts which companies are permitted to list H-shares.
- Red chips and private chips: these shares belong to companies that are incorporated outside of China, though the assets of the company are Chinese-owned.

Currently, China's stock market, including non-traded equities, constitutes approximately 15% of the country's financial system; however, based on market capitalization and the number of listed companies it has grown to become the second largest stock market in Asia even though it is still in its infancy, with investors and companies still learning how to invest and manage invested funds. As such, there is great volatility, and trading prices may not reflect the underlying economy. Another problem with the stock market is that it often acts more like a cash machine for state-owned enterprises, who use the market to collect money when needed, rather than as an open forum for both public and private companies to obtain financing for sound projects. Some of this is the result of tight government restrictions that limit the number of private companies that can list, as well as the limitation that two-thirds of the shares cannot be traded. Lack of transparency, weak governance and low dividend payout ratios also limit the role and influence of shareholders over corporate operations in China. Nonetheless, in light of expected reforms and growth, equity markets will likely play a significantly increased role in China and some analysts expect the Chinese market to overtake the Tokyo Stock Exchange as the largest market in Asia by 2015.

Public sources of capital are currently limited in China because legal property rights are not yet appropriately established, and the relatively immature state of the finance industry is still relatively immature. As noted by Child and Pleister,[36] until recently there has been a general reluctance of the part of Chinese banks to lend to Chinese private firms. Government policies, which dictated that preference be given to state-owned enterprises, were significant drivers of bank lending policies; however, banks have also been reluctant to provide capital to private enterprises in the absence of systems to provide reliable information about those enterprises and their assets and capabilities, and a general lack of ability among Chinese entrepreneurs to draw up business plans, especially in rural areas.

With regard to financing for SMEs, Xuegong and Xueyan have written that “[s]mall and medium enterprises (SMEs) have been suffering from financing difficulty even while China has experienced a lending spree” and their survey of Chinese SMEs revealed that financial institutions are quite selective in responding to the financing requests of SMEs and give preference to older, larger and faster-growing SMEs, in specific types of business, and to SMEs with experienced, wealthier and older owners.[37] Xuegong and Xueyan summarized their ideas regarding changes needed to China’s policy toward SMEs as follows: creating an enabling environment in which SMEs can fairly compete with big business and be treated equally; mitigating the difficulties of SMEs’ access to financing, including reorganization of the banking sector to allow small community-based banks to grow and expansion of the SME board in the stock market; increasing fiscal support to SMEs from central and local government SME development funds; speeding up the technological progress and restructuring of SMEs, including encourage of SMEs’ research and development activities and promotion of the use of information technology; expanding market access for SMEs; strengthening and improving service to SMEs; improving the management of SMEs through consultancies and training programs; and strengthening policy coordination.[38] Xuegong and Xueyan also argued for

[36] J. Child and H. Pleister, “Governance and Management in China's Private Sector”, Management International, 7(3) (2003), 13.
[37] S. Xuegong and L. Xueyan, “Small and Medium-Sized Enterprises’ Access to Finance in China” in C. Harvie, S. Oum and D. Narjoko (Eds.), Small and Medium Enterprises (SMEs) Access to Finance in Selected East Asian Economies (Jakarta, Indonesia: Economic Research Institute for ASEAN and East Asia, 2011), 351-384, 351.
[38] Id. at 378-380.

motivating financial institutions to make more loans to SMEs, developing financing products tailored to the needs of SMEs (including recognizing new forms of collateral such as intangible property rights), increasing SME access to direct financing, improving the credit guarantee system for SMEs and strengthening the credibility information system to help the banking sector better identify SME risks.[39]

§1:10 --India

Since 2000, there has been tremendous growth in overall investment levels in India, from less than 25% of GDP in 2000 to over 35% by 2006, and a significant part of this investment drive has come from the corporate sector. Given the links between a country's investment levels and its overall economic growth, financing, especially corporate financing, and investment have been crucial components of India's growth.[40] Foreign financing of Indian corporations has increased over the past few years including external commercial borrowings, foreign direct investment and credit from foreign banks and foreign institutional investors have also participated in domestic equity markets. The global financial crisis, unfortunately, hit several sources of financing in India. As foreign investors were hit by the crisis, they pulled back from the Indian market and turned risk averse. Small- and medium-sized enterprises ("SMEs") were most at risk from the financing slowdown, given their lack of significant retained earnings and corporate savings. External financing is not just supplementary capital used to fund growth and expansion plans, but rather essential funds that SMEs use to refinance existing debt and to sustain day-to-day operations.

The Indian financial system was thoroughly reformed after 1991 and has been characterized as highly developed and deep.[41] In the banking sector profits have been increasing, capital adequacy ratios have attained satisfactory levels and non-performing loans have been falling. As is the case in many developing and emerging countries, state banks remain dominant; however, this can be tracked to overall industrial development plans which call for bank resources to be set aside for, and targeted toward, specific priority sectors and borrowers. As for Indian stock markets, they have become more efficient, well-developed and buoyant; however, it is generally acknowledged that more work needs to be done in developing a market for corporate debt and establishing viable capital and credit sources for SMEs.

The Reserve Bank of India ("RBI"), which was established on April 1, 1935 in accordance with the Reserve Bank of India Act 1934, is the central banking institution of India and fully owned by the government. The RBI has general superintendence and direction of banks in India and performs this function under the guidance of the Board for Financial Supervision ("BFS"). The primary objective of BFS is to undertake consolidated supervision of the financial sector comprising commercial banks, financial institutions and non-banking finance companies. In addition, through its Audit Sub-

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[39] Id. at 381-382.

[40] R. Saxena, Trends in India's Corporate Financing (2009).

[41] The discussion in this paragraph is adapted from Bertelsmann Stiftung, BTI 2012—India Country Report (2012).

Committee BFS aims at upgrading the quality of the statutory audit and internal audit functions in banks and financial institutions. The RBI directs banks to meet Bureau of Indian Standards guidelines. Indian banks must also adhere to the prudential norms laid down by the Basel Group.[42] The Indian government is closely involved in banking operations and domestic banks are mandated to extend a minimum percentage of their loans to "priority" borrowers (i.e., agriculturists, exporters, and small businesses). In addition to imposing the aforementioned "sector lending requirements", the Government's control position with respect to the public sector banks allows it to exert a significant amount of influence over individual lending decisions made by those banks. Controls are imposed on external commercial borrowings, which are loans from lenders outside of India that Indian companies may wish to pursue when funds are not available from domestic sources, including restrictions on the amount of such loans, minimum maturity requirements and limitations on the use of loan proceeds.[43]

The RBI also supervises and administers Indian exchange control regulations in consultation with the government, and administers the government's monetary policy. India's foreign exchange control regime is governed by the Foreign Exchange Management Act, enacted with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India, and to give effect to the liberalization announced in the economic policies.

India has an extensive banking network, in both urban and rural areas. The banking system has three tiers: scheduled commercial banks, both Indian and foreign; regional rural banks, which operate in rural areas which are not covered by the scheduled banks; and cooperative and special purpose rural banks (including land development banks and a number of primary agricultural credit societies).[44] As mentioned above, large Indian banks and most Indian financial institutions are still in the public sector, and state-owned banks account for a significant percentage of the country's deposits and loans; however, numerous private and foreign banks exist and the government is continuously working to restructure ownership of public sector banks to reduce its ownership. Practices of domestic banks in India are obviously impacted by requirements imposed on domestic banks to extend at least 40% of their loans to priority borrowers (i.e., agriculturists, exporters, and small businesses). In addition to imposing sector lending requirements, the government's control position with respect to the public sector banks allows it to exert a significant amount of influence over individual lending decisions made by those banks. Controls are imposed on external commercial borrowings, which are loans from lenders outside of India to Indian companies seeking funds not available from domestic sources. These include restrictions on the amount of such loans, minimum maturity requirements and limitations on the use of loan proceeds.[45]

[42] US Commercial Service, Country Commercial Guides: India (2012).
[43] Doing Business in India: 2010 Country Commercial Guide for U.S. Companies (Washington, DC: US & Foreign Commercial Service, 2010).
[44] US Commercial Service, Country Commercial Guides: India (2012).
[45] Id.

As opposed to other developing countries, such as China, India has a sophisticated legal system underlying its capital markets, including application of the rule of law and guaranteed property rights. Indian capital markets, including public securities exchanges such as the National Stock Exchange of India Limited and the Bombay Stock Exchange Limited, have grown rapidly in recent years — they are now the world's fourth and fifth largest stock exchanges, respectively, in terms of volume of transactions although much smaller in terms of market capitalization when compared to other large exchanges around the world and have become one of the most popular global venues for initial public offerings; however, critics still complain about a lack of broad liquidity.

The Indian securities regulator—the Securities and Exchange Board of India—has attempted to enforce corporate governance by imposing a rigorous regulatory regime to ensure fairness, transparency and good practice. Foreign institutional investors generally agree that corporate governance is better in India than in many other emerging markets, even though many companies have been slow to comply and improvements could still be made in certain areas such as financial disclosures. Transaction costs and systematic risks, as well as market manipulation, have all gone down in India and this has boosted the confidence of retail investors.[46] One of the most important effects of the economic liberalization program was the ability of Indian firms to reach beyond the traditional domestic public and private sources of financing to tap into global capital markets. As a result, enterprises such as the Tata Group were able to find the financial support needed to fuel aggressive acquisition projects that allowed it to establish a foothold in new markets around the world.[47]

Given the rapid growth and size of India it is not surprising that a number of studies have been undertaken regarding various aspects of Indian corporate finance over the last few years. For example, with respect to reliance on internal financing the RBI has estimated that approximately 40% of financing for public and private limited companies comes from internal sources. For large firms involved in manufacturing and service industries, internal resources account for 67% and 47% of all funds respectively. However, the picture changes significantly for SMEs. These firms often do not have significant savings and internal sources average only 10% of total funds.[48] Apart from internal financing, most companies also rely on external financing from bank credit arrangements. The RBI found, for example, that in public limited companies bank borrowings accounted for 32% of external financing and 20% of total financing. In private limited companies, bank borrowings accounted for 28% of external financing and 17% of total company financing. Some of the constraints on greater bank lending are regulatory hurdles, such as high statutory liquidity requirements (which force banks to keep deposits in government securities) and the priority sector lending requirements which have been described above.[49] As mentioned above, the Indian corporate bond market is relatively underdeveloped in comparison to the equity market and the blame has been placed on

[46] Id.
[47] R. Grainger and S. Chatterjee, Chinese and Indian Systems: Divergent in the Midst of Global Trends (2007) 1, 32-33.
[48] F. Allen, R. Chakrabarti, S. De, J. Qian and M. Qian, Financing Firms in India (2007).
[49] Reserve Bank of India, Master Circular, Lending to the Priority Sector (July 2009).

illiquidity, lack of transparency, onerous regulatory requirements and the high cost of issuing bonds.

In addition to capital provided through domestic sources, Indian firms have benefitted from a significant increase in foreign direct investment ("FDI") as the government streamlined and clarified regulations and gradually increased FDI ceilings in various sectors such as mining, petroleum and civil aviation.[50] Commercial loans from non-resident lenders, so-called "external commercial borrowings" ("ECBs"), have been an important and growing source of financing for Indian corporations beyond the capital markets, as companies have taken advantage of lower interest rates abroad and often received loans with longer maturities. As larger amounts of foreign capital for ECBs have become available the government has provided support through gradual relaxing of regulations and sectorial restrictions and increasing ceilings for ECB debt levels.

A variety of international firms, from global private equity players to investment banks to sovereign investment funds, have entered the Indian private equity ("PE") market in recent years and provided financing. Since Indian PE was initially driven by foreign capital it was typically analyzed as part of the country's overall FDI strategy; however, it is clear that there will be a significant and growing number of domestic PE investors in the coming years and that PE is more properly viewed as a separate and distinct category of financing in India. As the government has renewed its commitment to infrastructure development, called for a greater number of public-private partnerships, and raised FDI caps, the PE industry has grown tremendously. According to industry estimates, there were over 350 PE firms currently operating in India as of 2009, with many focusing on a specific sector such as infrastructure.[51] Global PE funds accounted for 56% of value and 38% of volume in India during 2008 while Indian PE funds accounted for 28% and 49% respectively during that same period.[52]

§1:11 --Indonesia

1997 and 1998 was a period of extreme financial crisis for Indonesia, as well as many other parts of Asia, and saw the almost complete collapse of Indonesia's previously formidable banking sector. According to Srinivas, the crisis "cost the government a staggering 50 percent of GDP—one of the highest fiscal costs paid so far by any country in history" and not only ended an extended run of economic growth that had lifted millions of Indonesians out of poverty but also threw many of those who had just been rescued back into the depths of economic despair where they would remain for more than a decade until the country was able to once again reduce poverty levels to where they were in 1996.[53] Again, as mentioned in the corporate governance discussion "[t]he crisis

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[50] Reserve Bank of India, International Investment Position of India at the End of March 2009 (2009).

[51] Venture Intelligence, Estimates (2009).

[52] KPMG, The Indian M&A Landscape—A Perspective (2009). For further discussion of private equity, venture capital and "angel investor" funding in India see Section 5.2 in S. Mani, The Growth of Knowledge-intensive Entrepreneurship in India, 1991-2007 (2009).

[53] P. Srinivas, Indonesia's Financial Sector: A Half-Full Glass, Strategic Review: The Indonesian Journal of Leadership, Policy and World Affairs (March 14, 2013) http://www.stratfor.com/other-voices/indonesia%E2%80%99s-financial-sector-half-full-glass

exposed weaknesses in governance and regulation, corruption and politically connected business relationships that had led to the collapse of the banking sector".[54] Fortunately, during the period since the great financial crisis in the late 1990s the Indonesia banking sector has made a remarkable recovery, which has been described as including high profitability, continued growth, increased stability, consolidation, independent regulation and supervision and strong resilience to potential future crises. However, as discussed below, new challenges have emerged which must be addressed by policymakers in order for economic development to proceed.

Bank Indonesia ("BI") acts as the country's central banking institution and carries a three-fold responsibility as monetary authority and the regulatory and supervisory authority for the banking system and payment system. BI itself has identified several major roles that it attempts to play with respect to the Indonesian economy and financial markets including safeguarding monetary stability through the use of interest rates in open market operations; building the sound performance of financial institutions, particularly in the banking sector; maintaining a robust payment system; building and maintaining research and monitoring capabilities to access information on threats to financial stability; and, finally, operating a "financial system safety net" as parts of its function as the central bank lender of last resort.[55] On November 22, 2011, Indonesia established the Indonesian Financial Services Authority ("FSA")[56] to take over several regulatory and supervisory authorities previously held by BI and the Capital Markets and Financial Institutions Supervisory Board mentioned below and become the sole regulatory agency for all financial services institutions in Indonesia including securities companies, insurance companies, pension funds, financing companies and banks. This new government body is modeled after the UK's FSA, a single regulator scheme, and its authority in the banking sector will include bank licensing, bank operations, setting policy on banking liquidity and banking supervision.[57]

Under Indonesian banking law, Indonesian banks are classified as either commercial banks or community (rural) banks ("BPRs"). The main difference between the two categories is that rural banks have restricted operations, for example, they do not provide demand deposit. With regard to the bank systems used, there are commercial banks that carry out conventional business activities and banks that observe Islamic (sharia) principles in their operational activities. BPRs activities are limited to conventional bank activities or Sharia based bank activities.[58] A bank must obtain central bank approval to operate its business, open branch offices and enter into a merger, consolidation or acquisition. Rural banks substantially outnumber commercial banks; however,

[54] P. Srinivas, Indonesia's Financial Sector: A Half-Full Glass, Strategic Review: The Indonesian Journal of Leadership, Policy and World Affairs (March 14, 2013) http://www.stratfor.com/other-voices/indonesia%E2%80%99s-financial-sector-half-full-glass

[55] See Bank Indonesia: The Roles of Bank Indonesia at http://www.bi.go.id/web/en/Perbankan/Stabilitas+Sistem+Keuangan/Peran+Bank+Indonesia/Peran+BI/

[56] Law No. 21 of 2011.

[57] Banking Regulation 2012, http://www.nortonrose.com/knowledge/publications/66826/banking-regulation-2012.

[58] Banking in Indonesia, Angloinfo, http://bali.angloinfo.com/information/money/banking/.

commercial banks provide most of the credit offering in Indonesia and are dominated by a small number of state-owned institutions.

Capital markets in Indonesia have traditionally been regulated by the Capital Markets and Financial Institutions Supervisory Board (“Bapepam-LK”)[59] and other self-governing bodies such as the Indonesia Stock Exchange (“IDX”), the Indonesian Central Securities Depository (PT Kustodian Sentral Efek Indonesia or “KSEI”) and the Indonesian Clearing and Guarantee Corporation (PT Kliring Penjaminan Efek Indonesia or “KPEI”). As noted above, the FSA was created in 2011 to take over many of the functions and authorities previously performed by the Bapepam-LK with respect to supervision of capital markets and non-banking institutions, a process which began in early 2013.[60] The IDX is the sole surviving securities market in Indonesia following over 100 years of trading history in the country. The principal securities traded on the IDX are shares (including rights) and bonds. Some share options and futures trading are also carried on, but not a significant amount. To date, no foreign companies have sought a listing on the IDX despite the introduction of rules in 1997 permitting the issuance of Indonesian Depositary Receipts by foreign companies considering a dual listing, or even an initial public offering in Indonesia. Another ongoing regulatory issue in Indonesia is the creation of an exemption from registration and listing requirements for offerings that are targeted solely at sophisticated investors as a means for facilitating capital raising by both domestic and foreign issuers in Indonesia.

Deregulation of Indonesia’s capital markets over the last two decades has increased the role of equity capital in corporate finance and, in doing so, broadened use of equity in finance and the ownership base of many Indonesian firms. Rosser noted that, favoring increased and diverse equity, “[t]he regulatory framework for corporations [was] substantially revised and strengthened, especially in areas such as financial reporting, protection of minority shareholders and creditors, and mergers and acquisitions”; however, Rosser also pointed out that: “. . . [n]otwithstanding this change, Indonesian conglomerates remain heavily dependent on banks for finance. Indeed, the big problem for Indonesia's businesses at present is how to get themselves out of debt. In addition, with financial capital controllers avoiding the IDX and with many founding families apparently determined to retain majority control of their businesses, it is unlikely that there will be a significant shift towards increased equity financing in the near future.”[61] Similarly, Indonesian public listed companies remain substantially financed by credit.[62]

Srinivas provided a similar analysis of the Indonesia’s capital markets noting that “[a]lthough there has been strong growth since the Asian financial crisis, Indonesia’s capital markets remain small compared to the overall size of the financial sector, and also modest in terms of the country’s GDP” and cautioning that the investments normally

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[59] Capital Markets: Indonesia, Practical Law Company, http://us.practicallaw.com/3-518-5940#a221423.

[60] Indonesia, Background Notes, US Department of State, http://www.state.gov/outofdate/bgn/indonesia/195233.htm.

[61] A. Rosser, Coalitions, Convergence and Corporate Governance Reform in Indonesia, in K. Jayasuriya, Asian Regional Governance: Crisis and Change 106, 120 (2003).

[62] A. Santoso, An Empirical Analysis of Debt-Equity Choice in Indonesian Companies (2004).

provided through capital markets are "needed to fund the real economy and provide investment for industry and infrastructure, without which Indonesia will fall behind its peers in terms of competitiveness".[63] Similar to the conclusions reached by the other researchers mentioned above, Srinivas found that Indonesia's capital markets are not seen as a major source of funding or a significant vehicle for long-term investment and participation in the country's stock markets remains concentrated in a handful of firms. Srinivas provided a menu of issues for improving Indonesia's capital markets including expanding the markets for both corporate and government bonds, developing capital markets to the point where they are perceived as viable alternative investment opportunities for investors seeking to diversify and manage risk, increasing the domestic investor base while continuing to integrate foreign investors into Indonesia's capital markets, reducing stock market transaction costs and improving overall investor confidence by providing truly independent regulators with appropriate enforcement powers and strengthening legal and accounting standards.

While much of the story above is one of great progress within the Indonesia financial system, particularly given the dire situation that existed not too long ago at the time of the Asian financial crisis, commentators such as Srinivas caution that "reform has been slow . . . [and] [w]eaknesses exist that have the potential to destabilize the sector and damage the real economy".[64] Among the specific issues and concerns are the relatively low diversification of the financial sector, with a banking sector that is still highly concentrated dominating the country's relatively small capital markets; the limited role of pensions, insurance and other non-banking financial institutions; the need to improve financial sector intermediation; and significant shortcoming in financial inclusion, particularly the inability of a majority of Indonesians to have proper access to the formal financial sector and the difficulties that have been encountered in providing financial services and credit to Indonesia's SMEs.[65]

§1:12 --Korea

In 1972, Park Chung-hee, who had been reelected for a third term, pushed through the Yushin (Revitalization) Constitution, which in essence made him president-for-life. For a variety of reasons, he initiated the intensive promotion of heavy industry through what came to be known as the Heavy and Chemical Industry (HCI) policy. Modest financial-sector liberalizations that had been undertaken in the late 1960s were reversed in 1972, with the lowering of interest rates and increasing government control of the banking system in order to channel capital to preferred sectors, projects or firms.[66] In order to finance large-scale projects, special public financial institutions were established, and private commercial banks were instructed to make loans to strategic projects on a

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[63] P. Srinivas, Indonesia's Financial Sector: A Half-Full Glass, Strategic Review: The Indonesian Journal of Leadership, Policy and World Affairs (March 14, 2013)
http://www.stratfor.com/other-voices/indonesia%E2%80%99s-financial-sector-half-full-glass
[64] Id.
[65] Id.

[66] M. Noland, From Player to Referee? The State and The South Korean Economy, Toward the Second Miracle of Han River (2005), 4.

preferential basis. By the late 1970s, the share of these policy loans had risen to 60% of all loans.[67] These loans carried, on average, negative real interest rates, and the annual interest subsidy grew from about 3% of gross national product (GNP) in 1962–71 to approximately 10% of GNP on average between 1972 and 1979.[68] With such a large share of national income at stake, the allocation of these highly subsidized loans became the focus of intense political activity. This policy of capital channeling rested on the twin pillars of financial repression and comprehensive capital controls to delink the domestic and international financial markets.[69] In addition, the Won was kept nonconvertible.

In practice, this stance meant emphasizing indirect finance and maintaining limitations on foreign participation in financial markets and restricting domestic firm access to foreign capital. Less compliant foreign banks could not be allowed into the market in any significant way, for if they were allowed to establish a significant presence, they would undermine domestic banks operating under the burden of policy lending. Thus, the financial system had to be built around a relatively small number of Korean banks, and corporate finance had to be largely limited through regulatory fiat and tax provisions on borrowing from those intermediaries. Alternative sources of corporate finance were suppressed. The development of money markets and bond markets was retarded and restricted to a limited range of maturities with no real secondary markets, and issuance was effectively dependent on bank guarantees. The government discouraged the development of an efficient auction and secondary market for government bonds, and no swap, bond or interest futures markets existed. As for the stock market, in 1990 the government established a quarterly quota on new issues, and prior to the 1997 crisis, a backlog of more than 360 companies was waiting to be listed (relative to the 776 that were already on the exchange). Criminal proceedings documented how firms were forced to resort to bribing officials to bring their initial public offerings to the market. As a result of these policies, corporate capital sourced through bank loans exceeded equity, bonds and commercial paper combined until the late 1980s, and indirect finance from all sources was the primary form of corporate finance until 1991.[70]

Multiple implications arise from these policies. First, the firms emphasized growth, not profitability, since risk was socialized, and increased borrowing made further borrowing advantageous under the too big to fail notion, promoted by the government's habitual interventions. From the standpoint of a lender, the bigger the firm, the more creditworthy it was, since size increased the likelihood that the government would intervene in the event that the firm got into financial trouble, which it did on a fairly routine basis. The implication was that firms became extraordinarily leveraged as growth became the name of the game. Loans were the mechanism for growth and, paradoxically, debt signaled creditworthiness, a state of affairs that Yoo described as the "survival of the fattest."[71]

[67] Jung-ho Yoo, South Korea's Manufactured Exports and Industrial Targeting Policy, in Shu-Chin Yang (Ed.), Manufactured Exports of East Asian Industrializing Economies (1994).

[68] H. Pyo, Export-led Growth, Domestic Distortions, and Trade Liberalization, Paper presented at the United States-Korea Financial Policy Discussions (1989).

[69] M. Noland, South Korea's Experience with International Capital Flows (2005).

[70] Y. Je Cho, What Have We Learned from the Korean Economic Adjustment Program?, in D. Coe and S. Kim (Eds.) Korean Crisis and Recovery (2002).

[71] S. Yoo, Corporate Restructuring in Korea, 9 Joint U.S.-Korea Academic Studies (1999), 131.

Indeed, one study of corporate finance covering the decade 1977–86 found that "the largest firms have the weakest financial structure," as measured by the degree of equity in their capital structures,[72] while another found that the major chaebol were systematically less profitable than other South Korean firms.[73] A corollary to this system of corporate financing was the encouragement of extensive cross-shareholding, cross-loan guarantees and non-transparency, all of which served to facilitate borrowing and had the effect of disadvantaging outside shareholders.

In the late 1980s and early 1990s, the Korean state found itself under internal and external pressure to change. Internally, the democratization in the late 1980s had led to a surge in popular demands for reforms. At the same time, industrial firms in increasingly capital-intensive sectors found themselves disadvantaged in international competition by relatively high domestic interest rates and limited options for corporate finance. Sources of foreign pressure included the US government and with the successful conclusion of the Uruguay Round of multilateral trade negotiation, the World Trade Organization ("WTO"). Korea's growing prominence and the end of the Cold War contributed to an environment in which Korea's trade partners were more demanding that Seoul abide by international trade commitments, and the establishment of the WTO's new dispute settlement mechanism provided them the accepted diplomatic instrument to do so.

The result of these internal and external drivers was a liberalization undertaken in the early 1990s that was less a product of textbook economic analysis than of parochial politicking. A combination of Korean policy, its accession to the Organisation for Economic Co-operation and Development, and the Basle accords on capital adequacy created unintended incentives for short-term bank borrowing. The highly leveraged nature of the Korean economy, together with the currency and term mismatches embodied in the mid-1990s surge of foreign debt exposure, left the economy vulnerable to a variety of negative shocks. In 1997, amidst a regional meltdown, Korea experienced an economic crisis, evident in the swing from roughly 7% growth in 1997 to a –7% contraction in 1998 before rebounding to more than 10% in 1999.

Kim Dae-jung, a former dissident, was elected president at the peak of the financial crisis in December 1997 and moved resolutely to extract concessions from both the labor unions and the chaebol. The crisis forced a restructuring of Korea's systems of finance, regulation and corporate governance and a dismantling of the pervasive controls on international capital flows that characterized the pre-crisis regime. In the financial sector, the government immediately closed two brokerage houses and a number of merchant banks (including some affiliated with the chaebol). The government began auctioning off two nationalized commercial banks while putting other financial institutions on short tethers. Labor-market reforms that the National Assembly had rejected the previous year were passed with alacrity. The social safety net was expanded in an attempt to deal with the country's first experience with mass involuntary unemployment.

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[72] E. Han Kim, Financing Korean Corporations: Evidence and Theory, in J. Kwon (Ed.), Korean Economic Development (1990). 342.

[73] A. O. Krueger and J. Yoo, Falling Profitability, Higher Borrowing Costs, and Chaebol Finances During the Korean Crisis, in D. Coe and S. Kim (Eds.), Korean Crisis and Recovery (2002).

In the financial sector, prudential regulation was consolidated and strengthened through the creation of the Financial Supervisory Commission ("FSC") and the introduction of new regulatory practices, approaches and standards. What appeared to be more difficult to change, however, was the lending culture of Korean financial institutions.[74] In the aftermath of the crisis, lenders went from bingeing on corporate lending to bingeing on household lending and, as a result, Korean household debt registered the fastest growth in the world, increasing 18 percentage points of GDP in two years, before ending in crisis with insolvency of the country's largest credit card issuer.[75] Nevertheless, the improvement in the function of Korea's financial system can be seen in firm-level balance sheet data. Korean corporations on the whole have reduced their leverage, and access to capital increasingly is a function of profitability.[76] This development is, in turn, facilitated by improved corporate governance through enhanced financial transparency, stricter enforcement of existing laws, and expanded scope for minority shareholders to seek legal redress.

Korea's financial sector, which was hit hard by the recent global financial and economic crisis, started to show indications of recovery in mid-2009. Though Korean bank profits fell by 57% year-over-year in the first half of 2009, the picture improved from the second quarter of 2009 onward. In addition, the share of bad loans, which reached nearly 1.7% in early 2009, declined to 1.2% in October 2009. The range of bad loans ranged from 0.6% with respect to loans to private households to 1.85% in the case of loans to small and medium-sized enterprises. The FSC aims at reducing the share of bad loans to below 1%, where it rested before the onset of crisis.[77] Furthermore, the minimum capital equity quota (the so-called Bank for International Settlements or BIS quota) of Korean banks improved after the immediate stage of crisis had passed, rising from 10.9% in the third quarter of 2008 to 14.4% in the fourth quarter of 2010, well above BIS requirements. At the same time, external liabilities held by banks operating in Korea decreased. While these had corresponded to 92% of the ROK's foreign exchange reserves in the third quarter of 2008, this went down to 68% in the first quarter of 2010. The total value of short-term obligations held by banks operating in Korea also fell in the same period.

Bank of Korea ("BOK") is the central bank of Korea and issuer of the "Won", the currency of Korea. BOK was established on June 12, 1950 and is the largest bank in Korea with a wide range of functions in relation to formulating and implementing monetary and credit policy; issuing bank notes and coin; making loans to and receiving deposits from banks, thus serving as the banker to the banking sector; developing and managing payment systems; supervising financial institutions; compiling statistics and economic research; carrying out foreign exchange and managing official foreign reserves;

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[74] C. Mann, Korea and the Brave New World of Finance, 10 Joint Korea-U.S. Academic Symposium (2000), 55.
[75] International Monetary Fund, Republic of Korea: Article IV Consultation — Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; Statement by the Executive Director for the Republic of Korea (February 2004).
[76] A. Alesina and N. Fuchs-Schundeln, Goodbye Lenin (or not?): The Effect of Communism on People's Preferences (2005).
[77] Bertelsmann Stiftung, BTI 2012—South Korea Country Report (2012).

and cooperating with other central banks. In addition to the BOK there are a large number of domestic and international banks conducting operations in Korea. There are also a number of special semi-governmental and governmental banks, including banks focusing on development, industrial, fisheries and export-import activities.

The principal stock market is the Korean Exchange (“KRX”), which was created in 2004 under the Korea Stock and Futures Exchange Act as an integration of three existing Korean spot and future exchanges: the Korea Stock Exchange (“KSE”), which was established in 1956 and was principally governed by the Securities and Exchange Control Act of 1962, as amended, and rules promulgated by the Korea Securities Exchange Commission (“KSEC”), the Securities Supervisory Board and the KSE itself; the Korea Futures Exchange; and the Korea Securities Dealers Automated Quotation System (“KOSDAQ”). The instruments traded on the KRX include stocks, bonds, Exchange Traded Funds (“ETFs”), Real Estate Investment Trusts (“REITs”) and derivatives.

During the late 1960s, the government promulgated various tax and financing incentives to encourage qualified companies to list their shares on the KSE. In fact, the government went so far as to publish an annual list of companies that were encouraged to go public. Nonetheless, companies remained reluctant due to disclosure requirements similar to those imposed in the US, concerns about the loss of management control and fear regarding the current practice of promising investors an annual dividend equal to time deposit yields. In the 21st century, however, foreign companies and investors became increasingly interested in the Korean stock markets and the adoption of the new laws and regulations referred to below, which was designed to reduce institutional impediments, has led to an increase in investor participation and the number of listed companies.

In addition to the KRX the key government bodies regulating securities in Korea are:

- Ministry of Strategy and Finance (“MOSF”), which was established in March 2008 when the Ministry of Finance and Economy and the Ministry of Planning and Budget were merged. This ministry overseas the economy of Korea.
- Financial Services Commission (“FSC”) was created by an Amendment to the Establishment of Financial Services Commission Act and is responsible for the stability of the financial markets, promulgation and amendment of financial supervisory rules, and authorization of establishment and merger of financial companies.
- The Financial Supervisory Service (“FSS”) is Korea's integrated financial regulator that examines and supervises financial institutions under the broad oversight of the FSC. Prior to the creation of the FSS in 1999, Korea's market supervision was shared among Banking Supervisory Authority, Securities Supervisory Board, Insurance Supervisory Board, and Non-bank Supervisory Authority.
- Korea Financial Investment Association (“KOFIA”), which under the February 2009 Financial Investment Services and Capital Market Consolidation Act was a merger of the Korea Securities Dealers Association, the Asset Management Association of Korea, and the Korea Futures Association. It is a self-regulatory organization for the Korean financial industry, which sets regulations and best practices for the industry.

- Korea Securities Depository ("KSD"), the central securities depository of Korea which takes care of securities including stocks and bonds deposited by about 600 institutional investors and over three million individual investors.

In the past, the principal source of securities regulation in Korea was the Securities Exchange Act, which applied to all securities instruments including contribution certificates, domestic and foreign government bonds and corporate bonds. All securities were required to be registered. This included listings on the KRX, public offerings, over-the-counter ("OTC") sales, invitations to share subscriptions and mergers with listed companies. On February 4, 2009, the Financial Investment Services and Capital Market Consolidation Act ("FCA") became effective. In addition to creating KOFIA, it implemented a comprehensive regulatory system based on financial function and degree of consumer risk. FCA governs conditions for entry, soundness and disclosure for six financial investment services conducted by financial investment companies with respect to financial investment products. A financial investment company may provide a financial investment service simply by registering if the service is one in which the financial investment company does not maintain a fiduciary role for investors' assets. Those services that do, such as securities brokerage, require a license from the FSC. Financial investment products are categorized as securities, OTC derivatives and exchange-traded derivatives. Under the open-ended definitions of financial investment products that applies in Korea, a security is a product on which the investor's risk may include losing the principal while a derivative is one on which the risk may involve losing more than the principal.

Korean equity markets have become more integrated with markets elsewhere. In part, this increase reflects the natural integration of markets following the removal of restrictions on foreign ownerships of Korean stocks (foreigners now own approximately 45% of the shares on the KSE) and the removal of restrictions on Korean residents' ability to invest abroad. Yet, despite these developments, the interest rate spread on Korean sovereign debt remains higher than it was pre-crisis; and, despite recent increases in stock prices, Korean firms continue to trade at a discount relative to foreign comparators (the Korean discount). One potential explanation is that the market still lacks independent institutional investors capable of monitoring management. To the extent that such institutional investors exist in Korea, they tend to be affiliated with the major chaebol, and though some foreign institutional investors and the nascent shareholder rights movement have exerted some salutary influence, it is fair to say that the country still lacks a real market for corporate control. In the World Bank's Doing Business in 2006 report, Korea ranked 87 out of 155 countries in investor protection. By 2013, it had improved to 49.[78]

[78] World Bank, Doing Business: Economy Rankings. September 13, 2005, http://www.doingbusiness.org/EconomyRankings; World Bank, Doing Business: Economy Rankings, 2013, http://www.doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB13-full-report.pdf.

It appears, at least to foreigners, that the Korean government is ambivalent about their role in the economy.[79] Foreign investment in Korea has never been high. For decades, the government pursued policies that successfully impeded foreign investment. Even when foreign firms managed to invest in Korea, they were typically relegated to minority stake joint ventures with Korean partners. These policies were in part an understandable response to the country's colonial history and fears that if the economy were opened widely to foreign investors, the country's assets would be bought up wholesale by Japanese investors. But this is not the whole story. The state-led development strategy required that firms be responsive to government dictates. The bureaucrats rightly feared that foreigners would be less pliable than their domestic counterparts and thus required exclusionary laws and regulations to marginalize foreigners. Yet, this approach, which may have outlived its usefulness, appears to have inculcated in Koreans unhelpful attitudes toward inward foreign investment. In the 2003 Pew Survey on Global Attitudes,[80] one of the questions asked was whether respondents agreed with the statement that "our people are not perfect, but our culture is superior to others." The share in Korea responding affirmatively to this statement was a whopping 90 percent — the highest in any country polled. Yet, while an astonishing share of Koreans apparently feel culturally superior to the rest of the world, they also apparently lack confidence in their culture's resilience — five out of six Koreans think that it should be protected from foreign influence. As a result, foreign investment is not a primary source of corporate finance for most domestic Korean companies.

§1:13 --Mexico

Mexico's central bank, the Bank of Mexico ("Banco de México"), regulates the money supply and foreign exchange markets, sets reserve requirements for Mexican banks, and enforces credit controls. It serves as fiscal agent of the federal government, issuing bank for new pesos, and discount house for private deposit banks. It supervises the private banking sector through the National Banking Commission, and provides funds for government development programs. Legislation in 1984 required the Bank of Mexico to limit its lending to the government to an amount fixed at the beginning of each year. To ensure continued control of inflation, the central bank was made autonomous in April 1994.[81] Mexico also has a number of other official banks for agriculture, foreign trade, cooperatives, public works, housing, transportation and the sugar industry, among other specialized purposes. The most important such development institution is the Nafinsa, which provides financial support for Mexico's industrialization program. Nafinsa provides medium-term financing and equity capital for productive enterprises, promotes Mexican investment companies, oversees the stock market and the issuance of public securities, and serves as legal depository of government securities. By 1993, Nafinsa had divested itself of some of its interests, but it remained under state ownership. Mexico's

[79] G. De Jonquieres, If Korea is So Cool, Why Is Seoul in Lather?, Financial Times, September 13, 2005; E. Graham, South Korea Should End Its Corporate Xenophobia, Financial Times, August 4, 2005.
[80] Pew Research Center for the People and the Press, Views of a Changing World 2003, The Pew Global Attitudes Project, Washington. June 2003.
[81] Banking System, Mexico, http://www.mongabay.com/reference/country_studies/mexico/GOVERNMENT.html.

other most important state development bank is the National Bank of Public Works and Services (Banco Nacional de Obras y Servicios Públicos).

Financial services are regulated by laws, regulations and circular letters from the Secretariat of Finance and Public Credit, Bank of Mexico, National Commission of Securities and Banking and National Commission of Insurances and Guarantees. Two financial crises—one in the 1980s and the one in the 1990s--had significant effects on Mexico's banking industry.[82] The oil boom of the 1970s was followed by a financial crisis that eventually resulted in President Portillo nationalizing all of Mexico's banks in 1982. For almost ten years, the banks had no independent regulation. Most of the banks' reserves were used to pay for government projects. Consumers were faced with expensive fees. Only a few unattractive financial products were available. This led to the first financial crisis as banks were unable to compete and cover their costs.

Between 1991 and 1992, President Salinas reprivatized the banking system. Foreign banks starting purchasing large stakes in Mexico's banks. However, foreign banks were not allowed to own the majority of any bank in Mexico. The new foreign owners did not have much experience with retail banking. They were not capable of developing substantial credit services. While Mexican banks started to develop a small number of mortgages for real estate, these had high interest rates and high fees. In 1994, the low reserves and low capital led to another financial crisis in Mexico, eventually causing President Zedillo to devaluate the Mexican peso the following year. The devaluation of the peso resulted in interest rates increasing to about 110%, which in turn caused many consumers to default on credit cards, loans and mortgages. In response, credit was tightened severely.

In 1995, Mexico's Congress allowed foreigners to gain majority ownership in Mexican banks, with some restrictions. In 1998, the Mexican banking industry was opened completely. Many more foreigners began investing in Mexico's banks. They were attracted by the undervaluation of the Mexican banks, assets and by the way that Mexico's economy was integrating itself with the American and Canadian economies. By 2002, all major banks in Mexico, except for Banorte, were controlled by foreigners. With foreign ownership, the banks were recapitalized and Mexico's banking system was stabilized. Foreign owners brought innovative technologies and new management techniques to the Mexican banking industry, leading to increased profits in Mexico's banking markets and credit markets.

Most Mexican banks are not investor banks; that is, their activity is mainly focused on consumer lending, home and automobile loans, credit cards loans and ordinary deposit transactions. These businesses are very profitable, as the banks charge very high commissions and interest rates by international standards. Government officials have sporadically accused banks of charging too much, but the Banking Commission has proven incapable of changing the situation. Large Mexican companies that engage with international markets typically secure their loans in those markets, at lower interest rates.

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[82] History of Mexican Banking, Mexico Banks, http://www.mexicobanks.com/.

Small and medium-sized enterprises that cannot provide collateral for their loans have little access to the financial market.

Mexican banks are on a firm footing. “While in the US the crisis started in the financial markets and in the banking sectors, in Mexico the financial sector was not part of the problem but part of the solution,” former president Calderon told the US Council on Foreign Relations. “Thanks to the improvements in regulations, Mexican banks have a capitalization rate of 16%, almost double the recommendation of Basel and well above that of countries such as China, England or even the US.” Mexican banks — four of the five largest of which are foreign-owned —implemented Basel III standards early in 2013, ahead of schedule.

The Mexican Stock Exchange (Bolsa Mexicana de Valores or “BMV”) is Mexico's only stock exchange. It is situated on Paseo de la Reforma, an important avenue in central Mexico City. The total value of the Domestic Market Capitalization of the BMV was calculated at US$409 billion at the end of 2010, and raised to US$460 billion by the end of June 2011, making it the second largest stock exchange in Latin America (after Brazil's BM&F Bovespa) and the fifth largest in the Americas. BMV is a public company following its initial public offering in June 2008, and its shares are traded on the BMV equities market. It operates by concession of the Secretariat of Finance and Public Credit. Until its initial public offering, BMV was owned by its members, which were a group of banks and brokerage firms. The exchange trades debt instruments including Federal Treasury certificates, Federal Government Development bonds, Investment Unit bonds, bankers’ acceptances, promissory notes with yield payable at maturity, commercial paper and development bank bonds. In addition, it also trades stocks, debentures, mutual fund shares and warrants. Trading is conducted electronically through the BMV-SENTRA Equities System. Stock exchanges in Mexico are primarily regulated by the Securities Exchange Law (“SEL”) and circulars issued by the National Commission of Securities and Banking (“NCSB”), which resulted from a merger in 1995 of the National Banking Commission and the National Securities Commission. In addition to financial institutions, the NCSB regulates stock exchanges, investment companies, brokerage houses, stock specialists and portfolio management companies. Stock exchanges are primarily regulated by the SEL and circulars issued by the NCSB. Although legally possible to have more than one stock exchange, at present the BMV is the only exchange operating in Mexico.

§1:14 --Russia

The foundations of the Russian banking system are provided in the Banking Law,[83] and the Central Bank of the Russian Federation Law.[84] Bank insolvency is regulated by the Bankruptcy Law.[85] The Central Bank of the Russian Federation (“CBR”) is responsible for regulating banking activities. Through its instructions, regulations and other acts, CBR establishes rules, standards and obligatory requirements for banks and non-banking

[83] Federal Law No. 395-1 On Banks and Banking Activities, dated December 2, 1990.
[84] Federal Law No.86-FZ On the Central Bank of the Russian Federation, dated July 10, 2002.
[85] Federal Law No. 40-FZ On Insolvency (Bankruptcy) of Credit Organizations, dated February 25, 1999.

credit organizations throughout the Russian Federation.[86] The CBR Law provides for the establishment of a specific body within the structure of the CBR, the National Banking Council (NBC), comprised of representatives of various executive and legislative bodies. The NBC exercises control over the CBR's board of directors, and participates in establishing the basic principles of Russian banking and financial policy.

The CBR and the government share authority over monetary policy. The CBR is responsible for circulating monetary funds and ensuring the stability of the Russian Ruble. As part of its general oversight role, the CBR establishes state registration and licensing rules, determines minimum reserve requirements, and also approves the appointment of the senior management of all credit organizations. The CBR maintains regional offices throughout the Russian Federation. Several associations of Russian banks, among which the Association of Russian Banks is the largest, are also important standard-setting bodies.

Modern Russia inherited the banking system of the Soviet Union, with a few big state banks (like Sberbank, Vneshekonombank and Vneshtorgbank). Russia has a Central Bank; however, even after more than 15 years of reforms, including steps taken to scope with the country's financial crisis in 1998, the Russian banking sector remains severely underdeveloped and is still not able to perform its economic function as a financial intermediary. Russian banks are not yet able to compete internationally. Moreover, the banking sector is dominated by state-owned banks. At the same time, differentiation of the Russian banking sector is increasing and seems to be working. State regulation of the banking sector has some deficits, but seems by and large to be adequate. Banks have been forced to adopt international standards, though at a slower pace than originally planned.[87]

The international financial crisis, which reached Russia in autumn 2008, put a heavy strain on the small Russian banking sector. But the Russian state guaranteed liquidity of the banking system and thus prevented a breakdown. In 2008 and 2009, the government spent a total of US$31 billion (equal to slightly more than 1% of GDP in both years) to support the financial sector. About half of the money was used to recapitalize banks and other financial institutions. In addition, the government and the central bank adopted a package of further measures to increase banking liquidity, including a cut in central bank reserve requirements, and increased provision of central bank loans and budget funds (for administration) to commercial banks.[88]

As a result of state support, the 2008-2009 economic crisis did not accelerate the trend towards the reduction of the number of banks in Russia. This trend is due more to a clean-up of the banking sector, which has seen the closure of shady and tiny banks, and also to mergers and takeovers. At present, there are about 1000 banks operating in Russia, while the Minister of Finance claimed that he expects the consolidation of the

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[86] Baker & McKenzie, Banking, Russia, http://www.bakermckenzie.com/files/Uploads/Documents/Supporting%20Your%20Business/Global%20Markets%20QRGs/DBI%20Russia/qr_russia_dbguide_17banking_2009.pdf.
[87] Bertelsmann Stiftung, BTI 2012—Russia Country Report (2012).
[88] Bertelsmann Stiftung, BTI 2012—Russia Country Report (2012).

banking sector to halve that number in the longer term. Arguably the crisis helped to improve the functioning of the Russian banking sector by making authorities realize the necessity of enhancing regulation and supervision. State banks benefited from the crisis, serving as agents for distributing crisis financing to the economy. They also received direct capital injections from the state and acquired some of the troubled private banks.

The Federal Law on the Securities Market provides a legal basis for the Russian securities market.[89] The Federal Financial Markets Service ("FFMS") is a Russian federal executive body that regulates Russian financial markets including securities issuance and trading and supervision of exchanges, issuers, professional market participants and their self-regulatory organizations; the Russian Federation Pension Fund; and the state management company.[90] The major social role of FFMS is to promote public understanding of the securities laws and their practical application[91] and to ensure a smooth operation of the Russian financial market, enhance its efficiency and investment attractiveness, as well as transparency. The FFMS is headquartered in Moscow and has 13 regional authorities around the country. There are thirteen departments and three independent divisions within the FFMS.[92] Its primary responsibilities are regulation and control of investments; regulation of financial market participants; regulation and surveillance of securities; financial market information, monitoring and regulation; and preliminary control, supervision and monitoring of the insurance market. The FFMS exercises strict control over activities of financial market participants. It also establishes a legal framework regulating the terms and conditions for securities issuance and trading, as well as the operations of the respective professional participants. Notably, one of the prime objectives FFMS is to implement a set of regulatory and technical measures intended to counteract insider information misuse and attempted price manipulation.[93]

Until recently key stock markets in Russia were managed by MICEX Group (Moscow Interbank Currency Exchange) and the RTS Group (Russian Trading System). The MICEX Group embraced MICEX Closed Joint Stock Company (CJSC), MICEX Stock Exchange, National Commodity Exchange, MICEX Clearing House (clearing institution), and National Depositary Center (NDC), a specialized clearing bank and regional exchanges. These institutions provided trading, settlement and clearing, as well as depositary services to about 1500 Russian banks and brokerage companies—stock market participants, both in Moscow and in major financial and industrial centers of Russia. By overall trading volume, MICEX became the largest exchange in Russia and

[89] The Russian Securities Market Infrastructure Review, www.nfa.ru/nfa2/english/veb.doc.
[90] Decree No. 314 dated March 9, 2004, On the System and Structure of Federal Executive Branch Agencies.
[91] Федеральная служба по финансовым рынкам, *Территориальные органы ФСФР России* (The Federal Service for Financial Markets, Territorial authorities FFMS of Russia).
[92] Федеральная служба по финансовым рынкам, *Структура ФСФР России* (The Federal Service for Financial Markets, The structure of the Russian Federal Financial Markets Service).
[93] Notice should be taken of the roles of a number of self-regulating organizations seeking to bring together professional market participants and work out uniform standards for their members' activities. PARTAD is the Professional Association of Registrars, Transfer Agents and Depositaries. National Securities Association ("NFA") unites banks and professional participants on the securities market, and National Association of Stock Market Participants ("NAUFOR") includes non-banking professional participants on the securities market.

Eastern Europe. The RTS, established in early nineties, ranked second in terms of trading volumes. The list of securities traded on the RTS was much more comprehensive than that of MICEX, however, its trading volume wass smaller. The depositary engaged in record keeping and effecting settlements under the securities traded on the RTS is a Depositary Clearing Company. In 2011 MICEX merged with RTS creating the Moscow Exchange. Professional market participants, through the use of safekeeping accounts with custodial depositaries, effect trading in securities in the over the counter (OTC) market. Among major Russian custodian depositaries are Vnesheconombank, VTB, Rosbank and some other banking depositaries.

Securities to be quoted must comply with certain requirements and conditions, such as registered prospectus of securities issuances has been registered; report on overall securities issuance results has been registered; and the issuer keeps all legislative directions on the security market. Securities can be listed on the A, B, T, V or I Quoted List as long as preconditions are met. For example, for Quoted List A, the requirements are: three-year term of a company’s existence; issuer has not occurred losses during two out of three last annual tax periods; capitalized value of ordinary shares exceeds 10 billion Rubles or the capitalized value of preference shares exceeds 3 billion Rubles; and the monthly value of transactions on such securities exceed 25 million Rubles during the last three months. The requirements for Quoted Lists “B” and “V” are less strict respectively. Quoted List I includes only stocks. Normally, special professional organizations will guide the company and will ensure compliance with the legal regulations.

For certain levels of investment, venture capitalists provide a common source of equity funding in Russia.[94] The amount of money available through this source can be significant but success in securing such funding may not be easy in Russia. As in the West, venture capitalists demand a rapid and relatively high return on their investments and require evidence of a sound management track record and a clear exit plan. In return, they may provide not only financial support but also valuable relevant experience. Usually, they are also part of the board of directors.

§1:15 --South Africa

South Africa's well-developed banking system resembles Britain's system rather than that of the US and consists of three key elements[95]: South African Reserve Bank (the country's central bank); private sector banks (commercial banks, merchant banks, and general banks); and mutual banks. The heart of the banking system is the South African Reserve Bank, which is the primary monetary authority and custodian of the country's gold and foreign exchange reserves. The Reserve Bank is managed by a board of fourteen directors, seven representing major commercial and financial institutions, industry and agriculture, and seven appointed by the government. Of the latter, one serves as governor,

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[94] PKF, Doing Business in Russia 27-31 (2011), http://www.pkf.com/media/614183/doing%20business%20in%20russia.pdf ss

[95] South Africa, Country Commercial Guides, US Commercial Service, http://export.gov/southafrica/build/groups/public/@bg_za/documents/webcontent/bg_za_034197.pdf.

and three serve as deputy governors of the Reserve Bank.[96] The Reserve Bank's primary functions are to protect the value of the Rand and to control inflation. The Reserve Bank regulates the money supply by influencing its cost, i.e., interest charged on loans to other institutions. It is technically independent of government control, but in practice it works closely with the Treasury and helps to formulate and to implement macroeconomic policy. The Reserve Bank uses monetary policy to control inflation, primarily by adjusting the liquid-asset requirements of private banking institutions and by restricting bank credit in order to control consumer demand.

South African banks hold the first six places among the top 100 banks on the continent of Africa and four of those banks dominate the South African banking landscape by collectively accounting for around 85% of banking services throughout South Africa. In total, there are approximately 70 foreign banks operating in South Africa, either via representative offices, branches, subsidiaries or joint ventures with local companies. International banks in the country have focused on offshore lending where they have a competitive advantage as a result of their low overhead and their ability to raise funds at comparatively favorable rates, as well as treasury activities for corporate and clients and government. All banks offer a comprehensive range of products and services through extensive branch and electronic banking infrastructures, serve a wide customer base and have the characteristics of universal banks.

Based on population numbers, South Africa does not appear to be over-banked, as one branch exists for approximately every 9,500 persons. However, a large portion of the population does not have access to normal banking services and uses only a few products. Many black South Africans tend to save outside the formal banking sectors, and choose to save in cooperative savings institutions called stokvels. Excluding the non-banked segment of the population, it is estimated that there is one branch for every 3,200 persons. South African banks have gradually extended their business to the townships and included more and more South Africans in the modern sector. A banking culture has, however, not really been established among the majority of South Africans, as exemplified by the country’s generally low savings rate. This is due to high levels of poverty, but also high banking costs, particularly for those in the working- and lower-middle-class. As a result, new banks such as Capitec, which has been the country’s fastest growing financial institution, focus on this niche market with great success.[97]

E-commerce financial services (i.e., banking and share dealing online) are doing well in the local market, and it is projected that this segment will continue to rise. Although the services sector has, in the past, focused on the mid- to high-income population, government pressure, through the Financial Services Charter, as well as demand from the lower-income population, has pushed banks to join smaller micro-lenders. As a result, banks are incorporating the lower end of the market into their strategies, as well as developing Broad-based Black Economic Empowerment (BEE) strategies into their business development plans.

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[96] South Africa, Country Studies, Library of Congress, http://lcweb2.loc.gov/frd/cs/zatoc.html.
[97] Bertelsmann Stiftung, BTI 2012—South Africa Country Report (2012).

Despite the global turmoil in the banking sector, the South African banking system remained relatively stable and the South African Reserve Bank reported that banks were adequately capitalized, particularly compared to their international counterparts. This is due, in part, to the government's prudent measures and retention of exchange control. Overall, local banks are viewed to be relatively stable and are unlikely to default any time soon. If any South African bank was to default, it is likely that the government would intervene to help protect depositors. The country is an active member of the Basel Committee on Banking Supervision. Currently, the South African Reserve Bank and the government are working on new supervision standards according to the Basel principles. South Africa will implement the Basel III standards.[98]

The Financial Services Board ("FSB") governs South Africa's non-bank financial services industry.[99] The FSB regulates insurance companies, pension funds, unit trusts (i.e., mutual funds), participation bond schemes, portfolio management, and the financial markets.[100] The JSE Securities Exchange SA (JSE) is the fourteenth largest exchange measured by market capitalization in the world. Market capitalization stood at US$675,849 (million) in May 2010 with over 406 firms listed in June 2010. The Bond Exchange of South Africa (BESA) is licensed under the Financial Markets Control Act. Membership includes banks, insurers, investors, stockbrokers and independent intermediaries. The exchange consists principally of bonds issued by government, state-owned enterprises and private corporations. The JSE acquired BESA in June 2009.[101]

Since the 2007-9 global recession, many small businesses in South Africa liquidated, while many large corporations downscaled their staff to the minimal. As a result, many skilled employees ventured to their own small businesses. Since banks have been accumulating cash reserves and not easily offering loans after the recession, it is becoming more difficult for businesses to secure finance.[102] Business finance in South Africa, as in many other parts of the world, has become increasingly sought after but scarce. As a result, many businesses in South Africa seeking finance have turned to business angels and venture capital firms and, in fact, angel investing and venture capital investing have become more popular in South Africa during the past decade. Contrary to media reports about the lack of accessibility to private investors and their inability to fund new businesses, South African investors are bringing more business into South Africa.

§1:16 --Turkey

The Turkish banking system consists of the Central Bank and private banks, including foreign banks, divided between Ankara, where most state-owned banks are located, and Istanbul, the center for most privately owned banks. Turkey also had three state investment and development banks. The Development Bank is funded from the Treasury

[98] Bertelsmann Stiftung, BTI 2012—South Africa Country Report (2012).
[99] Financial Services Board, http://www.fsb.co.za/.
[100] South Africa, Country Commercial Guides, US Commercial Service, http://export.gov/southafrica/build/groups/public/@bg_za/documents/webcontent/bg_za_034197.pdf.
[101] Id.
[102] Corporate finance, Investors Network, http://www.investorsnetwork.co.za/component/content/article/117-business-finance-in-south-africa.

and invests in the private sector. The Export Credit Bank of Turkey (Türkiye Ihracat Kredi Bankasi) provides export finance. The Municipalities Bank (Iller Bankasi) supports local institutions. Merchant banks also operated in Turkey, both domestically and foreign owned.

The Turkish Central Bank, founded in the early 1930s, has the usual central bank responsibilities, such as issuing banknotes, protecting the currency, and regulating the banking system and credit. The Central Bank also finances the government's budget deficits and makes loans to public and private banks. Starting in 1983, however, the Central Bank began to reduce lending and stepped up its supervisory functions. In 1994, the Central Bank became an autonomous body but is not independent. Along with Banking Regulating and Auditing Commission ("BDDK"), the Central Bank supervises bank activities in order to guarantee that they meet liquidity requirements and operate in a responsible fashion. While the Central Bank's Bank Supervision Division acts as the government's supervisory authority, the Undersecretariat of the Treasury is responsible for the enforcement of banking laws. The BDDK also determines the disposition of insolvent banks.

The government, as well as international organizations such as the IMF, has taken an active role in providing access to longer-term finance for small and medium enterprises (SMEs) and exporting firms in Turkey. As a result, participants enjoyed both export and employment growth and gained advantages with respect to new product introduction, improved environmental management, adoption of cost-saving technologies and expanded client bases. Other types of government loan programs provided SMEs in underserved areas with access to medium term finance. Participants came from a number of different sectors including printing, plastic processing, tourism and food processing.[103]

The Turkish banking system is organized according to international and European standards, with functional supervision, minimum capital requirements and market discipline. According to a report prepared by the Turkish central bank, the Turkish banking sector consists of deposit banks, development and investment banks and participation banks that operate according to the profit-/loss-sharing principle. The Banking Regulatory and Supervisory Authority ("BRSA") was able to improve its supervisory and enforcement capacity further, and was accepted as a member of the Basel Committee on Banking Supervision and Financial Stability board in 2009.[104]

The number of banks in Turkey decreased to 50 after the 2001 financial crisis. According to the Banks Association of Turkey, that number decreased further to 45 by January 2011. The banking sector plays less of a financial intermediary role than one would expect in an economy of Turkey's size and sophistication. Stress tests by the regulators have proved that Turkey's financial sector is sound. The banking sector has been able to extend its share of the entire financial sector to 78%. The share of total assets held by domestic private banks is 32.5%. Foreign banks were able to increase their share to

[103] The World Bank, Turkey: Country Brief 2010 (October 5, 2010).
[104] Bertelsmann Stiftung, BTI 2012—Turkey Country Report (2012).

39.5%– this figure takes into account the investments of foreigners in the stock exchange. The stock exchange, in turn, represents 20% of the assets of the banking sector.

Although the government, public enterprises and private undertakings increased their use of stocks and bonds after 1970, capital markets in Turkey remained underdeveloped in the 1970s. After the passing of the Capital Markets Law ("CML") in 1982, a Capital Markets Board ("CMB") was established to issue regulations for institutions marketing bonds and other financial instruments. Based in Ankara, it is now responsible for overseeing the activities of capital markets. The reason for underdevelopment of the capital markets was that most Turkish corporations were closely held and tended to finance expansion through their own funds and from their small circles of stockholders. But in the 1980s, companies were allowed to issue profit-and-loss-sharing certificates with liability limited to the face value of the certificate. At the same time, the government also took steps to revive Istanbul's stock market, which had closed down in the late 1970s. The Istanbul Stock Exchange ("ISE") reopened in December 1985, and has become a major player in the capital market. In 1995, the Istanbul Gold Exchange opened for trading.

With the rise of emerging market funds, trading on the ISE expanded rapidly in the early 1990s; indeed, it was the best performing of any market in 1993. Foreign investment accounted for 25% of the daily trading volume. In early 1994, however, the stock market crashed in the wake of the currency and balance of payments crisis. Plans for privatization of state-owned enterprises helped to revive the stock market, once foreign investment and confidence in the government's attempts to stabilize the macroeconomic situation increased.

The legal and institutional framework for capital and securities markets in Turkey has improved, especially in the past few years, in parallel with the structural reforms carried out in cooperation with the IMF.[105] The improvement initially began with the passage of the CML and establishment of the CMB in the early 1980s, and more recently with the CMB's issuance of legally binding Communiqués on accounting and auditing standards and its issuance of the Corporate Governance Principles (Principles). At the same time, amendments were made to the Commercial Code, which addressed several crucial weaknesses in Turkey's corporate governance framework.

As is the case in many emerging markets, Turkey has an underdeveloped equity culture. In recent years, market capitalization has fluctuated at around 20 to 25% of GDP, which is significantly below the OECD average of 135%. Only 290 companies are listed on the ISE, and of the 500 largest Turkish companies by revenue, only about one-fifth are listed.[106] Free float is small, in the range of 20 to 25%. Market transactions are highly concentrated with the 25 most actively traded companies representing about three-fourths of the volume of the stock exchange. Also, most large Turkish companies are part of

[105] Corporate Governance in Turkey: An Investor Perspective, Institute of International Finance, Inc. (April 2005).
[106] Task Force Report, Institute of International Finance, Inc., Corporate Governance in Turkey: An Investor Perspective (April 2005).

conglomerates, typically organized around a group-owned bank. The five largest business groups account for about half of the total market capitalization of the ISE. Frequently, when one or more companies in a conglomerate is listed, the holding company, which generally exercises control over members of the group, is not. Income shifting and transfer pricing has been a problem in pyramidal and cross shareholding structures. Mandatory consolidated reporting, which began recently, should improve the transparency of such abuses.

In general, companies that do not access the equity market have little incentive to provide protections for minority shareholders that lie at the heart of many corporate governance guidelines, including those proposed by the Institute of International Finance. Without a corporate finance culture that values these protections, strategic investors are less likely to see the equity market as a good way to invest their money. In Turkey the result is that low demand for equity finance means less emphasis on minority shareholder protection, which leads to a low supply of shareholder investment and high equity financing costs.

There are a number of reasons why Turkish companies have not embraced equity markets. First, a tradition of poor corporate structure had a negative impact on the demand for private corporate finance. Until the 1980s, the Turkish economy was dominated by the state, which included a complex system of state-owned companies and restrictions on market entry. Government contracts with private sector firms tended to maximize government control and minimize both competition and opportunities for investment by firms. This kept the need for private investment capital relatively low and allowed for related or careless lending by banks backed by state guarantees.

Second, the nation's macroeconomic policy did not encourage private investment. Persistent government deficits financed through central bank lending led to high annual inflation rates averaging 50% in the 1980s and 70% in the 1990s, high real interest rates which peaked at over 30% in 1996, and relatively low average economic growth during the 1980s and 1990s. This stifled opportunities for profitable investment by firms. In addition, high real interest rates on guaranteed government debt absorbed much of the available private capital. Unstable governments, coupled with frequent intervention by the military, added political uncertainty, which raised interest rates further and constrained private sector investment opportunities.

Third, as is the case in many emerging market economies, the largest domestically owned Turkish companies are mostly family-controlled. A single shareholder controls more than 50% of voting rights in 45% of the companies listed on the ISE. Although calculations vary, it is reported that at least three-fourths of all companies in Turkey are owned by families or a holding company controlled by a family. This is due in part to majority shareholders valuing unrestricted control of their companies over higher profit margins and less expensive forms of financing. By maintaining tight control, family members have been able in some instances to secure well-paid jobs or perks from the company even if they are not qualified. Also, controlling shareholders have had the opportunity on occasion to extract profits from minority investors, typically through the use of company assets or non-arm's length related party transactions.

§1:17 --Vietnam

It is estimated that over 50% of personal savings in Vietnam are held as cash, gold or other assets outside the banking system. Improving its financial system, including infusing this money into the banking system to raise capital for development, is one of Vietnam's main economic priorities. Vietnam's current capital market is made up of three components:

- Organized credit market (based on operation of the banking system and credit institutions), consisting of state owned banks (composed of commercial banks and policy banks), joint stock commercial banks, joint venture banks, branches of foreign banks, financial enterprises, leasing companies, representative offices of foreign banks and credit institutions, and credit funds
- Unorganized credit market (or the black credit market)
- Bonds market (consisting of government bonds, commercial bank bonds and listed company stocks)

Reflecting its economic growth, Vietnam's monetary system has undergone rapid and radical reforms. In 1988, the mono-bank system of central planning was abolished and the State Bank of Vietnam (SBV") emerged as the central bank, with state-owned commercial banks taking care of credit activities and deposit mobilization. The SBV acts as the supervisory and regulatory body for the banking sector. As part of the reform effort, the SBV strengthened its internal processes and enhanced the level of inspection and supervision of banks within its jurisdiction. The SBV, however, is not an independent body such as the US Federal Reserve, and it continues to operate under government guidance. In some key areas of operation, such as provision of liquidity support, management of foreign currency reserves, and issuance of banking licenses, SBV's actions are subject to Prime Minister's approval.

New banking laws set rules for creation of a market-driven banking system, comprising different types of banking institutions and ownership (state-owned, private stock, joint venture and foreign owned). Soon afterwards, many new domestic and foreign banks opened offices in Vietnam. These reforms in the banking system were implemented in parallel with economic reforms in other aspects such as taxation, public finance, monetary policy and state owned enterprises.

The 1998 Law on State Bank of Vietnam and the Law on Credit Institutions comprise the current legal framework for banking business in Vietnam. The Law on Credit Institutions introduced a new regime for the establishment and operation of both domestic and foreign credit institutions. The Law created licensing and regulations for banking businesses such as funding, internal audit and inspection, state bank supervision, fiduciary requirements, dissolution, bankruptcy and liquidation. Vietnam's Law on Credit Institutions introduced rule-based supervision consistent with international banking standards.

In 2001, the Vietnamese government adopted a more market-oriented banking and state enterprise reform program. Supported by the IMF, the World Bank and other international donors including the US, the goals of this reform program were to ensure the stability of the banking system, expand banking services and rationalize domestic resource allocation by ensuring resources are dedicated to commercially viable activities. The reform program focuses on three main areas – restructuring of joint stock banks, restructuring and commercialization of state owned banks, and improving the regulatory framework and enhancing transparency.

Under WTO commitments, Vietnam committed to permitting the establishment of 100% foreign owned banks from April 1, 2007. The scope of operations of foreign bank branches, joint venture banks and 100% foreign owned banks has also gradually expanded to comply with Vietnam's commitments under World Trade Organization (WTO) and other bilateral and multilateral international agreements.

The State Securities Commission ("SSC") is the state body that manages and controls the operation of the Vietnamese securities market. A public list of securities must be registered with the SSC. Vietnamese law requires all public companies to register their securities with Vietnam Securities Depository (VSD), which is a limited liability company owned by the state and whose principal functions include: register and deposit securities which are publicly issued and listed and traded on the stock exchanges and Unlisted Public Companies Market ("UPCoM"), which is a market established by the Ministry of Finance ("MOF") to regulate over the counter shares and convertible bonds of unlisted public companies; clear and settle transactions of securities traded on the stock exchanges and UPCoM; and act as a transfer agent and handle corporate actions for issues which have securities that are publicly issued, registered and listed on the stock exchanges and UPCoM.

The local securities capital market is divided into two categories: primary market, where newly issued securities are first sold and bought; and secondary market, where securities are traded after they are sold at the primary market. Securities Trading Centers ("STCs") were opened in Ho Chi Minh City in 2000 and Hanoi in 2005. In August 2007, the Ho Chi Minh City STC was converted and renamed the Ho Chi Minh Stock Exchange ("HOSE") and the Hanoi STC became the Hanoi Stock Exchange ("HNX"). HOSE is the larger stock exchange in Vietnam.

Prior to the opening of HNX and HOSE, Vietnam had no officially traded securities. By February 2006, there were 35 listed stocks. By 2006, there were 65. During that time, the capitalization of Vietnam's stock market more than tripled to approximately US$8 billion. In response to the government's policy initiatives to push companies trading on the unofficial equity market (the over the counter, OTC, market) to list on the official boards, additional companies have joined the VN INDEX or Vietnam Index. The majority of listed firms are former state-owned enterprises ("SOEs") that have undergone a restructuring/equitization program. Recently, however, many small companies that have been growing rapidly are listing their shares and relying on the stock market, rather than loans from family members and banks, for capital. Unfortunately, the market for initial public offerings ("IPOs") has several problems to be resolved including excessive IPO prices and a significant gap in time, sometimes as much as a year, between when a stock is listed and subscribed and when purchasers must pay for the stock.

§1:18 Financing for growth-oriented entrepreneurship

The following sections provide an overview of financing for growth-oriented entrepreneurship, including venture capital, in various developed and developing countries. The information in the profiles is necessarily subject to the caveat that it is not maintained on a regular basis and readers should assume that circumstances may have changed since the profiles were first prepared. Information on each of the countries and regions included in the profile is available from public sources and financing for growth-oriented entrepreneurship, as well as other topics relating to entrepreneurial ecosystems, has become a staple of leading business publications around the world. When preparing the profiles the focus of attention in developed countries was on funding for "high-growth enterprises", which the Organisation for Economic Co-operation and Development has defined as enterprises with average annualized growth in employees (or in turnover) greater than 20% a year, over a three-year period, and with ten or more employees at the beginning of the observation period, and "gazelles", which are a subset of high-growth enterprises that have been formed, or "born", five years or less before the end of the three-year observation period. Profiles of financing for entrepreneurship in developing countries cast a wider net since fewer high-growth enterprises and gazelles are operating in those countries at this time.

§1:19 --United States

The United States is the clear global leader in the volume of venture capital financing and a wide array of resources are available for information and analysis on the US venture capital market and industry. The National Venture Capital Association ("NVCA") has become the widely recognized trade association of the venture capital community and the NVCA website includes research reports on venture capital investment, fundraising, exits and performance. The NVCA collaborates with PricewaterhouseCoopers to produce MoneyTree reports on a regular basis that provide quarter-to-quarter comparisons of venture capital activity using data from Thomson Reuters. Professional services providers, such as law firms, also aggregate deal information from their clients to produce "state of the market" reports for investors and entrepreneurs. Data from venture capital activities during the first half of 2015 indicated that venture capital investments had risen to their highest levels since 2000.[107]

In a 2002 survey that actually focused on the influence of immigrant professionals in Silicon Valley Saxenian reported that a majority of Silicon Valley companies, regardless of whether they were led by US or foreign-born entrepreneurs, followed a similar path during their launch phase: incorporated in the US, raised money from personal savings and angel investors initially, and then subsequently tapped venture capitalists for

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[107] For detailed discussion of the terms and conditions of preferred shares typically issued to venture capital investors in the US, see the chapter on "Venture Capital" in this Library.

additional financing.[108] Entrepreneurs from all of the surveyed companies, regardless of leadership, complained that "access to investors" was their biggest problem with respect to financing their ventures and reported that "friends and family" were their closest allies when looking for help in raising money.[109]

One of the most striking features of the results of the study by the SPEC was the remarkable diversity among the companies in spite of their common roots within the mythical Silicon Valley culture and the related business and social network. A number of theories on organizational development argue against the high level of diversity found among the companies in the SPEC study group. For example, neo-institutionalists that have studied the development and growth of Silicon Valley have predicted that companies will adopt specific corporate structures and practices because of the profound influence of venture capitalists, human resource professionals, and the law and accounting firms that advise those companies.[110] While the SPEC researchers conceded that companies receiving venture capital were more likely to bureaucratize more often and at an earlier stage[111], in general the companies that had been supported by venture capitalists in the study group evidenced substantial diversity in the organizational blueprints. This does not necessarily mean that venture capitalists did not have any influence upon the strategies and structures selected by their portfolio companies. In fact, many venture capitalists, in an attempt to differentiate themselves in what is often a very competitive marketplace where investors fight to get into promising new deals, are well known for their preferences for certain corporate cultures. One can identify venture capitalists that prefer to be associated with companies that are being built to survive based on long-term emotional ties, similar to the "commitment" model, while others are more interested in "Star" cultures or companies that value technological excellence and structure their organizations and selection processes accordingly.[112]

While only 42% of the companies studied by the University of Chicago researchers had a CFO among their top five executives at the time of their earliest business plan the importance of financial reporting and capital management for publicly traded companies pushed the CFO into this top group for 80% of the companies at the time of their IPO and 85% of the companies by the date of their third annual report following their IPO.[113]

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[108] A. Saxenian, Local and Global Networks of Immigrant Professionals in Silicon Valley (2002), 37.

[109] Id. at 42-43. Current or formerly colleagues came second with regard to helping raise money (actually of equal importance to friends and family for those born in the US) and professional associations ranked a distant third. Id.

[110] M. Suchman, "Dealmakers and Counselors: Law Firms as Intermediaries in the Development of Silicon Valley", in M. Kenney (Ed.) Understanding Silicon Valley: The Anatomy of an Entrepreneurial Region (2000), 70 (as cited in J. Baron and M. Hannan, Entrepreneurship: Lessons from the Stanford Project on Emerging Companies (September 2003), 9).

[111] J. Baron, M. Burton and M. Hannan, "Engineering Bureaucracy: The Genesis of Formal Policies, Positions, and Structures in High-Technology Firms", Journal of Law, Economics, and Organization, 15(1) (1999), 1, 41 (as cited in J. Baron and M. Hannan, Entrepreneurship: Lessons from the Stanford Project on Emerging Companies (September 2003), 9).

[112] J. Baron and M. Hannan, Entrepreneurship: Lessons from the Stanford Project on Emerging Companies (September 2003), 9-10.

[113] S. Kaplan, B. Sensoy and P. Stromberg, What are Firms?: Evolution from Birth to Public Companies (2005).

§1:20 --United Kingdom

With regard to financing, even though the UK has traditionally been the most developed venture capital market in Europe, and second only to the US on a global basis, the percentage of venture capital funding available to early-stage high risk companies has long been considered to be grossly inadequate and venture capital firms in the UK have typically been more interested in funding management buyouts and buy-ins involving mature businesses.[114] A report issued at the end of the 1990s by the British Venture Capital Association estimated that, as a percentage of GDP, the UK only invested one-third of what the US did in technology-based companies. With the exception of London, Cambridge has probably been the most successful region in the UK in developing a concentrated local pool of venture capital funds, including specialty funds focusing on particular technology sectors such as biotechnology, and angel investor sources. However, the size of these funds, and their investment range for a particular deal or portfolio company, pales in comparison to the mega-investors that have been active in Silicon Valley for several decades. Related issues impacting finance for emerging companies in the UK have included difficulties creating and sustaining formal capital markets catering to the needs of emerging companies and the introduction of relatively strict disclosure rules that significantly increased the time and expense associated with floating a new offering of securities.[115]

The availability and influence of venture capital investment in Silicon Fen has been a subject of much debate. In the early 2000s reports indicated that only a very small segment of startup companies in the Cambridge Cluster, perhaps only about 5%, had received financial backing from venture capitalists and many of the companies, particularly those that were spinoffs from larger and older firms, survived on consulting work and, if necessary, selling small amounts of equity to industry colleagues rather than seeking funding from venture capitalists.[116] At that time the consensus was that there was a shortage of local venture capital resources although some small funds were operating and specializing in technology investments. As a result, entrepreneurs looking for funding beyond their own resources needed to tap into local technology consultancies that operated as incubators as well as a fledgling network of angel investors; however, there were also others who argued that venture capital was readily available in nearby London and elsewhere for those companies that were truly interested in accessing the

[114] Koepp classified the activities of British venture capitalists as "merchant venture capital" and cited a study conducted by the Bank of England in the late 1990s that found that only 1% of venture capital funding in the UK could be considered "high-risk investment" and that only a small part of this 1% found its way to early-stage technology firms. R. Koepp, Book Excerpt: Clusters of Creativity, The Milken Institute Review (First Quarter 2003), 65, 81 (excerpting from R. Koepp, Clusters of Creativity: Enduring Lessons on Innovation and Entrepreneurship from Silicon Valley and Europe's Silicon Fen (2002)).

[115] Koepp noted that the UK did take steps during the 1980s and 1990s to introduce second-tier markets that would make it easier for smaller companies to list their shares for public trading and obtain liquidity; however, the cost of public capital for UK emerging companies was, in general, much higher than the comparable costs for US technology firms. R. Koepp, Book Excerpt: Clusters of Creativity, The Milken Institute Review (First Quarter 2003), 65, 81 (excerpting from R. Koepp, Clusters of Creativity: Enduring Lessons on Innovation and Entrepreneurship from Silicon Valley and Europe's Silicon Fen (2002)).

[116] "Silicon Fen Strains to Grow", The Economist (April 12, 2001).

money and managerial and strategic support offered by professional investors. Naughton reported on a club of Cambridge angel investors, numbering 56 as of November 2013 and all of whom with a net worth in excess of £15m and a track record of at least one successful "exit" from a startup, that provides a source of mentoring, critical feedback and seed funding to entrepreneurs well in advance of the stage where venture capitalists would be interested in their firms.[117]

§1:21 --Israel

Israel's first venture capital fund, Athena Venture Partners, was established in 1985 by Major-General Dan Tolkowsky, who was a past Chief of Staff of the Israeli Air Force, Dr. Gideon Tolkowsky and Frederick R. Adler, a leader of the US venture capital industry who believed that successful Israeli emerging companies could eventually become listed on US stock exchanges.[118] Additional venture capital funds were launched in the early 1990s, with investors from the US and other foreign countries such as South Africa[119], and the government lent support to the efforts to establish an Israeli venture capital industry by offering both tax incentives to foreign investors and promises of doubling any investment made by a venture capital fund with capital provided by the government.[120] The results of these efforts were spectacular as annual venture capital outlays during the 1990s exploded from $58 million at the beginning of the decade to $3.3 billion by 2000. During that same period the number of companies that were launched using funds provided by the Israeli venture capital industry skyrocketed from 100 to 800 and Israel rose to second only to the US worldwide with respect to invested private equity capital as a percentage of GDP.

As of the end of the 2000s Israel was at the top of the global charts with respect to R&D investment as a percentage of GDP.[121] In addition, hundreds of international funds, including many from the US, have actively invested in Israel through in-house specialists in their home offices even though they themselves did not have a local presence in Israel. Syndication of venture capital deals among groups of investors including both Israeli venture capital firms and foreign investors is commonplace in Israel.

A group of Israeli experts ranked the area of financial support in Israel for new businesses higher than all of the other countries included in the global survey of entrepreneurship conducted by the Global Entrepreneurship Monitor (GEM) in 2007.[122] Specific findings included confirmation that Israel had enough available equity funding for new businesses, credit financing for setting up new and growing businesses, available

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[117] J. Naughton, "They Call it Silicon Fen: So What is the Special Draw of Cambridge?", The Observer (November 30, 2013).
[118] See Company Overview of Athena Venture Partners, Bloomberg Businessweek (the fund was dissolved in 1997) and Ahavat-Israel, Israeli Venture Capital.
[119] Globes: Israel's Business Arena, Gideon Tolkowsky, Veritas.
[120] G. Gilder, Silicon Israel—How Market Capitalism Saved the Jewish State, City Journal 19(3) (Summer 2009).
[121] OECD Factbook 2010: Economic, Environmental and Social Statistics
[122] E. Menipaz, Y. Avrahami and M. Lerner, Global Entrepreneurship Monitor (GEM): Israel National Entrepreneurship Report 2007 (Beersheba, Israel: Ben-Gurion University of the Negev, 2009).

financing from private individuals (other than the founders) and venture capitalists who provide financial support to new and growing businesses and available financing by means of initial public offerings on the stock exchange for new and growing businesses. There were, however, concerns was with respect to the availability of governmental subsidies for the advancement of new businesses and this issue seems to be more problematic for conventional businesses since high-tech businesses appear to be well supported by governmental programs.[123] The experts also noted that many new businesses with no ongoing, recognized track records often had difficulties in obtaining quality services from Israeli banks and it was recommended that the government consider implementing loan guarantee programs for new businesses that might increase the credit that such businesses receive from private lenders. [124] A similar concern has been raised about the dearth of financial resources to support pre-seed funding in areas of keen interest such as biotechnology and medicine and commentators have recommended that the government provide funding currently unavailable from venture capitalists and other sources for proof of the industrial and commercial feasibility of projects, an activity that generally requires about $1 - $1.5 million in funding before a more elaborate business model can be launched.[125]

PwC Israel promulgated an extensive report on the recent development of the Israeli venture capital community.[126] The report noted that Israeli companies raised about $11.1 billion from 2001-2010 and that venture capital investment per capita in Israel was the highest in the world throughout that entire period[127]; however, the report also highlighted a number of challenges that confront the continuing impact of venture capital on the growth of the technology sector in Israel in the future, including the following[128]:

- The relative labor and cost advantages that Israel may have enjoyed over other destinations for technology investment, notably China and India, is deteriorating—the report noted that the cost of Israeli engineers is two to three times the cost of similar skilled workers in China and India.
- The small size of the Israeli domestic market is putting it at a disadvantage in relation to much larger countries such as China and India when competing for foreign direct investment capital.
- During the period running from 2001-2010 the level of venture capital investments in Israel was declining and there was also a significant decrease in the number of active venture capitalists—the report noted that while 44 venture capitalists made 90% of

[123] Id. at 54-55.
[124] Id. at 65 and 80.
[125] Id. at 82.
[126] PwC Israel, The PwC Israel MoneyTree Report: Venture Capital in the First Decade of the Third Millennium (PwC Israel, 2011). For further discussion of the development and evolution of the Israeli venture capital sector, see G. Avnimelech and M. Teubal, Venture Capital Policy in Israel: A Comparative Analysis and Lessons for Other Countries.
[127] By way of comparison, US high technology companies supported by venture capitalists raised about $247 billion from 2001 through 2010. PwC Israel, The PwC Israel MoneyTree Report: Venture Capital in the First Decade of the Third Millennium (PwC Israel, 2011), 4.
[128] PwC Israel, The PwC Israel MoneyTree Report: Venture Capital in the First Decade of the Third Millennium (PwC Israel, 2011), 2-3.

the investments at the beginning of the decade by the end of the decade 20 venture capitalists combined for 90% of the activity at that time. The future looks even more challenging as Israeli institutional investors appear to prefer Eastern European real estate investments as opposed to domestic technology companies.

- The activity and presence of "angel investors" in Israel lags behind the US although there are some proposed changes in the law to provide tax incentives for early stage investments in start-up companies and encourage institutional investors to support research and development companies.

The report noted that it can be expected that Israeli venture capital funds will soon be looking to raise additional capital since many of them have relatively mature portfolios of current investments that will need to be liquidated in the next two to three years as required under the terms of agreements with investors that provided the capital to the funds in the first place. The ability of those funds to attract new capital will depend on how the issues noted above play out as well as other factors such as the success of governmental and university efforts to build an Israeli presence in key technology areas such as "green tech" and biotechnology. The Israeli venture capital community also shares the concerns of others described in this chapter regarding neglect of education and training in science, engineering and entrepreneurship in Israel and the impact this might have on the perceived human capital advantage that Israel has enjoyed for so long.

The IVC Research Center, which collects and disseminates information on Israel's high technology industries, reported that in 2009 Israeli venture capital funds provided only 37% of the investment in the country's technology-focused companies and that the bulk of the capital came from investors in the US and Europe.[129] Abrar reported that Israel has been able to attract over twice as much venture capital investment per capita than in the US and 30 times more than all the members of the EU combined, and that as of 2013 there were about 70 active venture capital funds in Israel, of which 14 were international.[130] According to figures compiled by the IVC Research Center around 575 Israeli companies raised an aggregate of $1.92 billion in 2012, down 10% from 2011 but up from 52% in 2010. While the bulk of foreign venture capital flowing into Israel has traditionally come from the US, the projected expansion of the Israeli technology cluster is expected to require funding from other parts of the world. While the UK and other European countries have shown great interest in collaboration with Israeli technology firms, the Israeli have appeared to show a preference for teaming up with investors in the Far East that can presumably provide access to the large and growing Asia-Pacific markets.[131]

While the GEM researchers reported that angel investment activity in Israel as of 2007 was at its lowest point since the GEM project had begun in 2007, the GEM 2010 report disclosed, somewhat surprisingly in light of the difficult economic conditions during the late 2000s, that Israeli angel investors had actually steadily increased their funding

[129] Israel Venture Capital Research Center (March 2010).
[130] P. Abrar, What Makes Israel with Just Eight Million People, An Innovation Hub? (November 8, 2013).
[131] B. Rooney, "Israel's Big Tech Sector Looks to Produce Bigger Companies", The Wall Street Journal (October 23, 2013).

activities each year since 2008 to the point where angel investment reached its highest level in 2010.[132] The GEM researchers suggested that this trend may have reflected a tendency among angel investors to proactively search for new untapped growth opportunities during periods of crisis and noted that the increase in angel investment was particularly welcome given that entrepreneurs were encountering difficulties in securing capital from alternative sources such as banks. The researchers found that about 71% of the Israeli angel investors invested in a friend, neighbor or a close family member and that there was a noticeably higher interest in backing Arab and Russian immigrant minorities, particularly women in those groups, within the angel community. The greater support for the Arab and Russian immigrants was noteworthy because they had traditionally suffered due to lack of access to institutional funding in Israel. The GEM Israel 2012 Report confirmed that angel investment activity in the country had continued to grow in 2011 and 2012.[133]

In its 2011 report on Israel venture capital during the first decade of the new century, PwC Israel referred to the decade as a "rollercoaster ride" that ended with Israel firmly established as a "high-tech nation" with the highest venture capital investment per capita in the world and a reputation for broad availability well-seasoned technical capabilities.[134] PwC Israel sounded cautionary notes, however, in several important areas. For example, the costs associated with Israeli engineers were significantly higher than the costs of their counterparts in China or India and the sheer size of the Chinese and Indian domestic markets made them more attractive destinations for global investment capital than Israel. PwC confirmed that findings of others that there had been an overall decrease in venture capital investment in Israel from 2001 to 2010 and a significant decrease in the number of active venture capitalists in Israel (i.e., (the number of venture capitalists responsible for 90% of the investments declined from 44 at the beginning of the decade to just 20 by 2010). PwC noted that Israeli institutional investors showed little interest in providing financial support for technology businesses in Israel and tended to prefer real estate investment in Eastern Europe. While there has been an uptick in Israeli angel investing it remains modest by comparison to US angels. PwC observed that many Israeli venture capitalists have mature portfolios and that there will be a significant volume of exits throughout the 2010s. PwC argued that the results of these investments would be critical in setting investment levels, and the ability of Israeli venture capitalists to raise new capital, in the years to come. PwC also joined others in commenting on the inability of Israeli entrepreneurs to build "mega companies" and observed that "it is somewhat frustrating to realize that the Israeli entrepreneur is not aiming to be a global leader".[135]

Figures compiled by the IVC Research Center for 2009 revealed that 24% of the venture capital investment in Israel flowed to life sciences companies, making it the most popular industry sector for venture capitalists, and that investors were also quite interested in software (23% of total investment), communications (20% of total investment) and Internet companies (13% of total investment).[136] Life sciences and software remained the

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[132] E. Menipaz, Y. Avrahami, Y. Avrahami and M. Lerner, GEM 2010 Israel National Entrepreneurship Report (2011).
[133] E. Menipaz, Y. Avrahami and M. Lerner, GEM Israel 2012 National Summary (2013).
[134] The discussion in this paragraph is adapted from PwC Israel, Venture Capital in the First Decade of the Third Millennium: The PwC Israel MoneyTree Report 2001-2010 (2011).
[135] PwC Israel, Venture Capital in the First Decade of the Third Millennium: The PwC Israel MoneyTree Report 2001-2010 (2011).
[136] IVC Research Center, IVC High-Tech Yearbook 2009.

two most popular sectors in 2013, 23% and 21% respectively of total investment for that year, and analysts predicted that the software sector would continue to grow as Israeli entrepreneurs concentrated their efforts on cybersecurity, cloud infrastructure and big data and recruited growing numbers of former military systems professionals entering the Israeli civil market.[137]

The IVC Research Center reported that venture capital investment in Israel reached a ten year high in 2013 with 662 companies raising $2.3 billion.138 Of that amount, which was second only to the $3.1 billion raised in 2000, three-quarters went to fund 395 startup companies. Israeli venture capitalists contributed $546 million, continuing a year-over-year increase in the amount of funding; however, this represented an all-time low of just 24% of overall venture capital financing in Israel. The survey data indicated that the average round of financing was $3.47 million, which was up from $3.37 million in 2012 and just under the ten-year average of $3.56 million. Sela of KPMG Somekh Chaikin noted that foreign investors continued their traditional emphasis on later stage investments but were also broadening the scope of the industries in which they were participating. He commented that the relatively low percentage of total investment from Israeli venture capitalists and institutional investors would ultimately deprive Israel of the returns and tax payments from successful emerging companies and urged Israeli regulators to identify and remove barriers to greater participation by local investors.

Israel has a long history of supporting “incubators” for technology-oriented businesses and, in fact, the government, through its Office of the Chief Scientist, launched six incubators in the early 1990s to support seed and early stage development of entrepreneurial technology companies that could leverage the skills and experiences of the large number of scientists, engineers and physicians that had just arrived at that time from the former Soviet Union.139 By the middle of 2000s there were over incubators operating throughout Israel and their primary focus remained science-related R&D. These incubators have been successful in raising substantial amounts of private investment and continue to receipt large amounts of financial support from the Office of the Chief Scientist.

§1:22 --Korea

The Korean government has been undertaking a series of political and economic reforms to provide support for entrepreneurship and creation of new technologies as tools for fueling growth including the announcement of plans to invest $3.7 billion in early-stage Korean companies.[140] Cheng explained that the funds set aside by the government were to be allocated to a variety of programs and administered by several different agencies including the Korea Institute of Startup and Entrepreneurship Development, the National

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[137] Globes: Israel’s Business Arena, High-Tech Investment Hits 10 Year High (January 22, 2014).

[138] The discussion in this paragraph is adapted from Globes: Israel’s Business Arena, High-Tech Investment Hits 10 Year High (January 22, 2014).

[139] Israel's High-Tech Boom, The Jewish Policy Center, Summer 2008

[140] T. Thriveni, South Korea Gets the Startup Bug, USA Today (March 5, 2014), http://www.usatoday.com/story/tech/2014/03/05/ozy-startups-korea/6078853/

IT Industry Promotion Agency, the Korean Internet Security Agency, the Korea Trade-Investment Promotion Agency and the Korea Creative Content Agency.[141] Among other things, support will be provided for startup competitions, seed capital provided in the form of direct grants and investment and programs that fund visits by Korean entrepreneurs to Silicon Valley and other global technology clusters such as London, Israel and Singapore in order to expose them to technological trends and best practices for launching entrepreneurial ventures. Other initiatives include creation of innovation centers that are connected with Korea's major national universities.

Government support of private venture capital activities in Korea is extraordinary in scope, particularly in relation to the US: a founder of a leading incubator and accelerator in Seoul claimed that 60% of venture capital investment in Korea is backed by the government as opposed to just 1% in the US; however, it is consistent with long-standing industrial policies in Korea which have featured leadership and direction from the top.[142] Historically, government support for venture capital has come in a variety of forms including direct capital investment as a limited partner in venture capital funds and indirect support through the creation of preferential tax incentives to venture capital activities. The government has announced plans to team with local accelerators and investors to co-invest in promising Korean startups and it is expected that the willingness of the government to provide venture investment matching of up to 9 to 1 (e.g., of the $1 million in funding for a new startup only $100,000 would come from private investors and the remaining $900,000 would be publicly underwritten) will increase the number of Korean accelerators and early-stage venture capitalists.[143] In addition to providing financial support to startups through direct investments the government has promoted the establishment of a new domestic stock market to assist entrepreneurs in raising money from the public, introduced new laws intended to make it easier for startups to engage in crowd-funding and announced plans to provide tax breaks and other incentives to large Korean corporations to invest in startups.[144]

Venture capital first emerged in Korea during the 1970s and has long been recognized as a means for growing the Korean economy and as an important industrial policy tool with respect to financing, nurturing and growing startup or early stage companies pursuing new business opportunities. One of the leading organizations in Korea in the venture capital area is the Korean Venture Capital Association ("KVCA"), which was established

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[141] J. Cheng, Seoul Bankrolls Burgeoning Startups, Wall Street Journal Online, February 10, 2014, http://online.wsj.com/news/articles/SB10001424052702303874504579373922317838510 (accessed June 10, 2014).

[142] M. Gamper, "The World's Largest Startup"—Can Korea's New Culture of Business Creativity Rival Silicon Valley?, Venture Village (December 24, 2013), http://venturevillage.eu/korea-startup (accessed June 12, 2014).

[143] D. Crichton, Creating Billion-Dollar IPOs And Deleting ActiveX: The Elixir Making Korea The Key Startup Ecosystem In Asia, TechCrunch (March 25, 2014), http://techcrunch.com/2014/03/25/creating-billion-dollar-ipos-and-deleting-activex-the-elixir-making-korea-the-key-startup-ecosystem-in-asia/?utm_campaign=fb&ncid=fb (accessed June 11, 2014).

[144] Y. Lee, South Korea fosters startups as it seeks economic shift, Associated Press (May 31, 2013), http://www.northjersey.com/news/south-korea-fosters-startups-as-it-seeks-economic-shift-1.706665#sthash.YKDs6mYl.dpuf (accessed June 16, 2014).

in 1989 to represent the country's venture capital industry.[145] The KVCA is a member-based organization that had grown to include more than 89 venture capital companies by the early 2010s. According to KVCA itself, its mission is not only to promote a more favorable system and vibrant investment environment for the development of the venture capital industry, but also to enhance awareness and understanding of the importance of venture capital to Korean economy. The KVCA is also interested in facilitating interaction among its members and communications between its members and other important players in the venture capital sector including institutional investors, entrepreneurs and policymakers. Other activities of the KVCA have included networking in the international venture capital community, professional development and implementation and dissemination of professional standards across the industry.

The KVCA has noted that the major sources of venture capital funding in Korea have traditionally been the government, corporations and venture capital firms, but that pension funds and financial institutions—banks and securities firms—have also been increasing their participation in the market. Statistics compiled and made available by the KVCA on its website indicate that information technology ("IT") was by far the most popular industry sector for venture capital investment in Korea in 2013 and that manufacturing, entertainment and biotechnology followed behind in the next three places. Those four industries together attracted over 85% of total venture capital investment in Korea during that year. Investment in IT and biotechnology were significantly higher in 2013 than in 2012 and, in fact, overall venture capital investment in Korea had increased by about 12% from 2012 to 2013. When analyzed in terms of the amount of investment by stage of company development, Korean venture capitalists allocated their money in 2013 as follows: 27% to early stage companies, 23% to expansion stage companies and 50% to later stage companies. There were 101 registered venture capital companies in Korea as of 2013 and the 431 venture capital funds at that time.

Kim made the interesting observation that support from local investors for a new wave of technology-driven startups in Korea has been slowed by the difficulties that many of them, particularly older ones, have had in understanding non-manufacturing technologies and the new business models that younger entrepreneurs have been following.[146] Many Korean investors lack the educational and professional foundation to quickly grasp new ideas and this makes many startups appear even more risky than they already are. In response to all of this, Korean entrepreneurs have been forced to look to the US and Europe for investors who already have some experience with technologies and business models that have not yet been widely seen in Korea.

Many believe that significant changes will need to be made in Korean lending practices and bankruptcy laws in order to reduce the dramatic risks that local entrepreneurs face when they attempt to fund their companies with bank loans, since banks typically require personal guarantees from the founders before committing funds.

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[145] This discussion of the Korean Venture Capital Association ("KVCA") is based on information available on the KVCA website at http://www.kvca.or.kr/ (accessed June 17, 2014).

[146] J. Lim, Korean Start-Ups: Starting the New Wave, Tech Node (August 1, 2011), http://technode.com/2011/08/01/korean-start-ups-starting-the-new-wave/ (accessed June 14, 2014).

§1:23 --Japan

Allen and Gale found that "internal finance" (i.e., allocation of personal savings, retained profits, working capital and proceeds from the sale of fixed assets) was by far the most important source of funds used by Japanese firms for their investment purposes; bank financing was also an important source of financing; and bond and equity financing was relatively unimportant.[147] Allen and Gale also examined the link between savings and firm investment in Japan and several other developed countries by looking at the savings portfolios of households in those countries and found that the percentage portfolio allocation of cash and cash equivalents (including bank accounts) among Japanese households, as well as households in France and Germany, was much higher than households in the UK and US, countries in which equities were a much more important component of the assets held by households in their saving portfolios. These findings tended to support the traditional distinction between the UK and the US as "market-based" financial systems and the other countries, such as France, Germany and Japan, as "bank-based" financial systems.

Since the end of World War II, Japan's macroeconomic policies, as well as the organization and regulation of Japan's financial and credit institutions at the microeconomic level, have been dedicated to achieving growth in specific target industries. The underlying theory of these policies was that growth could be accomplished by ensuring that firms had access to reliable sources of funds at interest rate costs below those being borne by their international competitors. To achieve these objectives, the government took an active role in not only the regulation but also the operation of the nation's banking institutions. Moreover, an effort has been made to develop the nation's capital markets and to provide other outlets for the funds accumulated through the propensity of the citizenry and its businesses to save and invest.

The pattern of financing for Japanese firms has been such that equity has been a relatively unpopular and unattractive means of financing and investment. Japanese firms have tended to focus on such long-term objectives as market share and reliable cash flow for new investment rather than on the value of share prices. Thus, the ability of firms to deliver attractive returns to their investors has been of relatively minor concern until recent years. Nonetheless, formal equity markets have been in place in Japan for a number of years. Domestic stock offerings are regulated by Ministry of Finance

[147] The discussion in this section is based on F. Allen and D. Gale, Comparative Financial Systems: A Survey, http://www.econ.nyu.edu/user/galed/papers/paper01-04-01.pdf, 3-8. The article also appears as F. Allen and D. Gale, "Comparative Financial Systems: A Survey", in A. Boot, S. Bhattacharya and A. Thakor (Eds.), Credit, Intermediation and the Macroeconomy (2004) 699. The data, and the analysis thereof, was based on C. Mayer, "New Issues in Corporate Finance", European Economic Review, 32 (1988), 1167; C. Mayer, "Financial Systems, Corporate Finance, and Economic Development", in R. G. Hubbard (Ed.), Asymmetric Information, Corporate Finance and Investment (1990); E. Bertero, "The Banking System, Financial Markets, and Capital Structure: Some New Evidence From France", Oxford Review of Economic Policy, 10 (1994), 68; and J. Corbett and T. Jenkinson, "The Financing of Industry, 1970-1989: An International Comparison", Journal of the Japanese & International Economies, 10 (1996), 71.

("MOF"); however, listing requirements and market regulation remain immature in relation to the US and other Western capital markets. On balance, Japan's capital market strategies through the 1980s were extremely successful in facilitating the economic growth of the nation and its firms and the 1990s started with a tremendous upswing in the Japanese stock markets; however, when monetary policy was tightened, a collapse followed—one that has lingered for nearly twenty years.

In 2008, the name of the Securities and Exchange Law, which had regulated stocks and securities in Japan, was amended to the Financial Instruments and Exchange Law ("FIEL"). In addition, the following four laws were abolished and consolidated into the Financial Instruments and Exchange Law: Financial Futures Trading Law; Law Concerning Foreign Securities Firms; Law Concerning the Regulation of Investment Advisory Services Relating to Securities; and Law Concerning the Regulation of Mortgage Business. The scope of "securities" was expanded under the FIEL. For example, all interests in trusts are deemed securities, and interests in collective investment schemes are treated as securities. The prior Securities and Exchange Law, in contrast, only listed government bonds, local government bonds, corporate bonds, stocks, investment trusts, and the like, as "securities." Some financial instruments, such as bank deposits and insurance, continue to be regulated under the Banking Law and the Insurance Business Law, respectively, and thus are not subject to direct regulation under the provisions of the FIEL.

The FIEL requires registration for "sales and solicitation" operations of securities and derivative transactions, as well as "investment advisory," "investment management" and "customer asset administration" services for cross-sectional regulation. Under FIEL, financial instrument firms must comply with specified rules of conduct in carrying out sale1s or solicitations of securities or derivative transactions firms engaged in the conduct of securities business are required to deliver documents to customer, other than customers classified as "professional investors", before making a contract. Other provisions in the FIEL establish certified investor protection organizations; mandate "quarterly reporting" for listed companies, who are subject to audits by certified public accountants or auditing firms and subject to criminal or civil penalties for submitting false quarterly reports; mandate "internal control reports" to ensure appropriate disclosure of financial and corporate information; and require submissions of "certifications" by management of listed companies stating that the descriptions in their financial statements are appropriate and in compliance with laws and regulations. Finally, the FIEL includes serious sanctions against violations of disclosures requirements, unfair trading and market manipulation and insider trading.

Key characteristics of the domestic venture capital markets in the US and Japan cited by Eberhart during his work with the Stanford Project on Japanese Entrepreneurship highlight dramatic differences.[148] For example, in 2006 there were 3,080 deals in the US that raised about $23.5 billion while the comparable figures for Japan in that year were 1,500 deals and $2.8 billion raised. While the number of deals was roughly equivalent

[148] R. Eberhart, Japanese Venture Capital: An Analysis of Start-up Investment Patterns vs. Silicon Valley (July 2009).

between the two countries after taking into account the relative size of their economies, the average deal size in Japan was just one-fourth of the average size of US deals and the internal rate of return on those investments was much lower in Japan than in the US. Eberhart explained that the empirical differences between the two countries had typically been attributed to two sets of factors. The first set were characterized as "institutional" and included a lack of syndication (i.e., no common contracts among multiple investors providing funding at the same time and no designated director from the venture capital investment group); greater ownership control by founders at the time of any exit event; the structure of Japanese venture capital firms, which featured shareholders focused on a risk diversification strategy and reliance on an internal staff to identify and promote potential investments; and tax implications. The second set of factors were bundled under the central category of cultural explanations and included risk aversion among venture capitalists consistent with the broader societal culture in Japan; the resistance among founders of Japanese start-ups to surrender control to outside investors, something that was commonly accepted and expected by founders in the US seeking venture capital investment; and poorly developed reputation markets for Japanese venture capitalists that made it more difficult for entrepreneurs in that country to vet prospective investors.

Eberhart argued that the differences between the two countries could better be explained by focusing on the strategies used by venture capitalists to manage and control "common shareholder opportunism" (i.e., the possibility that the founders, as holders of common shares, would act in their own interests and in a manner adverse to the interests of the investors providing the capital). In the US, for example, venture capitalists obtained control over their portfolio companies at an early stage through larger investments and acquisition of preferred shares. In contrast, Japanese venture capitalists typically became common shareholders, minority owners in relation to the founders, and thus had less divergent interests and less ability to control the company through the acquisition of shares and preferred voting rights. According to Eberhart, the amount of control pursued by the venture capitalists in both countries was related to their need to mitigate opportunistic agency costs. US investors had more concerns about these costs and thus aggressively pursued control; however, once control was secured they were willing to provide more sizable investments that increased potential returns, albeit with higher levels of risk. Correspondingly, Japanese investors with less need, or ability, to mitigate opportunistic agency costs concluded that less money was needed to mitigate these costs, thus explaining the smaller deal sizes and reduced returns on investment in Japan.

Karlin argued that the biggest challenge facing prospective growth-oriented entrepreneurs in Japan is raising capital for their new businesses and noted that entrepreneurs are generally unable or unwilling to secure funding from "friends and families" and do not have access to the large communities of angel investors that have established themselves in Silicon Valley and other innovation clusters around the world.[149] With regard to angel investors, Karlin suggested that many of the successful Japanese entrepreneurs were, in his words, "one-hit wonders" rather than serial entrepreneurs with a long-term passion for being involved in starting new businesses, and thus tended to be more conservative and

[149] A. Karlin, The Entrepreneurship Vacuum in Japan: Why It Matters and How to Address It (January 2, 2013).

preferring to invest their wealth in stable and secure Japanese debt securities or the US stock market. Japanese banks had typically not been willing to provide loans to local entrepreneurs and when banks have provided support they typically demand that all of the assets of the business be used as collateral and that the founders provide personal guarantees. According to Karlin, foreign venture capitalists, particularly those from the US, have shown little interest in Japanese companies unless their founders are proficient in English and their business model calls for expansion beyond Japan's own limited domestic market. Other reasons given for the apparent lack of interest in Japan among foreign venture capitalists have included obscure accounting principles, concerns about the availability of relief in Japanese courts, and a perception that many new technologies introduced in Japan are simply too risky and futuristic.[150] Finally, Karlin reported that the domestic venture capital industry is small, perhaps because of the perception that there are limited opportunities for investment, and that Japanese venture capitalists had been criticized for their conservatism, aversion to risk, unprofessionalism, and lack of operational experience in running start-ups that makes them poor mentors for the founders of the companies that they do invest in. Japanese venture capitalists have also been accused of not supporting women entrepreneurs and not providing sufficient funding to help their portfolio companies scale to a size that is large enough to attract the interest of institutional investors if and when they are able to list their shares on the public market, a situation that actually reduces the attractiveness of investment in the company since it damages the eventual liquidity opportunities for the investors.[151]

§1:24 --Nordic Europe

Christensen noted that the level of involvement among Danish venture capitalists in the affairs of their portfolio companies varied significantly and found that their primary role was providing a link to other financing sources and serving as a networker and that they made only a modest direct contribution to innovation among their portfolio companies.[152] Half of the portfolio companies surveyed by Christensen reported that the involvement of their venture capital investors was either "a lot" or "very much". Christensen also concluded that venture capitalists in Denmark tended to be more highly involved with their portfolio companies when those companies were relatively large, innovative, financially fragile, and had high expected growth rates, and that ownership share and/or the age of the company were not significant factors in determining the level of their involvement.[153] Interestingly, Christensen argued that external environmental conditions influenced the venture capitalists' decisions given that at the time of his survey—the mid-2000s—Danish venture capital firms were under financial pressure and thus focused their efforts on second-round investments in selected existing portfolio companies, presumably to preserve their initial investment, rather than taking on new portfolio companies during a period of heightened overall risk due to global financial conditions at that time. In that

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[150] SPRIE-Stanford Project on Japanese Entrepreneurship, Panel Discusses Why U.S. VC Money Flies over Japan (November 11, 2011).
[151] E. Bayrasli, Entrepreneurship in Japan: Not in Tech (December 5, 2011).
[152] J. Christensen, Innovation and the Contributions from Venture Capital, Paper for DRUID Conference on Knowledge, Innovation and Competitiveness: Dynamics of Firms, Networks, Regions and Institutions (2006).
[153] Id.

situation, Christensen explained, the venture capitalists were apply specific competencies focusing on ensuring the surviving of their portfolio companies, perhaps by tapping into their networks to merge some of those companies with other firms.[154]

Isaksson provided a summary of several studies that he and his colleagues had completed on various aspects of the venture capital process in Sweden.[155] For example, Isaksson et al. conducted an empirical investigation of the standardization of contractual strategies used in the Swedish venture capital industry and found that the greatest differences occurred among those with differing investment preferences and that there was little difference between the contractual choices made by experienced and inexperienced venture capitalists.[156] Fredriksen and Isaksson examined the valuation practices of Swedish venture capital firms using interviews and a case prospectus of a firm that was valued by managers of the firms as part of the survey process.[157] The researchers were not only interested in identifying the most commonly used valuation methods, but also wondered whether valuation practices differed depending on "macro conditions", particularly the strength of external market in which the investment decisions were being made. The researchers found, to their surprise, that "in times of heightened stringency and economic downturn, venture capital investors employ fewer valuation models than they do in boom times". In 1999, venture capital managers relied primarily on DCF-models and relative valuation methods and also relied on "'rule of thumbs', 'common sense' or 'pit of the stomach' valuation, [and] 'kick-the-tire-valuation'".[158] A few years later, in 2002, venture capitals relied less on DCF techniques and more on relative valuation and "common sense".[159] As to how required rates of return were determined, the researchers identified two approaches: some venture capitalists accepted the forecasts and projections offered by the entrepreneurs and then added their own considerable risk premium, and other venture capitalists made adjustments to the projections provided by the entrepreneurs and then applied a more moderate rate of return when discounting the adjusted projections.

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Isaksson also found evidence among Swedish venture capital-backed companies to support a positive relationship between the level of trust between venture capitalists and the entrepreneurs of their portfolio companies and the financial performance of those companies, leading Isaksson to recommend that venture capitalists consciously focus on having governance structures that creates a trustworthy relationship between them and

[154] Id. Christensen suggested that Danish venture capitalists were providing two of the four types of venture capital "networks" identified by Florida and Kenney: a "financial" network, which includes the investors in the venture capital fund, syndication partners of the fund including other venture capitalists and angel investors, complementary financing sources, and even other portfolio companies, which can provide access to needed resources such as technology and alliance partners; and a network of accountants, lawyers, consultants and others that can provide professional services to portfolio companies. See R. Florida and M. Keeney, "Venture Capital and High Technology Entrepreneurship", Journal of Business Venturing, 3 (1988), 127.

[155] A. Isaksson, Studies on the Venture Capital Process (2006).

[156] A. Isaksson, B. Cornelius, H. Landström,and S. Junghagen, "Institutional Theory and Contracting in Venture Capital: The Swedish Experience", Venture Capital, 5(1) (2004), 47.

[157] O. Fredriksen and A. Isaksson, How Do Venture Capital Firms Value Entrepreneurial Ventures (2002).

[158] A. Isaksson, Studies on the Venture Capital Process (2006), 68-69.

[159] Id. at 69.

the entrepreneur and which includes, for example, cooperation, joint planning and problem solving.[160] Isaksson also argued that these types of governance structures reduce the need for the parties to negotiate and follow complex safeguarding mechanisms. Finally, Isaksson studied the impact of venture capital organization (i.e., independent, public sector or "captive") on exit strategies and exit-directed activities among venture capital-backed companies in Sweden and found that the organizational form did affect those strategies and activities.[161] Specifically, entrepreneurs financed by public sector venture capitalists were less clear about their exit strategies than entrepreneurs financed by other organizational forms and their companies tended to have fewer trade sale exit strategies and more buyback strategies. The researchers also found evidence of significant differences in the intensity of exit-directed activities between different exit strategies, with companies focused on trade sale exit strategies focusing more time and effort on activities associated with that strategy and formally integrating those activities into the overall company strategy. In contrast, companies pursuing buyback strategies tended to handle those transactions on an "ad hoc" basis with a great deal of formal advance planning.

§1:25 --France

A number of strategies were deployed in order to increase the pool of available financing for risk investment in radical innovation.[162] For example, tax incentives for French households to invest in venture capital were adopted in the mid-1990s to tap into the country's high private savings rates. The country's commercial banks, which as always provided some level of funding for French innovation in the form of direct loans that were guaranteed by the government, were encourage to increase their investment in venture capital and sometimes formed and managed their own venture capital funds to become more directly involved in promising technology start-ups. Many of France's largest corporations also began taking equity stakes in small start-ups working in areas related to their core businesses and these initial activities often led to the corporations forming their own corporate venture capital funds. Finally, while the state was pushing for strong private sector support of radical innovation, it continued to invest in the promotion of high-tech sectors using funds received from the privatization of various government-owned enterprises such as France Télécom in 1998. In addition, steps were taken to encourage private sector investment in R&D, promote cooperation between universities and research institutes on the one hand and new innovative companies on the other and reduce the risks of entrepreneurship for scientists and engineers interested in pursuing new ideas. Among other things, legislation was adopted that removed prior restrictions on the ability of public researchers to take equity stakes in private companies and created a "company creation holiday" that would allow employees to take a leave of

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[160] A. Isaksson, The Effects of Governance and Trust on Performance in Venture Capital Relationship (2004).

[161] A. Isaksson, "Exit Strategy and the Intensity of Exit-Directed Activities among Venture Capital-Backed Entrepreneurs in Sweden", in G. Gregoriou, M. Kooli and R. Kräussl (Eds.), Venture Capital: A European Perspective (2006).

[162] Id. at 29-31.

absence that could extend up to six years, including social security coverage, to work on launching a new business and also guaranteed they could return to the prior positions.

According to a reported published by Practical Law Company ("PLC"), 1,047 billion euros were investment in venture capital in 2010 and 948 billion euros were invested in 2011, with 2011 investments coming from around 50 venture capital funds and being distributed among 749 companies and 62% of the total amount invested coming from 21 of the 50 funds.[163] The angel investor community in France is quite small and the amount of venture capital dedicated to seed investments in 2010 was just 7.25% of the total investment while 21.6% went to "Series A" rounds and the remaining 71.15% went to later rounds. According to PLC, the most popular sector among venture capitalists in 2011 was e-commerce/Internet, followed by healthcare, software and clean tech. The average amount per investment in 2010 and 2011 varied between 1.2 and 1.4 million euros. Venture capital funds receive funding from institutional investors, French governmental agencies, public agencies of the EU, and individuals, and there has been an increase in the number of corporate venture capital funds over the last few years. French venture capital funds use a variety of regulated structures, with the choice varying based on whether fund investors come from the retail market or are sophisticated/institutional investors.[164] Funds generally have a term of eight to ten years, with extensions possible if certain conditions are satisfied and subject to a right of investors to demand redemption of their interest after ten years. Several different forms of tax incentives have been adopted to encourage venture capital investment and research and development tax incentives are available for the innovative companies seeking venture capital funding.

Venture capitalists typically make equity investments in French companies, usually in the form of a purchase of preferred shares. Rights of, and protections for, investors in France are similar to those in other industrialized countries. The investment agreement includes representations and warranties from the companies and the founders, and a breach of such representations and warranties can lead to personal liability for the founders. Preferred shares issued to venture capital investors generally have anti-dilution rights and liquidation preferences and increased participation by foreign investors in French venture capital investments has led to more common use of requirements that a majority of preferred shareholders must approve various decisions that had previously been left to the directors. Investors usually have preemptive rights with regard to new issuances of securities and approval of such new issuances must be obtained from the investors

[163] The summary description in this section of market conditions in France and the key terms and conditions of venture capital investment in that country is adapted from A. Baker, A. Tolila, K. Noel, O. Edwards and O. Couraud, Private Equity and Venture Capital: France, Practical Law Company Multi-Jurisdictional Guide (2012). Those authors noted that relevant figures and other information relating to venture capital in France could be found at various websites including www.chaussonfinance.com. www.clipperton.net, and www.go4venture.com.

[164] According to PLC, the terms of the legal relationship between fund investors and the managers of those funds are subject to regulation, but vary depending on whether the fund is retail or non-retail. Investors in a retail fund generally do not have flexibility to negotiate additional protections; however, investors in non-retail funds often negotiation special provisions relating to change of management, management and other fees, limitations on the ability of the managers to launch successor funds and composition and rights of advisory committees.

regardless of whether they purchase the securities. Boards of portfolio companies are generally kept small for the sake of efficiency; however, significant investors are typically given board seats and other investors may be given observation rights. It is customary to find both "tag-along" and "drag-along" rights in the investment documentation, and all shareholders, including investors, are subject to restrictions on their ability to transfer their shares.

Founders and employees of French companies receiving venture capital are commonly incentivized through options, restricted stock units and/or warrants, which must be issued in conformance to detailed regulations in order to qualify for favorable tax treatment. All of these options, shares and warrants are subject to vesting conditions, and PLC reported that the most common vesting formula called for a one-year cliff followed by quarterly vesting until all of the shares have become fully vested after four years; however, in some cases senior management may convince investors to agree that vesting will be tied to attainment of milestones that increase the value of the company for all of its shareholders. Founders' vested shares are subject to "claw-back" provisions that may extend for up to five years and will be triggered by their departure from the company due to resignation or dismissal for gross negligence. Restrictions on the founders' ability to sell their shares during their claw-back period are common and founders will also be subject to the drag-along rights mentioned above that will require them to sell their shares in a sale of the company transaction that has been arranged and approved by the investors.

French venture capitalists seek one of three primary types of exits from their investments: a sale of the company, an initial public offering ("IPO"), or a leveraged buyout. Investors generally are given "liquidity rights" that allow them to force an exit, including a liquidation, if the company has not completed an IPO or a trade sale by a specified date. While it is generally thought that venture capitalists add value to innovative companies in terms of increasing their survival time and chances of a successful exit via IPO or trade sale at an attractive valuation, a study by Pommet of 139 French companies that went public between 1996 and 2002 revealed that the survival rate of venture capital-backed companies was lower than for companies that had not received financial support from venture capitalists, leading Pommet to suggest that "[w]e need to encourage greater professionalism among French VC firms tin order to improve their selection, monitoring and value adding performance".[165]

§1:26 --Germany

Nuechterlein reported that as of the late 1990s the total amount of venture capital investment in Germany was about $4 billion, which was roughly equivalent to the amount of venture capital invested in the US in just a single calendar quarter in 1998, and observed that "[i]n Germany, the commercial banks, insurance companies, and venture capital firms that invest in start-ups historically have had limited success".[166]

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[165] S. Pommet, The Survival of Venture Capital Backed Companies: An Analysis of the French Case (July 2012).
[166] J. Nuechterlein, International Venture Capital: The Role of Start-Up Financing in the United States, Europe and Asia (1999), 10-11.

Nuechterlein estimated that about 7% of the venture capital investment was made in start-ups and that less than 15% was invested in high technology companies. At that time, the bulk of all venture capital investment 3in Germany, just below 60%, was provided by banks and their preference was to provide support to expansion stage companies. According to Nuechterlein, the primary challenges for German entrepreneurs up to that time included "excessive government regulation, relatively high capital gains taxes, high labor costs, inflexible labor laws (supported by powerful labor unions) that limit the ability to hire and fire employees and a general political concern with protecting workers from layoffs, inadequate exit mechanisms for investors, a lack of management talent to nurture early stage companies, a dearth of employees willing to leave the safety of well-paid jobs with large German companies to join a start-up (in part because of the stigma associated with failure in Germany), and an underdeveloped entrepreneurial culture".[167] Another factor that differentiated Germany venture capital activities from those in the US and the UK was the historical preference in German capital markets for bonds over stocks, which limited the availability of public offerings as exit strategies for investors in German portfolio companies and pushed those companies toward acquisitions by other firms as a means of satisfying the liquidity needs of their investors.

Financing—venture capital and otherwise—is a significant issue and challenge for technology-focused start-ups in Germany. The good news is that venture capital investors provided $226 million in funding to Berlin-based companies in 2010, a 164% increase over the prior year, demonstrating a level of interest that stood out in an otherwise gloomy economic environment which had caused venture capital investment across Europe to remain flat since the beginning of the global financial crisis.[168] However, when Deutsch Bank compared various countries with respect to venture capital investment as a percentage of GDP in 2012, Germany's .02% was well behind the .17% figure in the US and also trailed, albeit by much smaller margins, other European countries such as France (.03%), the Netherlands (.03%), Sweden (.05%) and the UK (.04%).[169] Commentators have noted, also based on 2012 figures, that when measured on a per capita basis the number of venture capital investments in Germany is comparable to the US—11 to 12 investments per one million persons—but the average investment in Germany (€780,000, or around $1,000,000) is significantly lower than in the US (€6,000,000).

German venture capitalists have been criticized for being slow to identify and support innovative ideas and products, a situation that has been attributed to a lingering conservatism after getting badly burned by the "dot-com bust" in the early 2000s. The Economist explained that German venture capitalists tend to be much more cautious than their counterparts in the US, typically avoiding investing in large numbers of companies hoping that one of them will be wildly successful and instead selectively concentrating on a smaller group of companies hoping for a higher success rate (i.e., profitability within 18

[167] Id. at 10.
[168] E. Westervelt, The Next Silicon Valley?: Berlin Startups Catching Up With the Hype, NPR All Tech Considered (July 9, 2012).
[169] Business Creation in Germany: A Slow Climb—A Vigorous Start-Up Scene Has Yet to Produce its First Breakthrough (October 5, 2013).

to 24 months).[170] One specific problem for Berlin startups has been the difficulties they have had securing early-stage funding, particularly from venture capitalists based in Germany and elsewhere in Europe, and when investments have been made the amounts, as noted above, have generally been quite small. There are exceptions, however, and Westervelt has reported on funds like Early Bird that had invested $40 million more than two dozen Berlin startups as of 2012 and had raised an additional $200 million, half of which was targeted for investment in Berlin.[171] While this is encouraging, the reality is that the venture capital environment throughout Europe remains cautious and local investors in Berlin have argued that Germany needs to launch more large venture capital funds and that Berlin itself needs to have several new funds focusing primarily on local opportunities and building an innovation infrastructure that will help their portfolio companies thrive.

Germany has also been slow to build networks of angel investors due, in part, to the absence of a large community of successful entrepreneurs who are able and willing to provide seed funding to new ventures as is commonly done in Silicon Valley. This situation may not change for five to seven years, since it will likely take that long for the founders of the current crop of startups to grow their businesses to the point where they can cash out and gather the funds need to reinvest in the Berlin startup community. In addition to their problems raising significant amounts of capital from local venture capitalist, German entrepreneurs must overcome the reluctance of German banks, including the local savings banks and cooperatives that have funded traditional businesses, to make loans to support untested digital business models.[172]

Outside of the local venture capital community support for promising start-ups is sometimes available from larger German companies, such as Deutsche Telekom, Axel Springer Verlag and Rewe, that have set up their own incubators and provide modest amounts of initial funding; however, these companies are not as interested in building larger enterprises and achieving substantial financial returns on their investment as they are in supporting an “early-warning system” that identifies new trends outside of their existing businesses that they can pursue using their internal resources once it is clear that profitable innovation opportunities are available.[173]

National and state governments have also attempted to provide assistance to German entrepreneurs in a variety of ways including the creation of development banks to make loans to new companies. The Economist described the role of a semi-official venture capital firm called High-Tech Gründerfonds (HTGF), which has been a major investor in the country’s national development bank relying on capital collected from big German companies and from the country’s economy ministry.[174] As of 2012, HTGF had provided seed funding and advice to hundreds of start-ups in exchange for 15% of the equity of the

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[170] Id.
[171] E. Westervelt, The Next Silicon Valley?: Berlin Startups Catching Up With the Hype, NPR All Tech Considered (July 9, 2012).
[172] Business Creation in Germany: A Slow Climb—A Vigorous Start-Up Scene Has Yet to Produce its First Breakthrough (October 5, 2013).
[173] Id.
[174] Id.

companies; however, entrepreneurs complain that HTGF is often overly bureaucratic befitting its governmental roots.

§1:27 --Switzerland

Among the Swiss start-ups in a database compiled by the Swiss Start-Up Monitor, the most frequently mentioned sources of financing were the personal savings of the founders or money provided by their friends and family.[175] Beyond these internal sources of financing, companies also tapped into external sources in the following order in terms of frequency: business plan competitions, business angels, public or government agencies, venture capitalists and banks. When the financing received by the companies was analyzed by volume, venture capitalists came in first, followed by public or government agencies and corporate venture capitalists, and the volume of financing from friends and family came in fifth out of all the identified categories of sources. Grichnik et al. observed that these results confirmed the challenges that start-ups have in successfully navigating the vetting processes used by the venture capitalists. Analysis of venture capital financing by business sectors revealed that more than half of the investment funds went to ICT and medtech/diagnostics companies and that biotechnology/pharmaceutical companies also captured a significant amount of venture capital financing.[176] Companies that received venture capital funding tended to have higher rates of employee growth than start-ups that were primarily financed by business angels or other sources.[177]

Many of the companies participated in business plan competitions and expended a good deal of effort on those activities; however, the cash rewards were not high. Grichnik et al. argued that while Swiss entrepreneurs would obviously like to receive grants from their participation in business plan competitions, they also viewed such as competition as great opportunities to increase their business know-how—most of the competitions offered participants opportunities to join workshops, seminars and coaching sessions to improve their management skills—and expand their networks.[178]

A 2012 report issued by the Swiss Federal Department of Economic Affairs noted that Switzerland was well positioned with respect to economic competitiveness due in large part to the country's excellent innovation capacity and strong business culture; however, the report also cited various reports that the availability of venture capital in Switzerland was much lower than it should be and that there are certain weaknesses in the public funding of research and development, cooperation among small- and medium-sized enterprises ("SMEs") with other companies on innovation projects, and the competitiveness of the knowledge-intensive service sector.[179] With respect to venture capital funding, the report explained that while Switzerland is generally considered to

[175] D. Grichnik, M. Fantetti and U. Gross, The Start-Up Landscape of Switzerland: First Insights from the Swiss Start-Up Monitor (2013), 22.
[176] Id. at 24.
[177] Id.
[178] Id. at 23.
[179] Swiss Federal Department of Economic Affairs, National Council Report on the Fulfillment of the Fässler (10.3076) and Noser (11.3429, 11.3430, 11.3431) Postulates: Venture Capital in Switzerland (June 2012).

have one of the best-developed venture capital industries in the world, only a small percentage of funding goes into early stage investments. Since Switzerland has not joined the other countries that have provide government funding for start-ups in order to make up for shortcomings in the private market, the report argued that it was imperative for Switzerland to take steps to address three potential gaps: an “innovation gap”, which is the gap between what is the between what is discovered during R&D activities and what is eventually developed into commercial products; an “information gap”, which occurs when investors do not have enough information about possible innovation projects and start-ups do not have sufficient information regarding potential financing sources; and, of course, a “funding gap”, which refers to the unavailability of sufficient funding to successfully develop new product ideas for the market.

The authors of the Swiss Venture Capital Report 2013 reported that 90 rounds of venture capital financing had been identified in Switzerland for 2013 and that participants in those rounds received a total of CHF415.3 million.[180] The results for 2013 were a marked improvement over the previous year with the number of financed companies increasing by almost 50% and the total amount of invested funds increasing by more than 30%; however, the authors cautioned that 2012 had been a historically weak year for venture capital investment in Switzerland and while 2013 was an improvement it was still not an exceptionally good year for venture capital investments in the country. They also noted that the amounts invested per financing round were quite low when compared to other countries. Interest in early-stage and seed financing surged during 2013, with the number of early phase financing increasing by 50% and the amount of funding provided in those rounds almost tripling. The largest financing rounds involved life sciences start-ups.

§1:28 --China

While much is written about the contemporary economic power of China and its position as the major creditor of the US, it should not be forgotten that China had been a very poor country for an extended period of time as it enduring consecutive periods of Western exploitation, invasion and occupation by the Japanese, internal civil wars and, finally, the chaotic period of Maoist oppression.[181] Capital flow, and the economic development that it supported, began in earnest in the last 1980s as government reforms facilitated foreign direct investment; however, capital was initially not distributed equally around the country and the benefit accrued principally to entrepreneurs and their related networks in a few select areas such as Hong Kong, Taiwan and parts of South East Asia, collectively referred to as “Greater China”.[182]

There have been limited efforts to create and expand “in-country” sources of capital including public financing and loans from Chinese banks; however, a number of

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[180] S. Kyora and T. Heimann, Swiss Venture Capital Report 2013 (February 2014). The Report was a joint effort from the news portal startupticker.ch and the Swiss Private Equity & Corporate Finance Association.
[181] G. Milston, A Short History of China (Stanmore: Cassell Australia Limited, 1978); and M. Beeson, Regionalism and Globalization in East Asia (Houndmills: Palgrave Macmillan, 2007).
[182] M. Beeson, Regionalism and Globalization in East Asia (Houndmills: Palgrave Macmillan, 2007).

institutional impediments must still be overcome including establishment of legal property rights, maturation of the local finance industry, development of systems for collecting and analyzing credit-related information about firms and training of managers in business and financial planning techniques.[183] In general, Chinese banks have been reluctant to make loans to private Chinese companies for the reasons stated in the previous sentence as well as the Government's long-standing policy of requiring the preferences be given to SOEs.[184]

The reliance on private capital from foreign sources has often limited the ability of the Chinese government to intervene productively in the development process and commentators have observed that the state has been hampered by the reduction in its control over means of production due to the dismantlement of many SOEs, the often chaotic approach of the Chinese bureaucracy with its widely dispersed centers of authority that has led to unclear and inconsistent policy decisions, the lack of a capacity to create and enforce an overall development plan and, finally, the absence of reciprocal and cooperative relationships between the state and businesses that might otherwise exist if the state was able to serve as a direct capital provider.

Blank discussed efforts of the Chinese government to provide seed capital to technology-based startups by describing the InnoFund program the government established in 1999 as a tool to provide financial support to early stage technology companies that had innovative technology and good market potential but had yet to advance their business models to the point where they could attract funding from venture capitalists, commercial banks or corporate partners.[185] In order to qualify for support from InnoFund, companies must be engaged in high-tech R&D, have less than 500 employees (at least 30% of whom must be technical workers), and be majority-owned by Chinese. Support from InnoFund comes in a variety of forms including grants, generally ranging between $150,000 and $250,000, loan interest subsidies and equity investment. According to Blank, about 9,000 companies had shared almost $1 billion disbursed through the InnoFund program through early 2013; however, it was not clear that venture capitalists placed significant weight on whether or not a potential portfolio company has received an InnoFund grant and the program came with many challenges common to working with the government in China: tedious and lengthy vetting and approval processes, an emphasis on relationships as opposed to quality in the decision making process, and bureaucratic reporting requirements. On the other hand, funding from the InnoFund program did provide companies with a certain amount of credibility from a governmental endorsement of their business model and prospects and likely made it easier to obtain commercial bank financing for expansion once their technology had been built out and validated.

[183] R. Grainger and S. Chatterjee, "Chinese and Indian Systems: Divergent in the midst of Global Trends", in University of Sydney (Eds), Asia-Pacific Economic and Business History Conference (Sydney, Australia: University of Sydney, 2007), 1-45.
[184] J. Child and H. Pleister, "Governance and Management in China's Private Sector", Management International, 7(3) (2003), 13-23.
[185] S. Blank, China's Torch Program—The Glow that Can Light the World (April 11, 2013), http://steveblank.com/2013/04/11/chinas-torch-program-the-glow-that-can-light-the-world-part-2-of-5/ (accessed May 15, 2014).

Blank noted that while there are angel investors active in China, they are relatively few in number, fragmented and generally inexperienced.[186] As a result, there is a shortage of seed capital available for Chinese startups and Chinese entrepreneurs do not have access to the mentoring and networking that experienced and sophisticated angel investors are able to provide to founders of companies in the US and Europe. Another issue that hinders the development of angel investment network in China is the reluctance of entrepreneurs to share their ideas and information about prospective deals. This tendency to guard information is driven by paranoia about the prospect that another entrepreneur might copy an idea and run with it and while these concerns are probably justified it makes it much more difficult for angel investors to find ideas that might interest them and for which they might be willing to provide capital. According to Gai, wealthy Chinese without experience in launching and building startups are willing to serve as angel investors and this means that Chinese entrepreneurs do have opportunities to secure capital from people who have made their fortunes in finance, law and real estate.[187] These angel investors are often able to provide introductions to government officials; however, they are not able to provide founders with the mentoring they often need to get through the difficult period of getting the new business up and running.

Gai observed that there is often a lack of mutual trust between founders and investors and that people in China continue to be suspicious of persons who are outside of their immediate circles.[188] Gai cautioned foreigners looking to be angel investors in China that they would need to invest substantial time and effort, including spending a lot of time in China, to understand Chinese markets and culture, identify and vet opportunities and carry out the extensive due diligence that is necessary in order to detect fraud and other issues.[189] Gai recommended that prospective foreign angel investors should learn the language, be humble in their interactions within the Chinese entrepreneurial ecosystem and forge relationships with trustworthy and experienced Chinese partners.

Blank explained that the Chinese government decided to become more directly involved in the country's venture capital activities by establishing the Venture Guiding Fund in 2007 under the direction of the central Ministries of Science and Finance.[190] The Venture Guiding Fund used four different programs including direct investments into venture capital funds, typically taking no more than 25% of the equity and only requiring a fixed rate of return; co-investments with other venture capital funds, with the amount of the investment being capped at the lower of 50% of the amount invested by the venture capitalists or $500,000; risk subsidies for venture capitalists that would compensate them

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[186] S. Blank, Zhongguancun in Beijing – China's Silicon Valley (April 13, 2013), http://steveblank.com/2013/04/13/zhongguancun-in-beijing-chinas-silicon-valley-part-4-of-5/ (accessed May 16, 2014).

[187] B. Gai, The China Startup Report (October 2011), http://www.slideshare.net/bowei/the-china-startup-report-a-15min-crash-course-by-bowei-gai (accessed May 21, 2014).

[188] Id.

[189] Id.

[190] S. Blank, China's Torch Program—The Glow that Can Light the World (April 11, 2013), http://steveblank.com/2013/04/11/chinas-torch-program-the-glow-that-can-light-the-world-part-2-of-5/ (accessed May 15, 2014).

for the losses sustained on their investments in technology-based startups and grants to technology-based startups that are being incubated and coached by venture capitalists.

Blank described the evolution and rise of venture capital investment in China as a series of phases that began in the 1980s with universities and R&D centers providing seed capital, as well as technology, to individuals and groups that wished to "spin out" or "spin off" from the universities and centers to launch new technology-based startups.[191] During the 1990s, promising technology-based ventures in China could obtain seed funding from the government's Torch Program to develop their technologies and product ideas to the point where they could qualify for funding from the country's commercial banks, which provided financing for expansion and later stages that was guaranteed by local governments. Another element of the Torch Program, the technology business incubators operating inside science and industrial parks supported by local governments around China, included opportunities for financing from those governments, since they were interested in tapping into the opportunities for economic development provided by the startups operating in their local incubators.

Blank explained that by the mid-1990s, Chinese government leaders realized that the financing schemes included in the Torch Program were not sufficient to provide expansion and later stage financing to promising technology-based companies and that commercial banks and local governments also lacked the funds and expertise to provide financial support on the scale necessary for the country to achieve its goals with respect to private sector innovation. However, according to Blank, the Chinese government had not yet taken the steps necessary to formally recognize and endorse the concept of venture capital firms as legitimate organizational types. The government took some initial steps by allowing local governments, and then universities, to form and finance venture capital firms, but it wasn't until 1998, when the government authorized the formation of corporate-backed venture capital firms, that venture capital became a fixture in funding commercialization of new technologies in China.

Since the end of the 1990s, China has enjoyed a steadily growing infusion of venture capital from firms launched and supported by a variety of sources including local governments and corporations and foreign investors. By 2013, Blank was able to report that the Chinese private equity and venture capital businesses were booming and that over 1,000 firms were active investors at that time, including both domestic (i.e., fully-owned by Chinese investors) and foreign (i.e., partially or fully owned by non-Chinese investors) Renminbi funds that invested using local currency and were allowed to operate with fewer restrictions on the industries in which investments could be made and with less regulatory oversight.[192] One of the other advantages of Renminbi funds is that their portfolio companies have easier access to ChiNet, which was established in 2009 to expand exit opportunities and which has subsequently become China's equivalent of the NASDAQ stock exchange for startups. This is particularly significant for foreign investors since they previously had to rely on dollar-based funds created using offshore

[191] S. Blank, The Rise of China's Venture Capital (April 12, 2013), http://steveblank.com/2013/04/12/the-rise-of-chinese-venture-capital/ (accessed May 16, 2014).
[192] Id.

legal entities and plan for exits through offshore listings, a structure that was generally quite complicated and expensive.

Blank noted that recent venture capital investment in China has focused on companies in and around Beijing and on companies operating in the technology, media and telecommunications ("TMT") sector and reported on statistics that showed that China has become the largest venture capital industry outside of the US.[193] In 2011, for example, venture capital investment in all deals was around $13 billion in China and $3.2 billion of the amount went to Internet deals—the comparable amounts for investments in the US for that year were $26.5 billion and $6.7 billion, respectively. However, venture capital activity in China in 2012 declined dramatically from the previous year, with total investment being just $3.7 billion, of which $536 million went to Internet deals, and the total number of deals declining 40% from 2011.

According to Blank, Chinese venture capitalists have traditionally looked for, and supported, domestic Internet startups willing and able to execute business models that have already been demonstrated as successful in the US and other Western markets. This "copycat" strategy was viewed as a good way to reduce developmental risks and Chinese companies did not have to worry about competition from the original developers of the models since they were usually frozen out of the Chinese market by governmental policies that included the legal authority to block "objectionable" website content. The focus on Internet companies, and the overall popularity of the TMT sector, among venture capitalists was driven by the enormous size of the domestic market in China and the overwhelming interest of Chinese consumers in mobile web access, microblogging and online shopping and social networking. Statistics provided by Blank showed that more than half of the venture capital deals in the TMT sector in 2011 and early 2012 were for companies engaged in online services and that investors were also extremely interested in providing support for firms involved in e-commerce, software services and mobile Internet. 60% of the recorded TMT deals were Series A round investments.

While the abundance of venture capital was good news for the Chinese startup ecosystem, it also meant that venture capitalists were more than willing to fund companies pursuing business models that had already been pursued multiple times. In those situations, everything depending on the ability of the founders to effectively adapt the business model to local conditions and fend off competition and they also had to contend with a fickle customer base that often moved quickly to another idea or solution. There was little time, or motivation, for true innovation among Chinese software companies and local venture capitalists were slow to push their portfolio companies to push out beyond existing business models. However, Blank argued that the current rush of "copycat" strategies among Chinese startups will subside within the next few years and one will gradually see more and more innovation among local software companies as they continue to develop products and services that are customized to the social and technological environment in China. Blank pointed out that consumer demographics and

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[193] S. Blank, Zhongguancun in Beijing – China's Silicon Valley (April 13, 2013), http://steveblank.com/2013/04/13/zhongguancun-in-beijing-chinas-silicon-valley-part-4-of-5/ (accessed May 16, 2014).

user expectations in China are unique and that most of the Internet users are quite young, under 30, and have grown up using instant messaging rather than email for their communications and are comfortable using the mobile web for almost everything in their lives including communications with friends and colleagues, commerce and gaming. Blank also expected that Chinese software companies will begin move away from the complicated, crowded and busy web pages that have traditionally been seen in China toward creating sleeker and cleaner interfaces that improve user experience.

Writing for VentureBeat in 2014, O'Dell observed that US venture capitalists remained uneasy and tentative about investing in China due to a lack of understanding about the Chinese startup market.[194] Among other things, US venture capitalists have difficulty identifying promising investment opportunities and are put off by social and political instability, market illiquidity and perceived difficulties in establishing trusting relationships with Chinese entrepreneurs.

Another issue for Chinese entrepreneurs and professional investors is liquidity, and in this area Blank noted that there were substantial differences between US and Chinese startups.[195] In the US, for example, 90% of the exits for venture-backed companies come through mergers and acquisitions ("M&A"); however, Blank reported that there is virtually no domestic M&A market for Chinese Internet startups since larger companies interested in their businesses will simply steal their ideas and hire their key employees rather than going to the trouble and expense of buying the entire company. According to Blank, 70% of the exits for Chinese venture-backed Internet companies are through an IPO, either in the US or domestically on ChiNet, which is China's own NASDAQ equivalent exchange. Qing also confirmed that one of the main differences between startup scene in Silicon Valley and China is the lack of M&A activities in China as a potential exit opportunity for founders, employees and investors.[196] Qing noted that larger Chinese companies are not interested in making offers to buy all of the assets and employees of smaller companies and this has pushed Chinese entrepreneurs toward IPOs. In addition, many Chinese entrepreneurs covet the cachet of being able to say that they have led their firms to an IPO. However, many of the newly-public Chinese companies have found that they are not ready for the rigors of public company status and that they have not achieved maturity with respect to management and financial processes. As a result, it is not uncommon to see investors in those companies quite dissatisfied with the way that things have turned out.

§1:29 --India

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[194] J. O'Dell, Why So Many U.S. VC Firms are Holding Back on Startup Investments in China (May 10, 2014), http://medcitynews.com/2014/05/many-u-s-vc-firms-holding-back-startup-investments-china/ (accessed May 22, 2014).

[195] S. Blank, Zhongguancun in Beijing – China's Silicon Valley (April 13, 2013), http://steveblank.com/2013/04/13/zhongguancun-in-beijing-chinas-silicon-valley-part-4-of-5/ (accessed May 16, 2014).

[196] L. Qing, Chinese Startups Don't Value M&A Exit Option (February 20, 2013), http://www.zdnet.com/cn/chinese-startups-dont-value-m-and-a-exit-option-7000011541/ (accessed May 21, 2014).

Thakur noted that the lack of universal access to institutional credit and other financial services is a critical problem for Indian entrepreneurship and explained that one of the main problems is that Indian banks place an unrealistic emphasis on personal guarantees from entrepreneurs backed by personal property not used in the business.[197] While this financial model provides protection to the banks, it significantly increases the perceived risk of obtaining bank financing for entrepreneurs since failure means that they will likely lose all of their personal assets. Thakur explained that some effort had been made to establish government programs that focused specifically on financing micro, small and medium-sized enterprises in India; however, his view was that initiatives had failed to provide support and information to entrepreneurs and small business owners lacked strong advocacy/industry associations that could look after their interests.

Yu and Tandon conducted a survey of Indian entrepreneurship for Gallup and found that the founders and senior managers of Indian startups were regularly challenged by difficulties in accessing initial stage funding.[198] They took notice of the fact that India's bustling economy and large domestic market had attracted the interest of global investors and that venture capital funds, both domestic and international, were active in India; however, they found that these larger and more institutional investors tended to focus their activities on export-oriented IT or mobile solutions and ignore Indian startups that were developing and offering high-demand products and services in India's large domestic energy and healthcare markets. Yu and Tandon argued that foreign investors often had trouble connecting with Indian entrepreneurs and failed to understand that India had its own unique market demands, talent supply and business culture that needed to be taken into account when structuring investments. Yu and Tandon also noted that Indian venture capitalists preferred to get involved at the later stages of development of their portfolio companies, typically funding expansion of existing businesses with proven products or services, and that Indian startups suffered from the lack of a formalized and mature angel investment ecosystem that could provide both funding and, just as importantly, mentoring and managerial know-how to new business owners.

According to Mane et al., venture capital funds in India can be classified into five categories: funds promoted by the developmental finance institutions controlled by the central government (e.g., ICICI Venture Funds Ltd., IFCI Venture Capital Funds Ltd (IVCF) and SIDBI Venture Capital Ltd (SVCL); developmental finance institutions controlled by state governments (e.g., Punjab Infotech Venture Fund, Gujarat Venture Finance Ltd (GVFL) and Kerala Venture Capital Fund Pvt Ltd.); funds promoted by public banks, such as Canbank Venture Capital Fund and SBI Capital Market Ltd; funds promoted by India's own private sector, such as IL&FS Trust Company Ltd. and Infinity Venture India Fund; and overseas venture capital funds.[199] Mane et al. explained that

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[197] A. Thakur, Skill Development in India: Big Promises, Tall Failures, Governance Now (February 17, 2014), http://governancenow.com/views/columns/skill-development-india-big-promises-tall-failures (accessed May 30, 2014).

[198] D. Yu and Y. Tandon, India's Big Problem: Nurturing Entrepreneurs, Gallup Business Journal (August 1, 2012), http://businessjournal.gallup.com/content/156143/india-big-problem-nurturing-entrepreneurs.aspx#1 (accessed May 27, 2014).

[199] S. Mane, A. Waghmare and N. Rupali, Welcome to Venture Capital Presentation, http://www.slideshare.net/SandeepMane22/what-is-venture-capital-venture-capital-in-india (accessed June

venture capital activity in India is subject to regulation by the Securities and Exchange Board of India ("SEBI"), which reviews applications for registration as a venture capital fund from companies or trusts. Once a fund receives a certificate of registration from SEBI it may raise money from any investor, domestic or foreign, and is permitted to invest in equity or equity-related instruments of unlisted companies and also in financially weak and sick industries whose shares are listed or unlisted.

Mane et al. argued that venture capital activity has been growing in India for several reasons including high technology, human resource capital, scientific and technical research and government initiatives. The most popular market segment for venture capital investment in India has been information technology ("IT") and information technology enabled services ("ITES") and other popular sectors include energy, manufacturing, media and entertainment and banking, financial services and insurance. Sectors of interest to venture capitalists vary from city-to-city around India with Mumbai being best known for investment opportunities in software services, BPO, media, computer graphics, animation, finance and banking; Bangalore for investment opportunities in IT and ITES and biotechnology; and Delhi for investment opportunities in software services, ITES and telecommunications.

Annamalai and Deshmukh analyzed data relating to activities in the Indian venture capital and private equity ("VCPE") industry during 2004-2008 and noted that this was a period in which India experienced the fastest rate of industry growth in the world and rose to third among all the countries in the world with respect to the number of VCPE investments.[200] In terms of the actual amounts invested by Indian VCPE funds during that period, the figure rose dramatically from US$1.8 billion to 2004 to US$22 billion in 2007 and then leveled off to US$8.1 billion in 2008. They found that most of the investments that were made during the period were in later stage financing and that portfolio companies generally received funding many years after they were first incorporated and organized. In general, the investments that were made were short-term.

Annamalai and Deshmukh noted that the concept of venture capital and private equity ("VCPE") investment began to take shape in India as long ago as the 1960s but that the industry did not begin to take off and grow until the country's economic reforms were announced and launched in 1991.[201] Before the beginning of the 1990s, public sector financial institutions were the main providers of VCPE funding and India and the amount of capital provided was generally quite low. During the 1990s, however, India's VCPE funds raised just under US$1 billion for domestic investments, which meant that the country ranked 25th out of 64 countries in a survey conducted by Venture Economics, and in the 2000s India jumped to 13th out of 90 countries with respect to fund raising as Indian VCPE firms raised US$16.682.5 million.

3, 2014). The Indian Private Equity and Venture Capital Association is an excellent source of data and other information on private equity and venture capital activities in India.

[200] T. Annamalai and A. Deshmukh, "Venture Capital and Private Equity in India: An Analysis of Investments and Exits", Journal of Indian Business Research, 3(1) (2011), 6. The authors also provided an extensive set of references to other studies of the India VCPE industry and industry practices as well as various multi-country studies that had included India.

[201] Id.

82% of the total VCPE investments were first round, meaning that they represented the first time that VCPE funding had been provided to the portfolio company. Only 18% of the deals investments were “follow on” investments to provide additional financing support to existing portfolio companies and the researchers surmised that these results could be attributed to the fact that VCPE investments were typically made at later stages of the firm lifecycle of the portfolio companies when they presumably were more mature and did not need much in the way of additional and sustained financing before identifying an exit strategy, such as an IPO or a sale to an outside party. The researchers also suggested that the relatively small proportion of follow on investment could be attributed to poor performance of the portfolio companies or the desire of investors to find a quick exit rather than settling in for a long-term commitment with the companies that might requires one or more additional rounds of financing.

The researchers argued that the data from their survey confirmed that Indian VCPE investors have a strong aversion to investing in young companies and noted that a majority of the growth stage investments occurred when portfolio companies were between five and eight years out from their original date of incorporation and that a large number of companies were not financing by VCPE investors until they had been in business for over fifteen years. Annamalai and Deshmukh suggested that the delays in outside financing could be attributed to a lack of readiness among potential portfolio companies or the preference of the owners of those companies to obtain funding from other sources, such as friends and family and/or commercial banks, before engaging with professional investors. They pointed out that Indian VCPE investors seemed to have a strong preference for companies that had already established a long track record and operating history and reached sufficient size and commented that the overall pattern of investment in the country tilted more toward private equity investments as opposed to venture capital investment and its traditional focus on early stage financing.

Annamalai and Deshmukh found that the most commonly used methods for exiting VCPE investments in India were IPOs and trade sales through mergers and acquisitions (“M&As”), with an M&A exit being twice as more likely as liquidity via an IPO on an across the board basis but with variations between different industries (i.e., companies in industries that were more capital- and asset-intensive were more likely to gain liquidity through IPOs while companies operating in the computer hardware, IT & ITES and healthcare sectors generally became M&A targets). The researchers noted that the timing of an exit, and the amount of time that passed between the investment and the exit event, were both heavily influenced by the overall stage of Indian capital markets.

Annamalai and Deshmukh found that in India the duration of VCPE investments (i.e., the period beginning on the date of investment and ending on the date exit via IPO or acquisition) was much shorter than would normally be expected, with the average investment duration being just 17 months in an industry in which the worldwide norm ranges from between three to five years and investors in the US typically waited around five years for either an IPO or acquisition. While this finding would be influenced by the preference of Indian investors for later stage deals, 75% of the investments made during the growth stage of the portfolio company had duration of less than two years. The researchers noted that the results provided support for concerns often raised by Indian entrepreneurs that their VCPE investors were more interested in quick exits as opposed to making longer term commitments to their portfolio companies and providing their management teams with advice, expertise and other value-adding support. They suggested that great long-term commitments from investors might be created by expanding the pool of domestic VCPE funds in India.

Finally, the data collected by Annamalai and Deshmukh indicated that the intervals between successive rounds of financing among the companies surveyed was relatively short and the researchers expressed concern that this approach to financing caused top management to be continuously distracted from business operations and overly focused on capital raising activities. They argued that entrepreneurs and investors should settle on investment terms that provide sufficient capital to allow the portfolio companies to operate and execute their business models for at least two years before the issue of additional financing once again becomes important. They noted that while some entrepreneurs might be reluctant to raise larger rounds of financing because they might be deprived of the benefits of valuation increases that might occur when capital is raised in multiple rounds, they would realize savings in transaction costs and it would also be possible to address valuation increases by including incentive structures in the agreements with the investors. For their part, investor support for larger rounds might be enhanced by broader acceptance and use of syndications in which several VCPE investors pool their funds, expertise and connections to support a portfolio company.

§1:30 --Brazil

The primary source of financing for new and existing businesses in Brazil has traditionally been through the country's retail banks and, in fact, Brazil has an extensive, sophisticated and competitive domestic banking sector. Brazil has been praised for having one of the best banking systems in the world and a wide range of financial products are available to Brazilian firms (i.e., traditional banking services, insurance, stock, bond and future trades, retirement plans, currency trading etc.) through a relatively stable and secure financial sector.[202] The largest financial firms are Brazilian and the two largest banks are owned by the government; however, US and other foreign institutions are active in the marketplace and have achieved their own significant market shares.[203]

Buclon, a Brazilian venture capitalist, argued that Brazilian companies face tremendous challenges in bridging the gap between seed investment capital, which is relatively easy to access through the strong network of incubators and accelerators that have been established in Brazil, and growth financing provided to companies that have achieved a relatively advanced status.[204] Between these two extremes, companies have difficulties

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[202] R. Eunni, "Institutional Environment for Entrepreneurship in Emerging Economies: Brazil vs. Mexico", World Journal of Management, 2(1) (March 2010), 1-18, 6.

[203] Background Note: Brazil, Washington, DC: US Department of State, March 8, 2011.

[204] M. Buclon, Investing Seed And Growth Capital In Startups in Brazil With Marine Buclon, Principle of Bolt Ventures (February 9, 2014).

finding sufficient funding to allow them to leave the incubators and begin scaling their operations to the point where they would be attractive candidates for growth financing. A lack of education and experience with respect to entrepreneurship also makes it difficult for companies to escape the incubator stage and survive long enough to prove the viability of their product or service and stabilize operations to the point where the company becomes attractive to seasoned executives and later-stage venture capitalists.

The demand for angel investment in Brazil is quite high and Grossman reported that studies had shown that Brazil was third in the Americas, behind the US and Canada, with respect to the number of startups seeking angel financing.[205] More than half of the requests for financing were sent to Brazilian groups; however, Grossman noted that more and Brazilian entrepreneurs are willing to look outside of the country for financial support from investors in the US, Europe, Asia and Oceania. While the number of angel investors in Brazil remains small relative to the size of the country, there are signs that the group is expanding, the amount of invested capital is increasing and that Brazilian investors are willing and able to provide mentoring and share their knowledge about the startup process at the same time they are contributing financial support. According to Grossman, the angel investor community is expected to be an important part of the necessary process of educating prospective Brazilian entrepreneurs and training them about how to take a more disciplined, professional and commercially-focused approach to launching and operating their businesses. Grossman suggested, however, that more can and needs to be done in order to promote angel investment including tax incentives, strong legal protections for investors and expansion of exit opportunities.

Despite some of the difficulties that their portfolio companies have had with achieving profitability and carving out a niche in a hyper-competitive, albeit growing, domestic market, venture capitalists have not written Brazil off and fears that investors would move their funds to other Latin American markets, such as Mexico with an economy that is the second largest in the area behind Brazil, have proven to be unfounded as venture capitalists expect Brazilian deal flow to continue at the same pace as prior years and have put together new funds to pursue opportunities. While venture capitalists and other resources such as incubators have made it somewhat easier for Brazilian entrepreneurs to secure initial financing, it remains difficult to find subsequent financing and the founders of the country's startups have been admonished to tighten their belts and use their initial seed capital wisely.

One of the first areas of interest for foreign venture capital firms in Brazil were local Internet and technology companies that were often referred to as "copycats" since they were launched largely to try and replicate already existing consumer Web business models that had done well in the US and Europe (e.g., "Groupon of Brazil," "Zappos of Brazil" or "Amazon of Brazil").[206] The assumption among the investors appeared to be that the Brazilian domestic market was large and eager enough to support several entrants in various e-commerce vertical markets and it was common to see a number of startups

[205] I. Grossman, Startups, Investors and the Brazilian Way (July 30, 2013).

[206] K. Fehrenbacher, 10 Things to Know about Tech Startups in Brazil (May 17, 2012) and V. Sreeharsha, Despite Stumbles, a Promising Path for Start-Ups in Brazil (May 21, 2013).

competing against one another to sell pet supplies, fashion items or taxi services. It turned out that while there was indeed a market for the products and services offered by these companies, competition was too intense for many entrants and they were unable to execute their business plans effectively. Moreover, Brazilian entrepreneurs were so pre-occupied with fending off their local rivals that they have no time or other resources to engage in innovative activities and create new ideas for improving their business models and adapting them to local conditions.

Not surprisingly, the emphasis in Brazil on funding copycat companies, rather than new and truly innovative business models, has been widely critiqued.[207] Defenders argue that it makes sense to focus on executing proven business models, with appropriate adaptations to local conditions, in Brazil because much of the work has already been done and tested in the US and elsewhere and the market opportunities are so large in Brazil if everything is done correctly. Grossman noted that Brazilian entrepreneurs interested in establishing one of the copycat companies recognize that their business models are not truly innovative, at least when viewed from a global perspective; however, they argue that there is wisdom in selecting ideas that have already proven to be successful in foreign markets and then consciously and carefully adapting to local conditions in Brazil to provide Brazilian customers with an even better value proposition.[208] Others claim that disruptive innovation is neither practical nor necessary in Brazil at this point since there are few established technology players in the local market to be disrupted. All of this may be true to some extent; however, cynics are often dismissive of the notion that Brazil is becoming the Silicon Valley of Latin America and conclude that while there may be capital available for new companies, as long as they fit into an already proven business model, there is little in the way of "venturing" into new and untested areas that might lead to Brazil staking out its own place as an innovator in the global technology arena.

Venture capitalists are now looking to avoid financing copycat business models and instead focus their efforts on entrepreneurs interested in pursuing true innovation and opportunities in market sectors that have been ignored to date, such as health care and education. Another interesting trend is the expansion of venture capital sources beyond US and European funds to include capital from Chinese Internet companies, many of which already have substantial experience with building e-commerce models in a large and fast-changing economy such as the one operating in Brazil.

One impediment to expansion of investment by foreign venture capitalists in Brazil is the slow progress of institutionalizing exit events, such as IPOs or acquisitions. It has been argued that Brazilian entrepreneurs, unlike some of their counterparts in the US and Europe, do not start their businesses to make a lot of money but are more interested in creating a comfortable lifestyle and achieving a place in what is perceived to be a cool and exciting place in the emerging Brazilian society. Brazilian entrepreneurs also need to overcome their apprehensions about working with, and talking to, venture capitalists from the US and Europe, and it is understood that time needs to be spent on improving

[207] C. Dannen, The Getaway Career: Deep Inside Brazil's Robust Startup Scene (October 17, 2012).
[208] I. Grossman, Startups, Investors and the Brazilian Way (July 30, 2013).

English-speaking skills. A few companies have attempted to bridge the gap by bringing on expatriates from the US as members of their founding group.

A study conducted by graduate students at the MIT Sloan School of Management under the auspices of MIT's Global Entrepreneurship Lab included a review of industry publications, online sources, academic papers, as well as interviews with participants in Brazil's startup ecosystem and venture capital community, and was aimed at obtaining a better understanding of the evolution and future direction of growth-oriented entrepreneurship and venture capital in Brazil.[209] Among the key findings of the study reported in an article prepared by Tejwani et al., who collected and analyzed the data and authored the final report regarding the study, were the following[210]:

- Long-term demographic and technology trends underpin investment focus. Specifically, the rapidly growing consumption-oriented middle class in Brazil, coupled with high levels of engagement in social media and Internet usage, has inevitably pushed entrepreneurs and investors toward creating and backing Internet-enable companies. While there have been signs of softening in the overall economy, and economic growth in general has slowed in Brazil, the general feeling is that the secular embrace of the Internet as a means for communicating, learning and shopping is sufficiently de-coupled from short-term ebbs and flows in the economy to warrant continued support of Internet entrepreneurs by investors.
- Investors are changing and domestic general partners are in high demand. The level of venture capital investment activity in Brazil, including the number of deals and the number of different investors, has increased substantially since the beginning of the 2010s, and investors from all over the world have set aside capital and other resources for opportunities in Brazil. In addition, a small but growing group of Brazilian venture capitalists and "super angels" is also emerging and are being hotly pursued by foreign venture capitalists as syndicate partners who can help navigate the local investment scene and manage day-to-day contact with portfolio companies. Done correctly, these arrangements can accelerate the development of early-stage companies, and the management skills of their founders, while providing them with access to the sector experience and expansive acquisition networks of global venture capitalists.
- Focusing on "fast follow" and proven business models for now, but more innovation needed in the near future. The large number of "fast follow", often referred to as "copycat", companies launched and funded in Brazil in recent years, particularly in the e-commerce sector, is well documented and investors have generally accepted the rationale that reliance on proven business models reduces risk and allows entrepreneurs to focus on "geographic strategies" (i.e., tailoring the generic business model of local needs in Brazil, the so-called "tropicalization" process). However, these companies have been met by intense competition and eroding margins and investor returns have been steadily diminishing and it is becoming clear that the

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209 H. Tejwani, R. Wallace, N. Holda and S. Bonawitz, Brazil VC Ecosystem Study (February 2013).

210 The following summary of the key findings of the study is based on H. Tejwani, R. Wallace, N. Holda and S. Bonawitz, 5 Things You Need to Know about Venture Capital in Brazil, Venture Beat (March 19, 2013), http://venturebeat.com/2013/03/19/5-things-you-need-to-know-about-venture-capital-in-brazil/.

knowledge gained about the local market while trying to deploy business models imported from abroad must be used to develop what Tejwani et al. described as "uniquely Brazilian business models that may not have comparable analogs in developed markets and that will offer more defensible and lucrative investment opportunities".

- While Brazil has a large and relatively well-developed banking and financial system, it has yet to create a sustainable capital market for smaller technology-focused companies and this has led to concerns among venture capitalists investors about how they will be able to exit their investments. Tejwani et al. reported that the study pointed to strategic acquisition transactions, primarily driven by multi-national trade sales, as the best near-term hope for generating exit momentum. The stakes are high since proof that successful exits are available is needed in order to demonstrate to local Brazilian talent that growth-oriented entrepreneurship is a viable career path and induce investors to provide additional capital, something that will only happen if they gain confidence that valuations are realistic and liquidity is a reasonable expectation.
- Launching a tech startup in Brazil is tough, especially for outsiders. The study reinforced some of the nagging concerns about the viability of growth-oriented entrepreneurship in Brazil including what Tejwanit et al. described as "restrictive labor market rigidity, regulatory complexity, high taxes, and pervasive bureaucracy". While the government has been a big supporter of venture capital and entrepreneurship, graduates of top universities continue to be wary of the startup path, and venture capitalists interviewed during the study were skeptical about the chances that the Brazilian startup ecosystem would mature to the point where there was sufficient talent to consistently scale up business models rapidly and transition companies to and through the growth stage.

Tejwanit et al. concluded that the venture capital ecosystem in Brazil had reached "a state of fragile growth where a select group of strong businesses will emerge from the current ecosystem, capitalize on the secular technology and demographic trends to scale, and achieve exits via strategic mergers and acquisitions (or possibly international public offerings for outliers)". Assuming that this occurs, investors should gain more confidence in the exit potential of the Brazilian market; however, shallow capital markets in Brazil in comparison to competing emerging countries such as China and India may cause investors to remain conservative about their engagement with Brazilian startups and local entrepreneurs will need to demonstrate an ability to move beyond the "fast follow" business models and create truly innovative companies based on a keen and accurate understanding of the local market.

Institutionalized rules for maintenance of financial records (i.e., financial accounting standards) have not been widely accepted in Brazil and Eunni has reported that record keeping in Brazil is not in accordance with internationally accepted accounting standards. The problem is particularly acute among small businesses who generally do not both to maintain accurate financial records or understand and comply with professional and commercial conventions regarding accounting practices. While industry and trade associates do exist in Brazil, they are typically more concerned about lobbying for tax and other concessions as opposed to playing a significant role in establish professional standards in the financial area and pushing enterprises to comply. In addition, the fact that a large percentage of the economy is dominated by informal businesses tends to discourage entrepreneurs who are complying with the law from adopting professional standards with respect to their financial records since the process involves additional expense and brings them no perceived additional benefits in the marketplace.[211] According to Eunni, the byproduct of all of this is a decided tilt toward businesses that remain small and informal in order to take advantage of "institutional infirmities".[212]

§1:31 --Mexico

While all countries need capital to build and modernize their economies, the issue is particularly crucial for developing countries such as Mexico. A report prepared several years ago noted that important improvements had been made in Mexico's financial infrastructure, including greater efficiencies in the country's domestic bond markets that allowed Mexican firms to raise debt capital more easily than when the only recourse was entering global financial markets.[213] However, as of the end of 2004, Mexico's capital markets remained small and illiquid by world standards and the Mexican stock market remained highly concentrated. In addition, efforts to create a high technology sector in Mexico were hampered by the lack of risk or venture capital. The same report cited above observed that it was imperative for Mexico develop "broad and deep capital markets" that provided households with sufficient confidence to move their savings from unproductive bank deposits or real estate into more productive uses, including financial support for new businesses that hopefully would create jobs that would lift the entire economy. The report also noted that the failure to develop domestic capital markets would make Mexico overly dependent on foreign direct investment and that Mexican business models with the highest potential rate of return would be controlled by foreigners who would siphon off profits that could be better used in Mexico.[214] In addition, Eunni described the Mexican banking system as of the mid-2000s as being generally weak and undercapitalized and noted that only a third of the country's registered businesses had adequate access to bank financing.[215]

Entrepreneurs in Mexico, like their counterparts in many countries, have always faced challenges in accessing both seed capital and funding to finance growth once the viability of their initial product or service has been verified. When analyzing the availability and use of risk capital in the Mexico entrepreneurial ecosystem in the early 2000s Fabre and Smith observed that risk capital investment opportunities were somewhat different than

[211] J. Capp, H. Eistrodt and W. Jones, Jr., "Reining in Brazil's informal economy", McKinsey Quarterly (January 2005).
[212] R. Eunni, "Institutional Environment for Entrepreneurship in Emerging Economies: Brazil vs. Mexico", World Journal of Management, 2(1) (March 2010), 1-18, 6.
[213] R. Jackson, Building Human Capital in an Aging Mexico: A Report of the U.S.-Mexico Binational Council (Washington, DC: Center for Strategic and International Studies/The CSIS Press, 2005), 24-25.
[214] Id. Dependence on foreign direct investment is also problematic during periods, such as the recent global recession, when capital providers from the US and Europe are unable to fund existing or new projects due to issues in their own markets.
[215] R. Eunni, "Institutional Environments for Entrepreneurship in Emerging Economies: Brazil vs. Mexico", World Journal of Management, 2(1) (2010), 1.

in the US and other industrialized countries in that less emphasis was placed on transformational high technology and more attention was paid on applying existing technologies in ways that might transform and improve the overall Mexican economy.[216] Fabre and Smith also pointed out that risk capitalists in Mexico place less emphasis on technology expertise than their counterparts in the US and must focus more on identifying and managing environment risks associated with launching and operating a business in Mexico. Fabre and Smith described several structural issues that needed to be overcome in order to develop a sustainable venture capital sector in Mexico including the need for regulatory changes to allow institutions that are normally the primary suppliers of risk capital to make venture capital type investment, the need for more education to prospective investors on how to invest in relatively high-risk ventures and the lack of participation in risk capital investment activities by high net worth individuals. As a result of the difficulties caused by these issues the risk capital industry in Mexico was quite small, thus impeding opportunities for syndication and "funds of funds".

According to Stargardter, financing for startups was increasing with the entry of venture capital firms, capital available from incubators in the form of grants and the creation of a seed fund by the Mexican government.[217] While the availability of venture capital financing in Mexico has been improving, it still lags well behind Brazil among Latin American countries and Suesada reported that as of 2012 62% of the venture capital in Latin America went to Brazil while Mexico accounted for 13% and Chile and Argentina received 11% and 7% respectively.[218] Entrepreneurship.org reported that the Mexican government had established a $30 million capital fund for entrepreneurs that would provide both seed capital and participate as a co-investor in startups.[219] Efforts were also under way to encourage private banks to be more accommodating to startups and entrepreneurs; however, progress on this front will be dependent on larger policy decisions regarding the appropriate regulatory framework relating to risk-taking throughout the banking industry in Mexico.

A.T. Kearney, a global consulting firm, hosted a conference of entrepreneurs, investors and academics to discuss innovation, entrepreneurship and venture capital financing in Mexico and reported that the key takeaways offered by the attendees were as follows: support for Mexican entrepreneurs is available from a variety of different organizations, including universities, incubators, and non-governmental organizations (NGOs), that have been offering guidance on how to launch and manage a business and attract investors; however, more needs to be done in terms of providing founders with access to mentoring from entrepreneurs that have overcome challenges and been successful; as

[216] F. Fabre and R. Smith, Building an Entrepreneurial Culture in Mexico, Nacional Financiera SNC (May 2003).

[217] G. Stargardter, Mexico's fledgling startups: Facebook-sized ambitions, Reuters (September 17, 2012), http://www.reuters.com/article/2012/09/17/us-mexico-startups-idUSBRE88G15U20120917 (accessed July 24, 2014).

[218] J. Suesada, Mexico,: The Land of Technology Startups, El Pais, (June 2, 2013), http://elpais.com/elpais/2013/06/02/inenglish/1370180073_767283.html (accessed July 24, 2014).

[219] J. Ortmans, Decisive Action for Startups in Mexico, Entrepreneurship.org, http://www.entrepreneurship.org/policy-forum/decisive-action-for-startups-in-mexico.aspx (accessed July 21, 2014).

Mexican startups mature they have a real need for experienced managers skilled in traditional areas of business administration and operations, particularly with respect to implementing and overseeing cost controls and governance procedures; while Mexico is making good progress toward the development of an entrepreneurial ecosystem, startups still need more support from domestic and foreign investors, public policies and service providers; venture capitalists need to provide their portfolio companies with more than just funding and be prepared to work directly with the business functions within those companies and provide them with hands-on expertise; and venture capitalists operating in Mexico believed that the most promising opportunities for Mexican entrepreneurs lie in finding new ways to use established technologies.[220]

In the early 2000s Hallmark et al. described some of the major risks that investors were then confronted with when contemplating a private equity investment in Mexico.[221] With regard to economic risks, they mentioned Mexico's weak accounting standards, which included a lack of standardized accounting principles, incompatibility of local standards with generally accepted accounting principles in the US and local rules in a number of important areas that were less onerous than those imposed by the US Financial Accounting Standards Board; difficulties that investors had in identifying and quantifying contingent liabilities of prospective target companies (e.g., overdue taxes, delinquent social security contributions, employee claims, products liability and breach of warranty claims, environmental cleanup costs etc.) noting, for example, that the tax auditing process in Mexico was far from clear and typically took substantial periods of time; currency devaluation risks associated with the Mexican peso; and the challenges associated with investing in family-owned firms, the dominant business ownership structure in Mexico at that time, that included interacting with business owners who typically had no experience with having to be accountable to outside shareholders and disclosure business and financial information to persons outside of their immediate circle of family members and close friends. Among the legal risks that confronted private equity investors in Mexico were a less flexible corporate law regime, fewer legal instruments to structure investments and less than adequate enforcement of the available instruments. Finally, Hallmark et al. mentioned that investors had to deal with a turbulent internal political situation in Mexico and the risk that the Mexican government might expropriate property owned and used by local portfolio companies.

§1:32 --Vietnam

Hoang and Dung mentioned that it was well-known that Vietnamese entrepreneurs generally had difficulties in obtaining bank financing and they observed that for many potential entrepreneurs the prospect of having to launch a new venture by investing even more of their own capital, thereby creating additional personal risk for themselves and

[220] A.T. Kearney, Mexican Innovation, Entrepreneurship and Venture Capital Financing, http://www.atkearney.com/innovation/ideas-insights/article/-/asset_publisher/VHe1Q1yQRpCb/content/mexican-innovation-entrepreneurship-and-venture-capital-financing/10192 (accessed July 27, 2104).

[221] J. Hallmark, L. Gonzalez Nieves, S. Pardo and D. Hryck, "The Entrepreneur's Guide to Private Equity in Mexico", Law and Business Review of the Americas, 9 (2003), 319, 336-348.

their families on top of the uncertainties associated with starting any new business, was simply too much for them to bear, particularly when social norms in Vietnam do not reward additional risk-taking by entrepreneurs with appreciation and celebration.[222] Hoang and Dung also referred to the importance of "trusting relationships" in Vietnam and other Confucian societies and, in fact, argued that the lack of such relationships between Vietnamese entrepreneurs and bankers explained why entrepreneurs typically had difficulties securing bank financing for their business activities while banks continued to support customers with which they had long-standing relationships such as state-owned enterprises.[223]

Huang interviewed an experienced local venture capitalist in Vietnam in 2013 and reported that the investor was concerned about finding opportunities that are being promoted by cohesive teams of entrepreneurs with a shared vision and understanding of their strengths and weaknesses and willingness to seek out solutions for areas in which they need support.[224] The investor also emphasized that startups needed to have ideas for products or services that had a clear purpose and solved an identifiable problem or need of users and that the projected market size should be large enough to justify investment of resources to scale up the size of the company. Finally, the investor conceded that many new companies in Vietnam need two to three years to establish their product or service—for social media ideas, for example, this would mean acquiring users and building long-term engagement and loyalty—but cautioned that investors will want to see positive cash flow at the end of this initial period as both a means for investor liquidity and evidence that the company can survive without investors and continue to serve its customer base and attract new customers.

A report published by the Information for Development Program (IDP) in June 2008 discussed the challenges and opportunities associated with financing technology entrepreneurs and small- and medium-sized enterprises (SMEs) in Vietnam and noted at the outset that the country's ICT/ICTE sector had experienced significant growth in the years leading up to the report based on its "strong vocation in Hi Tech industry" and its relative cost advantages.[225] The reported noted that several large foreign IT multinationals had established a presence in Vietnam and that most of the ICT activities in the country at that time were related hardware manufacturing and assembling; however, progress was also being made in developing Vietnam's software and IT services sectors. The report argued that Vietnam was viewed by many as being "the most promising Asian economy for offshore operations" and mentioned that the country had a dozen national IT "champions" involved in developing and producing locally branded PCs, software and BPO services. The Vietnamese government was cited as doing its part to support the development of the country's IT sector by providing financial support for infrastructure projects for the promotion and development of technology.

[222] V. Hoang and T. Dung, "The Cultural Dimensions of the Vietnamese Private Entrepreneurship", IUP Journal of Entrepreneurship and Development, VI (3 & 4) (2009), 54.
[223] Id.
[224] E. Huang, What a VC firm has to say about investing in tech startups in Vietnam, e27 (July 9, 2013), http://e27.co/to-all-internet-startups-in-vietnam-heres-what-a-vc-firm-has-to-say/ (accessed July 10, 2014).
[225] R. Zavatta, Financing Technology Entrepreneurs & SMEs in Developing Countries: Challenges and Opportunities—Vietnam Country Study, Information for Development Program (June 2008), 1-2.

The IDP report noted that the transition from a centrally planned economy to a market economy in Vietnam had required and included liberalization of the country's financial sector and reforms had gradually improved the confidence of investors and increased the flow of foreign direct investments, including venture capital, into Vietnam. However, in spite of these changes many SMEs operating in the ICT/ICTE sector still had difficulties in securing financing for their development and first expansion stages and the report highlighted several factors that were contributing to this "financing gap": financing policies, including the "conservative attitude" of banks, "heavy" collateralization requirements and the tendency of governmental financing programs to focus on sectors other than ICT; limited diffusion of alternative financing instruments and sources such as credit guarantees, leasing and angel investment; demand side constraints such substantial opacity and informality of SMEs and poor quality of many SME proposal submitted to institutional venture capitalists; lack of understanding of ICT among bank officers which leads to problems with getting them to understanding ICT/ICTE business models; and ongoing constraints in the overall business environment including restrictions on certain types of operations by foreigners, poor protections for minority investors and limited and unreliable credit information.

Taking the above-described issues into account, the IDP report went on to recommend that steps be taken to increase the amount and accessibility of equity financing to SMEs in the ICT/ICTE sector as a means for reducing the dependence of those firms on obtaining capital from a banking industry that appears to be poorly suited for meeting the needs of technology businesses. The report argued that there was sufficient demand among Vietnamese SMEs to justify mobilization of additional investments and the creation and support of venture capital funds; however, the report recognized that the country's business environment was still relatively immature and rapidly changing and that financial support from institutional investors might be best be coupled with government funding and provided to portfolio companies with technical assistance on how new firms are built and managed. The report also recommended that initiatives be taken to ease the path for SMEs seeking bank financing and suggested that credit guarantees from the government might be a good first step in easing the concerns of bank officers. As for the difficulties that Vietnamese banks had in understanding the needs and business models of technology entrepreneurs, the report suggested that incubators could provide assistance on preparation and presentation of projects.

§1:33 --Africa

Omidyar Network believed that the greatest challenge facing African entrepreneurs was the state of entrepreneurial assets.[226] With respect to financing, estimates published by the International Finance Corporation indicated that up to 84% of Africa's small and medium-sized enterprises (SMEs) were un-served or underserved and Omidyar Network noted that the cost of funding for the SMEs was prohibitive. For example, entrepreneurs reported that banks sometimes required 150% of the borrowed amount as collateral, a

[226] Omidyar Network, Accelerating Entrepreneurship in Africa: Understanding Africa's Challenges to Creating Opportunity-Driven Entrepreneurship (2013), 4-11.

condition that automatically disqualified many applicants, and that government funding was virtually impossible to secure in many cases due to bureaucracy and nepotism. Lack of access to financing was a common complaint among African entrepreneurs; however, capital providers countered that many projects that were brought to them were not fundable. The byproduct of this situation was that the main sources of capital for African SMEs were retained earnings, credit cards, loan associations and investments from family and friends. Venture capital and other types of equity funding remained relatively scarce in Africa and the report pointed out that in order for venture capital to be successful in Africa local entrepreneurs would need to demonstrate that they were motivated to building profitable businesses that would generate sufficient returns for investors to justify the risk that they would be taking in providing capital. However, as noted above, investors found most of the proposals from African entrepreneurs to be flawed and complained that the entrepreneurs failed to demonstrate that they were capable of engaging in rigorous business or that they understood the target market well enough to identify and develop a high quality and realistic business idea.

Omidyar Network made the interesting point that many African entrepreneurs run into difficulties in raising funds to grow their businesses because they have problems accessing new markets for their products and services.[227] Before investors decide to provide capital to support growth they need to be sure that the entrepreneur will be able to increase revenues and profits by successfully identifying and developing multiple product distribution channels. Another problem for entrepreneurs during the capital raising process is their failure to completely understand the requirements of potential funders and their inability to effectively communicate the value and potential of their business ideas in the documents and reports they provide to funders. Omidyar Network suggested that funders need to explain their requirements more fully to entrepreneurs and entrepreneurs needed easier access to service providers who could assist them in packaging their documentation and improving their "financial pitch". Finally, the lack of viable exit opportunities for investors in African SMEs is a significant issue that makes it difficult for entrepreneurs to sell their business ideas; however, Onidyar Network pointed out that African business owners could address concerns of investors by being more open to potential buyouts by multinational corporations or private equity funds.

Omidyar Network argued that seed financing and angel networks needed to be more formalized in Africa and that efforts should be made to professionalize seed financing in order to make investment in startups more efficient and cost effective.[228] Omidyar Network also made a number of recommendations for improving financing for growth-oriented entrepreneurship in Africa[229]:

"Early-stage enterprise financing in Africa:

• Reduce bureaucracy for early-stage companies to access government funding in order to provide 'softer' sources of financing for less-experienced entrepreneurs.

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[227] Id. at 6.
[228] Id.
[229] Id.

• Expand or initiate local angel investing ecosystems to ensure the availability of the most appropriate type of funding for start-ups, especially for entrepreneurs who lack the network of friends and family that traditionally play this role.
• Provide tax and other incentives to formal, as well as informal (e.g., family and friends), angel investors to make it easier for people who have extra cash to invest in start-up businesses and reduce their risk.
• Provide tax and other incentives for large clients of early-stage ventures to provide supplier credit to incentivize and reduce the risks suppliers take when providing generous payment terms and/or stock to new ventures.
• Educate entrepreneurs about possible sources of funding outside banking systems.
• Train and assist early-stage entrepreneurs in the intricacies of capital-raising and, when necessary, extend the training to general business management so that fund seekers understand the 'language' and requirements of fund providers and become better prepared for their fundraising searches.
• Train the local financial community to evaluate investment opportunities on the basis of future prospects rather than historical cash flows.

Mid-sized enterprise financing in Africa:

• Leverage indirect personal sources of funding, such as pension funds to fund SMEs, so that more resources are available to fund more-established enterprises where the risks are lower.
• Expand or initiate local venture capital investing ecosystems to ensure that the most appropriate source of funding is available for companies at the mid-level stage of development.
• Use local banking systems to disburse donor or government lines of credit to SMEs to reduce prohibitive interest rates and collateral requirements.
• Provide incentives and support to mid-sized SMEs to practice sound financial management and maintain adequate records, including audited statements.

Later-stage enterprise financing in Africa:

• Create capital-raising engagement programs with leaders of well-established private African enterprises to inform entrepreneurs about the benefits of private equity funding, as well as the benefits of listing at local stock exchanges.
• Create continent-wide 'regional champions' programs to facilitate access to capital (both debt and equity) for independently vetted pan-African companies that are expanding across the continent."

Endeavor Insight highlighted the following quote from a 2013 African Development Bank report that described some of the challenges that African entrepreneurs must overcome in obtaining financing for their new ventures: "Using one-year growth rates in employment as a measure of firm growth shows that about 15% of SMEs in both Africa and other developing countries are high-growth firms (i.e., with one-year growth in employment greater or equal to 20% (OECD, 2008)). However, there are important differences in the sources of financing used to finance this growth: In Africa, 84% of investments of SMEs are financed through internal funds compared with 70% in other developing economies. The share of bank financing in Africa is 8% (compared to an average of 11% in other developing countries) while the share of equity financing in Africa is less than 2%, as compared to about 8% in other developing economies."[230]

[230] T. Triki and I. Faye (Eds.), Financial Inclusion in Africa, African Development Bank (2013), 54 (as reported in African Firms Have Great Difficulty Accessing Capital, Endeavor Insight (December 18, 2013), http://www.ecosysteminsights.org/african-firms-have-greater-difficulty-accessing-capital/ (accessed August 8, 2014)).