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Venture Capitalists in Malaysia: Challenges and Future Directions

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Abstract The Malaysian venture capital industry had started in 1984 but until now, the industry is still developing with limited number of venture capital companies and experts in this area. Besides the small size of the industry, VC companies in Malaysia face several challenges such as limited amount and source of funding, risk aversion of the VCs, cyclical nature of the industry and difficulty of the VCs to exit the industry due to thin capital market. These factors, to some extent, contributed to the slow growth of the industry.

Keywords: *venture capital, external financing, challenges, Malaysia*

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1. Introduction

Companies have two main types of financing: internal and external. Among the most popular internal financing types is retained earnings. Besides, companies can also get internal financing from their owners or family members. Companies in the stage of expansion/growth, bridge, mezzanine or pre-IPO may require external financing if internal financing is not sufficient to support the high growth rate of the company.

The most popular external financing method include bank loans and equity financing. Another method of raising external funds is through bond issuance. This method of financing is, however, relatively less popular compared to loans and equity financing since the Malaysian bond market is still developing. The effectiveness of raising funds through equity and bond financing very much dependent on the performance of the capital markets. The ability of raising funds is high in developed capital markets where there are many participants in the markets.

Besides loans, equity and bond financing, another type of external financing is venture capital. This type of financing is relatively new in emerging market such as Malaysia since it was started in 1984 with the establishment of the first Malaysian venture capital company, the Malaysia Venture Berhad. In Malaysia, venture capital financing is not as popular as bank loans and equity financing. On average, only about one hundred venture capital (VC) companies registered during 2006-2013. The growth of VC industry is dependent on the performance of the equity market where VC needs to exit. The performance of the equity market, in turn, depends on the regional and global economic conditions and the challages facing the industry they are in. Therefore, the external environment plays a very significant role in determining the survival of VC industry.

Schilit [8] argues that VC investments are risky than investment in listed companies due the higher risks in their investee companies. In mitigating their risk, VCs are very selective in choosing potential investee companies. The potential investees need to go through a rigorious selection process known as the due diligence.

The purpose of this paper is to update on the development of venture capitalists in Malaysia, their challenges and future directions. This paper is organized as follows. The next section discuss the background of the Malaysian VC industry. The discussion continues with the development of VC industries in terms of the industry participants, sources of funds, focussed industries, and preferred stages of investment. This is followed by the challenges facing the VCs in Malaysia. The final section concludes the paper.

2. Background of the Malaysian Venture Capital Industry

The Malaysia VC industry started in 1984 with the establishment of the Malaysia Ventures Berhad with a fund size of RM13.8 million. This firm invested in rubber products and furniture. Since then, the Malaysian government has played a significant role in promoting the development of the Malaysian venture capital industry. The two main bodies that promote the development of VC industry in Malaysia are the Malaysia Venture Capital and Private Equity Association (MVCA) and the Malaysian Venture Capital Development Corporation (MVCDC).

On 27 February 1995, the Malaysian Venture Capital Association (MVCA) was founded to develop the VC industry as a source of equity financing for business enterprises and startup companies. The objective of the establishment of MVCA is to promote the growth of VC and private equity industry through joint venture, research, and forums. MVCA organizes forums, conferences and establish collaborations with international venture capital associations [5].

In August 2002, Venture Capital Consultative Council (VCCC) was established to address the issues of the VC industry in Malaysia. This agency was then replaced by the Malaysia Venture Capital Development Council (MVCDC) in September 2004. The main objective of MVCDC is to provide the strategic vision and direction for the development of the Malaysian venture capital industry and to ensure coordinaton of strategic implementation relating to the venture capital industry. Besides, the agency also acts as an intermediary between policy makers and practitioners in relation to the development of the venture capital industry.

Besides MVCA and MVCDC, the government has also established Malaysia Venture Capital Management Berhad (MAVCAP) in 2001 to assist small and new ICT companies in getting financing. MAVCAP is the largest venture capital company in Malaysia and is wholly owned by the Ministry of Finance. Until today, MAVCAP plays a significant role in providing financing to start-up, seed and early stage businesses from the ICT and technology industries [6].

3. Venture Capital Industry Participants

The number of VC companies have increased from 91 to 114 in 2009 but declined to 108 in 2011 (Table 1). Throughout 2006 to 2011, the number of investee companies have shown ups and downs. In 2006, there was about 461 investee companies. However, the figure declined to 409 in 2011. The number of VC professionals peaked in 2009 at 313 but declined to 131 in 2011. This declining trends may be due to several factors such as the susceptibility of VC to economic conditions, the decline in the availability of funding to the VCs and the risk aversion of the Malaysian VCs. During this period, there was a number of global economic crisis including the subprime crisis in 2008.

Table 1. Number of Participants and Ownership Structure

	2006	2007	2008	2009	2010	2011	2012	2013
Number of registered VC funds/companies	49	52	56	59	58	56	59	61
Number of registered VCMCs	42	46	52	55	55	52	53	58
Total	91	98	108	114	113	108	112	119
Number of investee companies	461	433	450	445	389	409	466	356
Number of VC professionals	184	132	248	313	186	131	124	103
Ownership structure								
100% local ownership	87	93	98	104	102	98	100	99
Joint ventures	4	5	9	9	9	8	10	15
100% foreign ownership	0	0	1	1	2	2	2	5

Note: VC – venture capital; VCMC – venture capital management companies
Source: [4].

The number of investee companies and VC professionals, on the other hand, shows some ups and downs during 2006-2011. In terms of investee companies, the figures showed a declining trend from 450 in 2008 to 389 in 2010. The number of investee companies showed some improvement with an increase by 5% in 2011. Additionally, the number of VCs professionals rose from 184 in 2006 to 313 in 2009, an increase by 70%. A downtrend was observed in 2011 with a total of only 131 VC professionals. The majority of the VCs and VCMCs are 100% locally owned. The number of joint ventures between local and foreign VCs had increased by more than double from 4 in 2006 to 10 in 2012. Even though there is some improvement in terms of the joint ventures, the number is still very small. Joint ventures between the small and large VCs may assist the smaller and newly established VCs in terms of risk sharing, market exposure and amount of funding. Lerner [3] argues that venture capital may minimize the effect of information asymmetries through syndication (joint venture between two or more venture capitalists).

4. Sources of Funds

Since 2007, the government is the main contributor to VC funds in Malaysia. The two main government agencies actively involved in providing fundings for pre-seed and seed companies are Cradle Fund Sdn Bhd (Cradle) and MAVCAP. The Cradle Investment Programme (CIP) was established in 2003 to assist pre-seed and seed Malaysian technology entrepreneurs with a maximum amount of RM50,000 (CIP50). Cradle also provides funding for researchers at universities and institution of higher learning in Malaysia under the programme known as University CIP or U-CIP. In 2007, the maximum amount had been increased to RM150,000. In 2009, Cradle provide seed funding up to RM500,000 to help technology companies to commercialize their products.

Government contribution was 36% (RM1.2 billion from a total of RM3.31 billion) in 2007 and the figure had increased to 54% in 2011 and 2012 (from a total amount of RM5.46 billion and RM5.7 billion in 2011 and 2012) (Figure 1). In 2013, government share of VC fund had increased drastically to 61% amounting to RM3.54 billion from a total of RM5.8 billion. Besides MAVCAP, Kumpulan Modal Perdana is another example of VC funded by government agencies. This company is among the main players in the industry. Their scope of investment covers Malaysia, the Southeast Asian region (mainly in China) and Silicon Valley, US. Their main investee companies in Malaysia include Green Packet Berhad (ICT), BSL Corporation Berhad (High-Precision Manufacturing in Electronic Products), ETI Technology Berhad and BCT

Tech Berhad (Fabless semiconductor / Power Management). Another VC funded by government agencies is MIDF Amanah Venture Sdn Bhd founded in 1990. Its preference stages of investment are expansion/growth, mezzanine and pre-IPO.

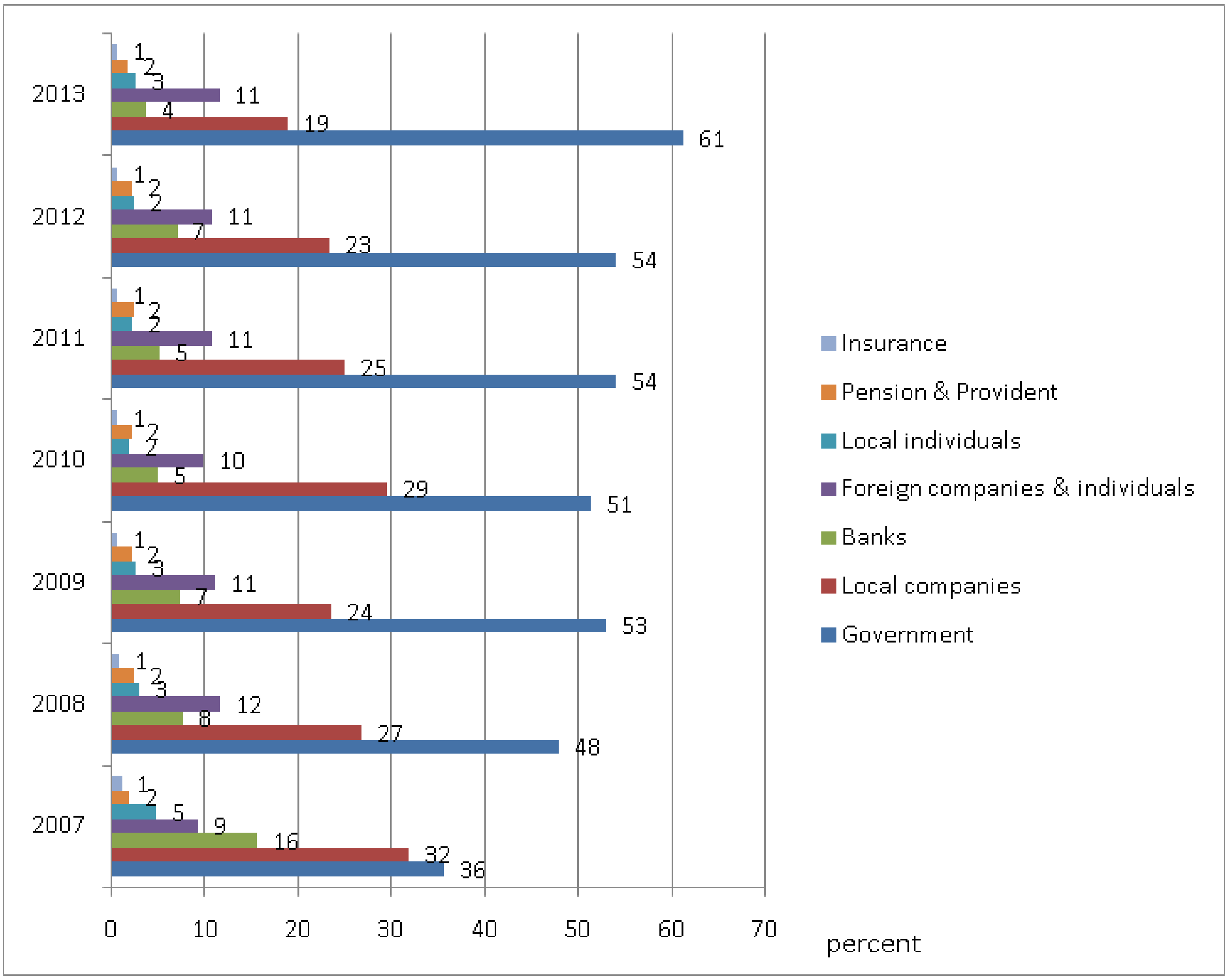

Figure 1. Sources of funds (Data source: [4])

The second largest contributor of VC funds is the local companies that made of 32% of the total investment in 2007. The contribution share declined in 2008 (27%) and 2009 (24%) in 2009. The share peaked to 29% in 2010 (RM1.73 billion from a total of RM5.96 billion) before declining to 25% (RM1.36 billion from a total of RM5.46 billion) in 2011 and 19% in 2013 (RM1.1 billion from RM5.79 billion). iSpring Capital Sdn Bhd is an example of VC funded by corporation. This company invests in the start-up and early stage companies in Malaysia.

Other sources of VC funds include foreign companies and individuals, banks, local individuals, and pension funds and insurance companies. Foreign companies and individuals contributed about 11 percent, on average, of total VC funds in 2007-2013. Banks contributed 16 percent of total VC funds in 2007. However, their contribution had declined to 6 percent, on average, during 2008-2013. Examples of VCs funded by banks include Mayban Ventures Sdn. Bhd, Mayban Agro Fund Sdn Bhd and CIMB Private Equity Advisors Sdn. Bhd. These companies are mainly private equity companies. Besideds expansion/growth, their preferred investment stages include start up and early stage.

Local individuals contributed, on average, about 3 percent of total VC funds during the 7-year period. An example of VCs funded by local individuals is Intelligent Capital Sdn Bhd. invests mainly in the ICT industry in Asia and Southeast Asia. Its preferred stage of investment are seed, start-up, early stage, mezzanine and pre-IPO. Last but not least, pension funds and insurance companies together they contributed about 3% of total VC funds during 2007-2013.

5. Preferred Investment Stages and Sectors

Venture capitalists in Malaysia invest in several stages of business: the initial stage (pre-seed, seed, early stage), the growth stage (mezzanine and expansion stages), and later stage (pre-IPO and buy in/buy out). Companies in the seed stage are developing their prototypes and start marketing their products. In some cases, companies may yet to sell their products. These companies may already have established their mangaement team and conducted initial market search. Companies at the early stage start commercializing their products. When the company reaches its mezzanine stage, companies may have increased in sales and reach their breakeven point. There may be some improvement in the product lines [2].

The majority of the venture capital companies in Malaysia invested in the companies at their expansion/growth stage (Figure 2). The amount of investment rose from RM299 billion in 2008 to RM317 billion in 2009. However, after 2009, the figures showed a declining trend from RM176 billion in 2010 to RM91 billion in 2013.

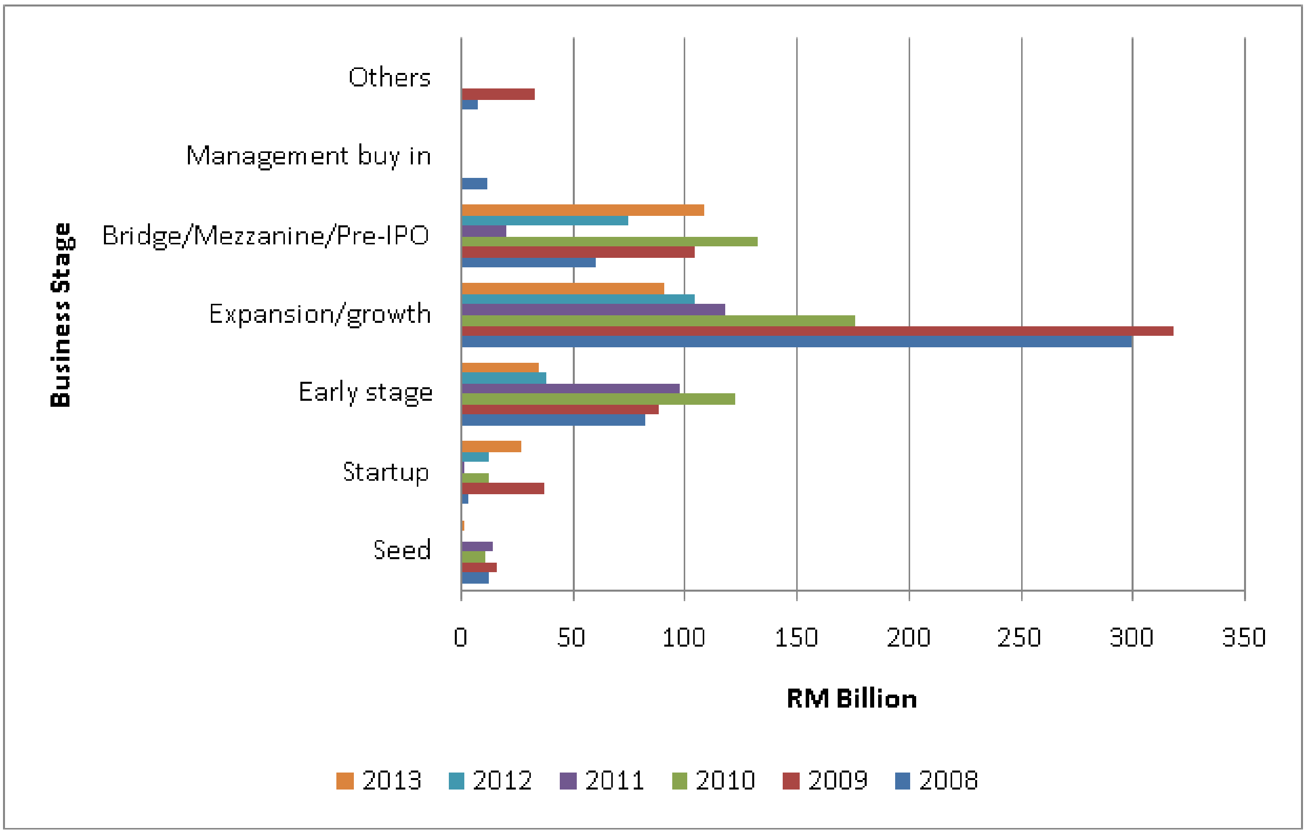

Figure 2. Investment by Business Stage (Source: [4])

The other preferred investment stages of Malaysian VCs are early stage and bridge/mezzanine/pre-IPO (BMP hereafter). Investment in these stages peaked in 2010 with the amount of RM122 billion for early stage and RM132 billion for BMP. Investment in the early stage declined slightly to RM97 billion in 2011but the figure dropped drastically to RM21 billion for BMP during that year. However,there is a positive turnaround for investment in BMP with a total investment of RM75 billion and RM109 billion in 2012 and 2013. A big investment drop was observed in 2012 and 2013 for early stage with a total amount of RM38 billon and RM35 billion.

To a lesser extent, the preferred investment choices of VCs are the start-up and seed companies. There was, on average, a yearly invesment of RM13.7 billion for seed companies during 2008-2011. The figure dropped drastically to RM1 billion during 2012 and 2013.

This trend shows some changes in the risk profile of the VC companies in Malaysia in terms of their willingness to take on higher risk projects. Even though there is some improvement in the risk profile of the Malaysian VCs, most of the VCs still prefer to invest in the expension/growth stage.

For the start-up companies, investment peaked at RM38 billion in 2009 before declining to an average of RM9 billion during 2010-2012. The figure improved to RM27 billion in 2012. The number of investee companies for expansion/growth stage had also declined from 65 in 2008 to only 24 in 2011 (Table 2). The trend is consistent throughout 2008-2011.

Table 2. Number of Investee Companies by Business Stage

Business stage	2008	2009	2010	2011	2012	2013
Seed	31	8	9	1	1	1
Startup	3	9	8	5	4	12
Early stage	21	16	24	15	13	10
Expansion/growth	65	49	25	24	19	17
Bridge/Mezzanine/Pre-IPO	11	12	18	6	10	16
Management buy in	2	0	0	0	0	0
Others	1	5	0	0	0	0
Total	134	99	84	51	47	56

Source: [4].

The amount invested in the early stage has increased from 17% in 2008 to 38.6% in 2011 (Table 3). The number of investee companies at the early stage peaked in 2010 with 24 companies before declining to 15 companies in 2011.

Table 3. Percentage of Investment by Sector

Sector	2006	2007	2008	2009	2010	2011	2012	2013
IT & Communication	44.1	15.2	18.5	25.2	30.4	19.5	7	22.1
Manufacturing	9.6	12.3	27.4	18.7	15.7	11.5	45	18.8
Life Sciences*	24.3	25.9	18	17.4	24.8	49.3	26.4	22.6
Others	22	46.6	36.1	38.7	29.1	19.7	21.6	36.5
Total	100	100	100	100	100	100	100	100

*Includes Biotechnology (Source: [4]).

From 2006 until 2010, ICT sector was the most highly invested sector by the VCs. However, the change in trend has been observed in 2011 with life sciences had become the lead sector for VC inestment.

Investment in the life sciences sector averaged around 25% of total VCs investment in 2006 and 2007. However, the proportion declined to around 17.5% in 2008 and 2009. The declined could be associated with the global economic downturn in 2008.

Life scieces is the second most popular sector to the venture capitalist. Biotechnology industry is one of the most important industry under this sector that has identified as a highly potential industry as engine of growth to Malaysia in relising its Vision 2020. There are four main subsectors categorized under this industry. They are agriculture, healthcare, industrial and bioinformatics. The main challanges in the boitechnology industries include (1) the lack of experts (both quantity and qualitly) in this area, (2) moderate collaboration among industry, university, entreprenuers and government; (3) local environment is not condusive enough to promote development of the industry; (4) limited number of companies that are up to the international standard [7].

Another important industries for VC investment include nanotechnology and green technology.

6. Challenges

The VC industry in Malaysia is still developing with a small number of VCs and VCMCs and the number is still growing. The number of VC professionals have also increased. Even though there is some positive trend observed in this industry, MAVCAP - the government-owned VC leads the industry with the highest amount of funding. The main challenges facing VCs in Malaysia are limited funding, risk aversion of the VCs, cyclical industry and difficulty to exit the industry.

Limited funding is a critical issue for the Malaysian VCs. As highlighted in the previous paragraphs, government is the main source of funding for VCs in Malaysia. More than 50% of funds come from government agencies. Most of these VCs invest in the later stages of business such as mezzanine, expansion/growth and pre-IPO. In contrary, VCs funded by corporations, banks, and private individuals tend to invest in the early stages of the business such as seed and start up. Since most of the VC funds come from the government, majority of the investee companies are at their later stage.

High investment in the later stages of business is an indication of risk aversion of the VCs in Malaysia. Companies at later stages have bright prospects with secured markets for their products with high potential of going public. By choosing these companies, the probability of getting high returns on their investment is very high. One of the reason for the risk aversion of these VCs is that they have to report to their investors the progress of their investee companies on regular basis. Since investors usually have high expectations on their investment, VCs would try to avoid reporting poor investment results to their investors.

The VC industry is cyclical and the growth of this industry is very much dependent on the regional and global economic conditions. During good times, many new businesses spur up and these businesses provide new opportunities for the VC companies in getting potential good investee companies. Another important factor that affect the survival of VC industry is the development of technology industries such as ICT, green technology, and biotechnology. Most of the VCs in Malaysia invested in the ICT-related businesses. The growth of the ICT industry would very much dependent on the ability of these companies in adapting to the fast changing customer demand and taste. Thus, these technology companies need to have advanced research capabilities and R&D facilities to develop new technology to remain competitive in the industry.

Another factor that affect the growth of VC industry is the existance of a well-developed capital market. This environmnent will help VCs to exit the industry with some profits. This is another challege to VCs in Malaysia since the Malaysian capital market is still developing and the market is relatively thin as compared to capital markets in advanced countries.

7. Conclusion

The VC industry in Malaysia had started in 1984. Even though the industry had evolved over the last thirty years, the number of participants in this industry can be considered small. There are several factors that influence the development of VC industry in Malaysia. They are limited funding, risk aversion of the VCs, cyclical industry and difficulty of the VC to exit the industry.

From the above arguments, it is learnt that the Malaysian VC industry is still developing and the industry needs some transformation before the country can become a high income nation. VC can play a vital role providing financing to early stage and start up companies who may have difficulty getting loans from banks. To move forward, the role of government in VC industry need to be minimized to give room the the private corporations, private individuals and other private financial institutions to play an active role in investment at the early stages of business. With such transformation, VCs in Malaysia would be willing to take on higher risk investment.

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