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The Participant of Venture Capital Company in Malaysia

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Abstract

A successful company performance has been associated with the involvement of Venture Capital (VC) globally. This can be explained by the natural role of VC in providing the guidance and equity towards the beginning of the start-up companies. Effect of certifying role by VC such as network contacts towards the start-up and growth of the company will benefit company which been backed by VC in acquiring new resources that may enhance their business performance. The involvement of VC in decision making helps company increase the quality in formulating business strategy, business partnership and the company management team. In Malaysia, first established VC company was in 1984. However, until now, the VC industry in Malaysia is still developing as compared to other countries such as US and UK. The difficulties in obtaining resources and fund due to small size of industries have become a crucial challenge for VC companies in Malaysia to exit their investment successfully. Thus, this study objective is to review the growth of VC companies in Malaysia since the establishment by adopting a single case study by comprehensive review of newspaper, data analysis, secondary data and empirical literature. The outcome of this study will contribute to add some insight information regarding the growth of VC industry in Malaysia.

Keywords: Venture Capital, Reputation, Stakeholder, MAVCAP

Introduction

VC financing is viewed as being among the important types of capital especially for the entrepreneurs. Entrepreneurs may benefit not only from the financial investment, but more significantly, from having access to value-added by VC investors such coaching and training ability (e.g., financial, strategic, marketing, legal, administrative, human resource aspects), and investors with an ability to connect entrepreneurs to others that afford strategic alliances to help the entrepreneurial company to grow and prosper (Cumming & Johan, 2013).

In Malaysia, the increasing number of VC companies in the market has become one of major alternative sources for financing, especially during their developmental stages. This is because companies will be facing difficulties in obtaining fund from the bank or acquiring fund by debt or equity market. The first VC company in Malaysia, Malaysia Ventures Berhad was

established in 1984 with RM13.8 million size of fund. This company was founded with intention to focus on investment in furniture and products made from rubber. Since the establishment of Malaysia Venture Berhad, Malaysia government had taken several steps in promoting the development of venture capital industry in Malaysia such as establishing VC funds, providing tax incentives and liberalizing foreign equity ownership. During that period, Malaysia Venture Capital and Private Equity Association (MVCA) and the Malaysian Venture Capital Development Corporation (MVCDC) been appointed as to ensure the growth of Malaysia venture capital industry are on the track.

In 1995, MVCA was founded with purpose to organize the active and leading players in venture capital and private equities industry in Malaysia. Upon that, MVCA also served its members as a platform for them to express their thoughts and ideas in improving the industry growth of venture capital and private equity in Malaysia. This further highlighted mission of MVCA establishment as this agency acts as a policy advocator that can improve the environment of venture capital and private equity activities for Malaysian market. Since establishment of MVCA, this agency had conducted several activities such as conferences, forums, joint ventures and collaboration with foreign venture capital association as an action in promoting growth of industry for venture capital and private equity in Malaysia (MVCA, 2016). Acknowledging the importance of growth for Malaysia venture capital industry, the Venture Capital Consultative Council (VCCC) was established in August 2002 as a platform to address and discuss issues related to the improvement of Malaysia venture capital industry. However, in September 2004, Malaysian Venture Capital Development Corporation (MVCDC) was established in order to replace VCC. The MVCDC establishment main objective is to help in providing clear and strategic direction of venture capital industry development with regards to supervise, formulate and implement the policies and strategies which can help in improving the Malaysian venture capital industry. Upon MVCDC establishment, this agency has been responsible to act as intermediaries between the policy maker and practitioner in enhancing the venture capital activities in Malaysia.

Besides that, Malaysian Venture Capital Management (MAVCAP) is one of the important local agencies in Malaysia venture capital industry with more than 1 million Ringgit Malaysia investment through more than 160 companies in Malaysia and Asia (Cheryl, 2016). MAVCAP was incorporated in April 2001 with purpose of developing the industry of Malaysia venture capital and encouraging entrepreneur in terms of information, communication and technology sector (ICT) for Malaysia industry. As an agency that fully owned by the Minister of Finance, MAVCAP is been recognized as the biggest VC company with huge fund in Malaysia for technology-based industries and ICT sector (Ajagbe & Kamariah, 2013). Based on the vision in enhancing the venture capital activities in Malaysia, sources of fund for high-risk financing during the ventures start-ups stage, seed, and early stage have been provided by MAVCAP as an action in promoting growth of high-tech industries and ICT sector in Malaysia.

Literature Reviews

Stromsten and Waluszewski (2012) stated that there are three types of investment in venture capital namely seed, start-up and expansion. These three types of investment represent the financing stage development of venture capital starting from the stage of seed, start-up, and Expansion. Under the stage of seed investment, it focuses on the financing of newly formed company who are seeking for their capital. During this stage, the capital obtained will be used to finance the Research & Development (R&D) of their initial product and to commercialize their product. Subsequently, the start-up stage of investment which focuses on funding the

company who preceded the ideas stage with planning of producing the products and sell it in the market. At this stage, cash is used more than income that the company can generate. As asserted by Andrieu (2013), initial stage investment of venture capital can be referred as either stage of seed or start-up.

Final stage of the investment is expansion stage. During this stage, the company chosen by venture capital has passed their early stage of investment. In general, the company has already introduced their product in the market and additional funds are needed for further expansion including further R&D process as well as the capacity of manufacturing and distributing the products (Nahata, 2008). On the other hand, there is a type of investment of venture capital which is related with private equity known as buyout. Mature companies are usually synonym for the buyout investment. The buyout investment explained that any company can be acquired using debt as mechanism when leverage buyout is reduced by its equity base. As discussed by Ughetto (2010), current management will take control of the company if the management buyout is the leveraged buyout.

In the financial market, venture capital serves as financial intermediaries towards the borrowers when they find it costly to get from lenders. Most entrepreneurs will require a substantial amount of capital to start or to expand their current business. But, since banks and other financial institutions implement strict financial regulations and require reasonable collateral for the loans (Andrieu 2013; Behrens *et al.*, 2012), most of them find it difficult and are unable to meet those criteria in order to obtain loans from those institutions (Chua *et al.*, 2011). Given the need for financial intermediaries for start-up and business expansion, the venture capital organization acts as an in between to complete the business financing (Vinturella & Erickson, 2013). According to Allen and Hevert (2007), the first modern association of venture capital was founded in 1946 in Massachusetts known as American Research and Development. In addition, Winton and Yerramili (2008) stated that that due to the leeway of repayment schedule based on the structure of venture capital equity financing by the modern venture capital association has made them more attractive for investment purpose. Furthermore, venture capital can gain success in start-up ventures when they focus on the start-up stage as they will achieve the skill in locating and financing potential growth company.

In Malaysia, the development of VC industry had shown a tremendous growth from 91 registered VC companies in 2006 to 112 registered VC companies in 2014 (MVDC, 2016). The increasing number of the VC registered companies had indicated that Malaysian also acknowledge the importance of venture capital role in improving the economic sector. Thus, the government agencies had been a key player in contributing the growth of VC industry in Malaysia as they became the major sources of funding towards the VC companies. This can be illustrated by the increasing number of percentage sources of fund by government agencies towards the VC companies from 41 % in year 2006 to 65.87 % in year 2014 which approximately from RM3.31 billion up to RM6.21 billion (MVDC, 2016).

Although the data displays a good image of the VC industry in Malaysia, however, the number of sources of VC fund that came from the foreign companies and foreign individuals decreased tremendously over the years from 11.49 % in year 2013 to 7.84 % in year 2014 which approximately dropped down from RM 0.12 billion to RM 0.08 billion (MVDC, 2016). In parallel, it also been reported that the sources of VC fund that came from the local companies for the past decade also displayed a sharp drop from 37.91% in year 2006 to 18.94% in year 2014 which depreciated from RM1.25 billion to RM 0.19 billion (MVDC, 2016). In conjunction, Nor (2015) and Ajagbe and Ismail (2013) also highlighted in their study that VC industry in

Malaysia is still lagging behind as compared to other countries in Asian region especially in initial public offering (IPO) companies. As explained by Hussain (2010), the advantages that has been derived from VC itself such as monitoring skills and certification roles still need to be promoted as it will reflect to the reputation of VC itself as reputation of VC can signal the investors of the VC capability in managing the portfolio. Supported by Algahtani and Arshad (2012), besides innovation and investment environment, the success of Malaysia VC companies also can be related to the reputation of VC companies itself. In addition, the reputation that derive by VC can add value towards company been backed by VC for being a winner investor throughout the assessment from the private start-up company to initial public offering company (Nahata, 2008).

VC reputation had been associated with the success of investment in portfolio of the company (Wang & Li, 2015; Pollock *et al.*, 2011; Gompers *et al.*, 2008; Hochberg *et al.*, 2007). For example, Hochberg *et al* (2007) explained in their study that during the prior fund, the experience of VC company is positively related with the fund exit rate including the IPO and acquisition exit rate. Moreover, they also tested whether venture can survive in another round of funding as the intermediate success indicator and found that VC company with experience is related with the survival probability rate and the fund exit rates among other factors. Supported by Nahata (2008), he also argued that the successful exit rate for company been backed by reputable VCs is higher and the ability in accessing the public market is faster as compared to non-VCS backed company based on IPO capitalization share. In addition, he also explained that the measurement of reputation used in his study reflects the VCs monitoring and screening skills.

On the other hand, Gompers *et al* (2008) studied the relationship between entrepreneurs and VC success and found that VCs with experience is positively related with entrepreneurs who have success track records. In addition, they also argued that the involvement of VCs with industry's specific experience can help in increasing the success rate of the new entrepreneurs as experienced VC are able to identify good entrepreneurs whom turn to be serial entrepreneurs after being the first-time entrepreneurs and can add their value to the company. They also claimed those persistent performance and skill developed by VCs towards the entrepreneur will yield high performance in the future.

In conjunction, Sorensen (2007) also argued that experienced VCs are associated with better monitoring skills, larger network access and able to certify value to the company. Thus, he argued in his study that experienced VCs are more favorable in bringing the company for public listing. However, he also explained that sorting of investment in better companies by experienced VC is more important than direct influence from experience VC to go public in determining the success of the company. In parallel, Krishnan *et al* (2011) also stated that VCs with reputation is associated with good corporate governance, larger networks, high demand in IPO, and active involvement in post-IPO period. Moreover, they also found that superior post-IPO performance and the high frequency of VCs portfolio company went for listing are positively related with high reputable VCs.

In line with previous discussion, Aula and Heinonen (2016) argued that obtaining resources at the lower cost such as high skill and qualified employees or loans at lower interest rates due to good credit ratings are the advantage of company having a good reputation. As discussed by Krstic (2014), the relationship between stakeholders and organization is important as it can be expressed as positively or negatively in terms of corporate reputation, relationship, persistence and performance. Moreover, he also added that if the relationship is poor between the stakeholders and organization, then it can become

a threat towards the corporate reputation. Quality of products and services can be improved and organizational goals can be achieved if a good collaboration is made between stakeholders and organization. Furthermore, a good collaboration also can help in increasing resource availability, solving arising problems, and reducing the organizational reputational risks (Krstic, 2014).

On the other hand, VC is directly interconnected with service offering, supplemented with higher perceived risk which is more than manufactured goods (Mitchell & Greatorex, 1993; Murray & Schlacter, 1990). This is primarily owing to services' characteristics that include the physical and mental intangibility (Laroche *et al.*, 2004), coupled with the heterogeneity association which impedes a consistent level of service quality. Based on the theories of cognitive consistency, people consistently preserve a psychological harmony between their beliefs, attitudes and behaviours which resulted the company to receive consistent yet positive satisfactory reactions from the customers who will be committed and will also simultaneously intend to continue the interaction with the company whilst carrying out other actions favouring it (Zeithaml *et al.*, 1996; Bettencourt, 1997). The recognition of company with high reputation also will lead to cumulative belief benefits such as loyalty improvement as the company value are difficult to be determined and were unrecorded as an intangible asset. In conjunction, Ladhari *et al.* (2011) showed that varies in percentage between 25% and 85% due to increase from the retention by the customer can lead to increase in company profit up to five percent. Besides, when considering high risk investments, positive word of mouth that is derived from high reputation companies can attract new customers to get involve in (Molina *et al.*, 2007) and it is being acknowledge as the best marketing tool as compared to traditional marketing tools (Silverman, 2001). Thus, it is important to maintain and enhance a good company reputation for VCs as the relationship between the stakeholders and organization is important in determining the company's success.

Industry Participant of Malaysia Venture Capital

The participant of Malaysia venture capital industry consists of total number of registered VC companies and VC management companies. As shown in Table 1.1, the total number of VC registered companies and VC management companies have increased from 91 companies in year 2006 to 114 companies in the year 2009. However, the total number of registered VC companies and VC management companies declined slowly to 112 companies for the next three subsequent years. In year 2013, the total number of registered VC participants shows a steady increase from 112 companies in year 2012 to 119 registered VC companies in year 2013 but it declined back to 112 companies in the following year. Although the number of total registered VC participants shows an increase in 2015 by 119 companies, but the number rose down to 105 companies in year 2019 throughout four subsequent following year.

In terms of number of investee companies, it shows a sharp decline by 61 companies from 450 companies in year 2008 to 389 companies in 2010. However, in 2012, the trend shows some improvement by increasing approximately near to 20% to 466 companies. In the following year, the number of investee companies once again fell by 50 companies to 356 companies and before rising up to 376 companies in year 2014. The number of investee companies displayed a declining trend throughout the year 2006 to 2010 from 461 companies to 389 companies. However, in year 2011, the number of investee companies spiked from 409 companies to 466 companies in the year 2012. Unfortunately, investee companies show a tremendously decline in number from year 2012 to 2019 by 162 companies.

Apart from that, the number of VC professionals with more than four years of experience also displays a similar trend with the number of investee companies. In year 2006, the number of VC professionals with more than four years of experience rose up by nearly 70% from 186 companies to 313 companies in year 2008. Unfortunately, a sharp declining trend can be observed from year 2008 to 2014 by approximately to 65% for the number of VC professionals with more than four years of experience. There were several factors that can clarify this declining trend, the awareness of VC towards the economic condition during that period, limitation of funds available for VC, and the risk-averse attitudes of Malaysian VCs. As discussed by Nor (2015), there were several number of global crisis that affected the market during those period such as the subprime crisis in 2008. In contrast, during the year 2015, it shows a tremendous increase by 206% from 111 companies to 229 companies. However, the number of VC professionals with more than four years of experience shows a fluctuation trend from the year 2016 until year 2019.

The majority of VC player in Malaysia are 100% locally owned (Nor, 2015). Apart from that, the local VC and foreign VC joint venture number shows some improvement from year 2006 by 4 units to 10 units in year 2014. Although there is an increase in the joint ventures numbers, however the increasing numbers is still small. As argued by Nor (2015), small and new establish VC received the assistance in terms of risk sharing, market exposure and amount of funding from the large VC through the joint ventures. The effect of information asymmetry can be reduced through the joint venture between the venture capitalist (Lerner, 1994). Besides that, the number of registered for private equity companies and private equity management companies have been reported in Malaysian Securities Commission annual report starting from year 2015 until recent period. From the Table 1.1, it shows that there is a sharp increased from 2 companies in year 2015 to 17 companies in year 2019. It indicated that there is a potential growth for the private equity in Malaysia market.

Table 1.1: Number of Registered Malaysian Venture Capital and Private Equity

Year	Number of registered						Ownership structure		
	VC	VCMC	Total VCC & VCMC	PECs & PEMCs	Investee company	VC & PE more 4years experience	Local 100%	JV	Foreign 100%
2006	49	42	91	N/A	461	184	87	0	4
2007	52	46	98	N/A	433	132	93	0	5
2008	56	52	108	N/A	450	248	98	9	1
2009	59	55	114	N/A	445	313	104	9	1
2010	58	55	113	N/A	389	186	102	9	2
2011	56	52	108	N/A	409	131	98	8	2
2012	59	53	112	N/A	466	124	100	10	2
2013	61	58	119	N/A	356	103	99	15	5
2014	56	56	112	N/A	376	111	100	10	2
2015	61	58	119	2	220	229	N/A	N/A	N/A
2016	48	55	103	6	376	194	N/A	N/A	N/A
2017	46	55	101	9	381	182	N/A	N/A	N/A
2018	38	67	105	12	387	235	N/A	N/A	N/A
2019	38	67	105	17	304	220	N/A	N/A	N/A

Note: VC- venture capital; VCMC- venture capital management companies; PEMC- private equity management companies; PEC- private equity

Sources and Usage of Malaysian Venture Capital Fund

The sources and usage of Malaysian venture capital fund in this study were obtained from the annual report of Malaysian Securities of Commission. The sources of Malaysian venture capital fund in Table 1.2 shows it was relatively unchanged for the total committed funds under management in year 2006 by RM 3.31 billion to RM 3.308 billion in year 2007. However, the amount of total committed funds under management growth tremendously year by year, since 2008 until 2014. The total funds increased by 87.64% (RM 6.21 billion) from 2006 until 2014. However, during the following subsequent year, the total committed funds under management shows a fluctuation pattern from year 2015 until year 2019. Besides that, government agencies were the largest contribution sources of VC since 2006, which is 41% (RM 1.4 billion from a total of RM3.31 billion) and the number had increased to 61% from the total amount of RM5.79 billion in 2013 to 66% from the total amount of RM 6.21 billion in 2014. Meanwhile, during the year 2015 and year 2016, local companies become the largest contributor of VC funding by approximately at 50% and 48% respectively. In addition, the contribution share declined over the three following years. During year 2017 until year 2019, the government agencies once again become the largest contributor for the VC funding by 30%, 40%, and 41% respectively.

Table 1.2: Sources of fund

Year	Total (RM in billion)	Sources In %								
		Local companies	Fund of funds & other asset managers	Foreign investor	Banks, Financial Institution & Others	Corporate investor	Insurance	Local Individual	Pension & Provident funds	Government agencies
2006	3.310	38.00	N/A	10.00	6.73	N/A	0.44	3.00	1.83	41.00
2007	3.308	31.91	N/A	9.31	15.51	N/A	0.99	4.69	1.88	35.71
2008	4.570	26.76	N/A	11.64	7.65	N/A	0.72	2.95	2.39	47.88
2009	5.347	23.52	N/A	11.01	7.31	N/A	0.62	2.53	2.10	52.92
2010	5.959	29.44	N/A	9.73	4.93	N/A	0.55	1.86	2.09	51.40
2011	5.460	25.00	N/A	10.64	5.15	N/A	0.61	2.27	2.23	54.10
2012	5.698	23.27	N/A	10.64	6.98	N/A	0.58	2.12	2.34	54.07
2013	5.796	18.73	N/A	11.49	3.64	N/A	0.54	2.60	1.64	61.36
2014	6.210	18.94	N/A	7.84	2.08	N/A	0.93	1.40	2.94	65.87
2015	7.150	49.76	1.45	1.97	0.63	6.43	0.33	0.86	0.60	37.98
2016	6.510	47.66	3.49	N/A	1.33	14.94	0.35	0.34	1.63	29.92
2017	7.000	29.54	7.25	N/A	2.43	26.70	0.35	2.32	1.49	29.91
2018	6.080	30.19	9.74	N/A	0.54	10.80	0.41	5.09	2.99	40.24
2019	5.998	24.40	3.40	N/A	1.40	21.50	N/A	2.80	5.40	41.10

On the other hand, Insurance agencies remain as a minor contribution for VC funding since the percentage of the new fund less than 1% starting from 2006 (RM33million) until 2018 (RM25million). Another source of fund for VC includes foreign companies and individuals, banks, pension and provident and local individuals. Foreign companies and individuals contributed about 10 percent, banks contributed 6.73%, pensions and provident contributed 1.83% and local individuals contributed 3% approximately from the total number of VC funds in 2006. As from the year 2007 until year 2019, fund of funds and other asset

managers, foreign investor, banks and financial institution, corporate investor, local individual, and pension and provident funds had become the minor contributor for the total committed of VC funding.

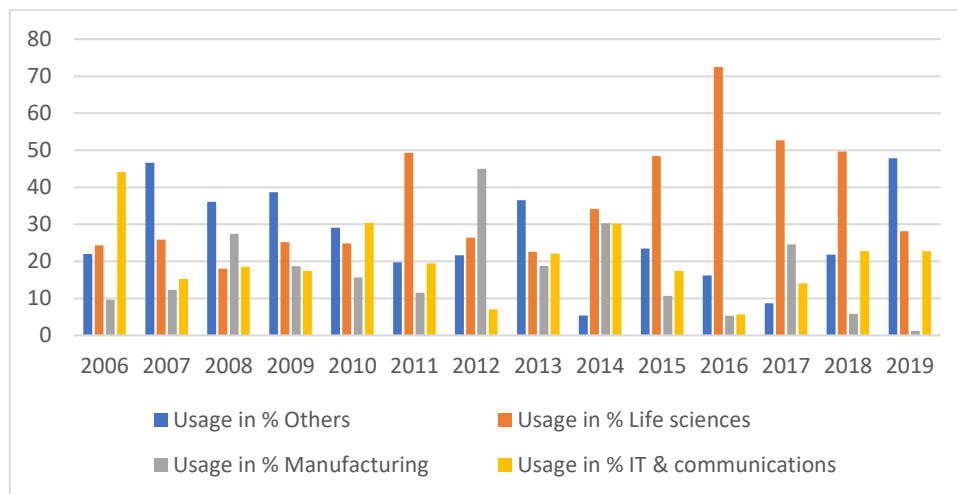


Figure 1.1: Usage of fund

Apart from that, Figures 1.1 shows the percentage of venture capitalists investment in Malaysia by sectors which includes IT and communication, manufacturing, life sciences and others. In year 2006, IT & communication become a major sector for venture capitalist investment which is approximately at 44% of total investment portions. The average percentage of the IT & communication investment sector was at 21% from year 2006 until 2019. Meanwhile, life sciences were the second largest investment sector around 24% of total VC investment portions for the year 2006. However, in year 2014 until 2018, this sector has become the main investment sector chosen by venture capitalist by the total number of percentages at 34%, 49%, 73%, 53%, and 50% respectively. Moreover, the average percentage of life sciences was at 36% from year 2006 until year 2019 for the total portion of VC investment. In contrast, during the years 2019, others sector has become the most sector be chosen for VC funding by percentage at 48%. In addition, from year 2006 until year 2019, the average percentage of others sector for VC usage of fund was at around 27%. Furthermore, manufacturing sector also is one of important sector for VC investment among venture capitalist where it shows that this sector received 17% of total investment on average since year 2006 until 2019.

Conclusion

The development of VC industry in Malaysia had started from the year 1984, however to the recent years, the numbers of VC company established in Malaysia is still considered small in scale although the industry had evolved for over thirty years. As the study been conducted, several factors that affect the small growth of VC industry in Malaysia had been identified by the researchers such as limitation of funds and difficulties in obtaining resources, the difficulties to exit investment by the VCs and the reluctant of VCs company to take high risk investment due to uncertainty outcome as most of the VCs investment are related with high technologies sectors that requires a huge sum of capital. This factor needs a lot of attention from all parties involved especially from the government. It is suggested that the government intervention in VCs industry should be minimized in order to make path for private sectors

and other parties to be involved in the VCs investment activities during early stage of company's establishment. During this stage, obtaining fund is crucial and it is difficult for the company to borrow loan from the banks. Thus, the involvement of private sectors and other parties will create a pool of fund and access in obtaining resources for VC which can leads to create an opportunity to help the growth of VCs industry in Malaysia.

In addition, it is also been suggested that the involvement of more reputable and experienced venture capitalist can help in increasing the performance of investment companies (Otchere and Vong, 2016). As supported by Krishanan *et al* (2011), a company may result a long superior performance post-IPO throughout the involvement of reputable VCs in the board directorships and shareholders as reputable VC are very selective in terms of investment they ventured. In line with this, Gerguri *et al* (2012) also discussed in their study that VC were very selective in choosing their potential companies to invest in as they would analyze more than 100 companies and only choose a few of them which meet their criteria such as having a strong potential growth and development. Furthermore, the involvement of high reputation VC in a company can increase the efficiency of the portfolio companies by developing a strategic quality formulation and acquiring resources (Lee *et al.*, 2011).

From the above discussion, it can be significantly concluded and noted from the research that, limited funding is the primary cause for the slow growth of VC company. On top of that, government control and limited resources are other significant findings that this research acquired. In order to heighten the growth of VC company, our recommendation would be, the power on VC company has to be shifted in the hands of the public as well as the increase involvement of experienced and reputed VC. The study regarding the Malaysian venture capital is still remain to be explored. As argued by Otchere and Vong (2016), reputational VC interest is to maintain their reputation at the time of IPO and thus, they will use their ability in screening and monitoring in selecting potential portfolio companies for them to invest in. Thus, it is suggested for future research that it may be beneficiary to find evidence on the performance of company been backed by VC in Malaysia and to study the factors that can contribute to the venture capital reputation as reputation play a vital role for venture capital companies.

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