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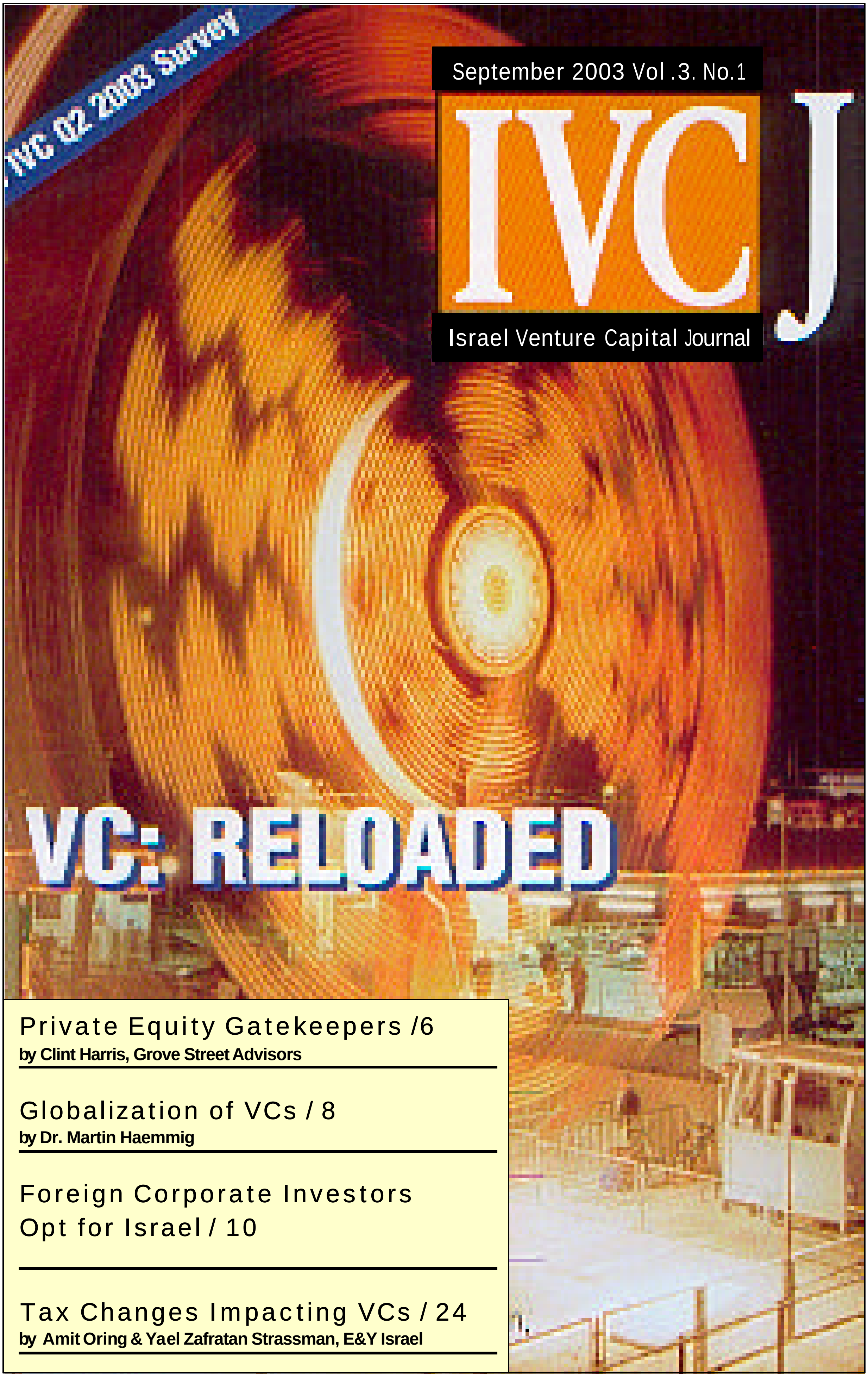


# VC: RELOADED

# The Globalization of Venture Capital

## “Israel in the International Venture Capital Arena”

**Dr. Martin Haemmig**

Below is an updated extract from *“The Globalization of Venture Capital” – A Management Study of International Venture Capital Firms*. The 600-page research study is based on a 13-country study of 100 international VC firms in Asia, Europe, Israel and the US. Released in 2003, the book is authored by Dr. Martin Haemmig, (Martin@MartinHaemmig.com) and published by Paul Haupt, Berne/Switzerland; ISBN 3-258-06565-9. Electronic orders can be made through the web site of the Swiss Private Equity & Corporate Finance Association SECA: www.seca.ch under “Books & Statistics”.

## Globalizing Venture Capital: Key Drivers

The “mobility” of technology, financing, people and dispersed markets has spurred substantial cross-border investments, because innovations developed in smaller countries need to be commercialized in larger markets to justify their huge investments. On the other hand, the future success of any country will strongly depend upon the integration and liquidity of its own venture capital market and the inventiveness and management of its high-tech industries.

The technology boom in the ’90s, modern telecommunications infrastructure and the availability of the Internet for ease and low cost global reach, have enabled many technologically excluded countries to become technological adopters. Israel, Taiwan, South Korea, and Singapore have in the last decade graduated from this group to join top innovators, with India and China engaging rapidly in such a move.

Europe and Asia have paid attention over the last decade to the need to replicate the entrepreneurial dynamism demonstrated by the United States and Israel. Although narrowing, the cultural gap remains obvious, particularly in the areas of risk taking and failure acceptance that impact entrepreneurial motivation. Governments, however, cannot command a change in culture, but can act to create a climate to encourage such change.

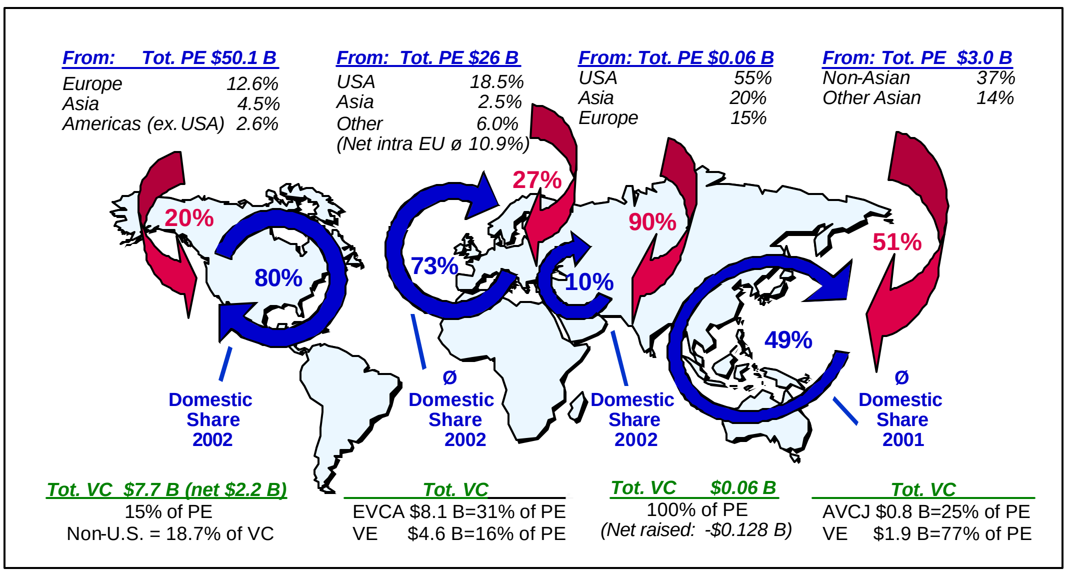
The vast majority of venture capital firms in small countries has no choice other than going international, both for seeking deals and for bringing investee companies to larger markets. As a consequence, internationalization is a matter of survival, while VC firms in larger countries have historically seen sufficient and interesting deals in their own neighborhoods. The rapid increase in domestic competition, combined with the Internet and technology downturn, motivates many VCs in bigger markets to look abroad, since the next disruptive technology may very well become available in foreign countries.

After all, venture capital is about venture creation, mainly through leading-edge technologies that require global commercialization. They will generate internationally competitive companies, which generate superior returns for their investors when compared with other asset classes.

## Global Fundraising Flow in 2002

Cross-border fundraising data for private equity and venture capital are difficult to compile because of different global definitions and the sheer number of investment vehicles. Europeans source about one quarter of their funding from neighboring or overseas countries. Asians, in contrast, obtain about half through regional cross-border funding and from overseas, while Israel gets 90 percent from other nations. The United States not only raises 80 percent domestically, but also represents the single largest investor in private equity and venture capital funds in Asia, Europe and Israel.

Volume allocated in 2002 towards future venture capital investments is down in all geographic regions. Of the $7.7 billion raised by US VC firms, $5.5 billion was returned to their investors from close to 30 of the largest funds, leaving a net balance of $2.2 billion raised. Several Israeli funds returned money to their investors, leaving Europe with the largest 'net' fund volume raised towards venture capital, while Israel ended up with a negative amount (-$128 million). Many of the top-tier funds were among those returning money, often under pressure from their limited partners. This reflects current market conditions in which quality deals not only cost less today, but the number of projects in the market that meet long-term return requirements are also fewer in number.



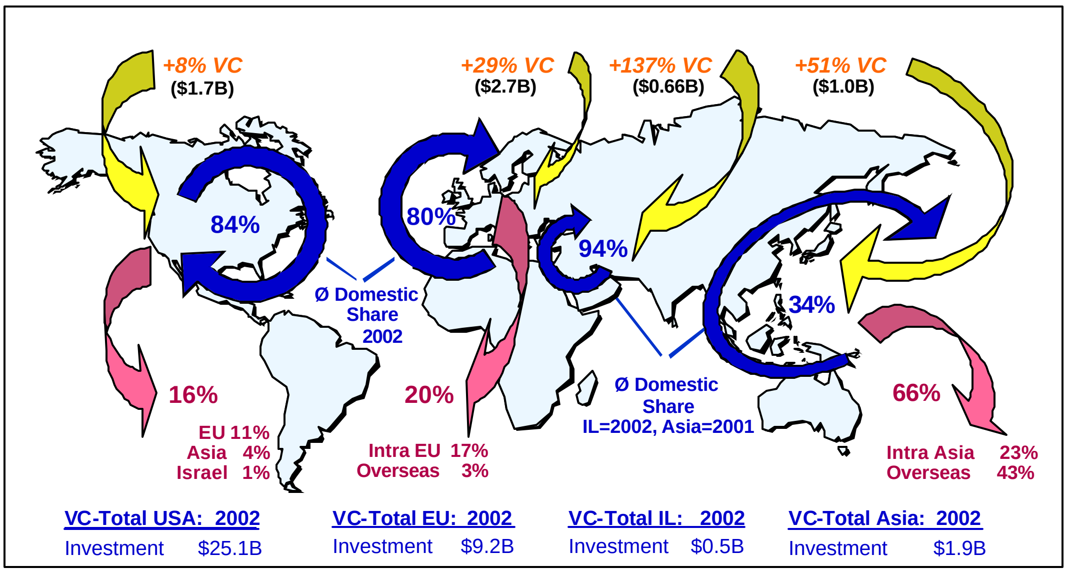

*Global Fundraising Flow 2002* [1]

There was substantial global venture capital "overhang" of about $150 billion at the end of 2001, since the funds raised globally had previously increased by an annual average growth rate of some 41% from 1996 to 2000, compared with a 35 percent increase for portfolio firm investments during the same period. This excess was reduced to about $110 billion in 2002 (US $80 billion, Europe $15 billion, Asia $10 billion)[2], as more money was invested than raised. Although this looks like a huge sum, the problem is that a large portion sits with bigger funds, leaving smaller VC firms with rather little "dry powder", since few could raise a new fund in 2001 or 2002. The remaining pool is still needed to support the large number of investee companies, as capital raising in 2002-2003 became very difficult for the venture funds and cash requirements by portfolio companies increased due to longer holding periods, as the IPO window is still shut.

## Global Direct Investment Flow in 2002

Foreign "direct investments" to local portfolio firms and investments made outside the domestic market can be significant. US-based VCs invest 84 percent domestically and 16 percent in foreign countries. Europe's average 80 percent is invested domestically within each country, while an additional 17 percent flows intra-Europe and just 3 percent goes overseas. Israel's VCs invest 94 percent in Israeli and/or Israel-related companies. The Asian domestic share on average accounts for only 34 percent per country, while 23 percent is directed to other Asian portfolio firms and 43 percent goes overseas, mainly to the United States.

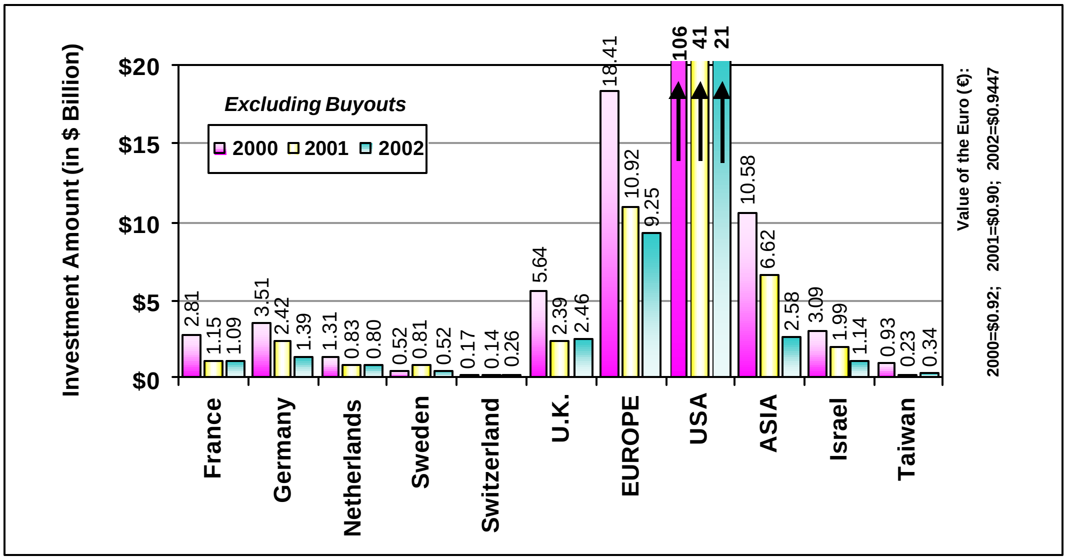
On the other hand, US portfolio companies receive an additional 8 percent on top by foreign venture capital firms. Europe's VC-backed entrepreneurial firms obtain an additional 29 percent, Israeli firms 137 percent and Asian companies 51 percent over their domestic VC volume.




*Global Portfolio Direct Investment Flow 2002* [2]

## Venture Capital Investment Comparisons in 2000-2002

US venture capital investment exceeds the volume of all other countries combined. At the same time, the US and Taiwanese markets are among the most volatile mature markets based on magnitude of fluctuations in recent years. In 2002, venture capital investment volume (excluding buyouts and restructuring) was down only 50 percent in Europe from its peak in 2000, versus 80 percent in US, 76 percent in Asia, 63 percent in Israel and 63 percent in Taiwan.




*Venture Capital Investment Comparison 2000-2002* [3]

## Trends in Globalizing Venture Capital

A truly global venture capital industry requires international investors and global technologies. The latter is gaining momentum, while current structural issues in many emerging countries will still take years to resolve before these countries receive international funding.

Several factors, however, contribute to limited prospects in the short-term for a truly global venture capital industry. First, experience has shown that even vastly larger public capital markets can remain effectively segmented from each other, despite massive cross-border capital flows. Additionally, since national public equity markets are much more segmented from each other than are national debt markets, it stands to reason that national private equity markets – like venture capital – will be even less globally integrated until reporting and transparency are globally aligned.

Israel has come close to the American concept and has seen a major influx of capital to finance innovative companies. Europe as a whole is undertaking major efforts to close the gap with the United States through an orchestrated effort by the European Venture Capital Association (EVCA) and its member states. They strive for uniform reforms across the continent within their own industry and also at government level in order to improve the fiscal, legal, regulatory and cultural environment that fosters venture creation and cross border capital raising. Asia as a whole has just started to build a regional platform with the launch of the Asia Pacific Venture Capital Alliance (APVCA). How ever, it will take several years to prove its effectiveness and gain the confidence and critical mass of global investors.

**Outlook:** The venture capital industry is set for resumed growth with a gradual recovery apparent for the second half of 2003. Pension funds in the United States and in Europe are likely to double their allocations to this asset class in the coming years, while Asian institutional investors and countries with high savings rates will find their asset managers trained for such investments. Growth will be driven by a narrowing of the perceived risk differential between private equity and public equity portfolios, easier access to private equity funds for investors, better exit opportunities through financial markets and continued long-term outperformance of returns by private equity.

Within the venture capital industry, scale or flexible networks will be increasingly important for VC funds, in order to spot trends and deliver value to companies and investors. The latter will become more sophisticated and will allocate their resources wherever the expected returns are likely to be the highest, and these opportunities will be increasingly outside Silicon Valley or Boston's Route 128. Other countries are not only creating clusters of competence, but also entrepreneurial frameworks and ecosystems to keep the smart people home or have expats return from abroad – going from 'brain-drain' to 'brain-circulation'.

## References


[1] GLOBAL DATA – 1, Venture Economics (J. Reyes, 2003), special data queries, EVCA Yearbook 2003, IVA/IVC Yearbook 2003, AVCJ Yearbook 2003

[2] GLOBAL DATA – 2, NVCA Yearbook 2003, EVCA Yearbook 2003, IVA/IVC Yearbook 2003, AVCJ (T. Yip, 2003), special data queries)

[3] GLOBAL DATA – 3, NVCA Yearbook 2003, EVCA Yearbook 2003, IVA/IVC Yearbook 2003, AVCJ (T. Yip, 2003, special data queries), TVCA Yearbook 2003



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