

## **Appendix S**

# **The Government's Role Orientation in the Development of Venture Capital**

# **The government's role orientation in the development of venture capital**

## **I. Foreign Governments' Experience in the Development of Venture Capital**

Based on the experience of various European and American countries, government promotion is indispensable in the development of venture capital industry, especially at the early stage of this industry. However at the later stage, the role of government should be reduced gradually and private investors should play a dominant role. Government's withdrawing from VC industry is also the indicator on the mature degree of the country's venture capital industry. Because the government's operation mode conflicts with the adventurous, aggressive entrepreneur spirit, and the flexibility, commercial operation and complicated investment management needed by VC, long-term government support and participation are harmful to the development of venture capital industry. It is important to know what the government should do in venture capital development so that it can effectively promote private investors to actively participate in this industry. First, we will make some analysis on the situations in Europe, America, and Asia.

### **1. Set up government VC-financing systems and support non-governmental VCs**

The support of government VC financing system to non-governmental venture capital includes providing supplementary low interest government loans to non-governmental venture capital and offering governmental guarantee to the loan non-governmental venture capital firms getting from relevant banks. In 1953, the USA set up a Small Business Administration (SBA) to provide guarantee for small business' banking loans. The SBA provides 90% guaranty for the loan less than US\$ 155,000 and 85% guarantee for the loan between US\$ 155,000 and US\$ 250,000. In Japan, such financial institutions as "SME Funds" and "National Funds" provide preferential loans for small and medium VC firms. Besides, in 1975, a venture capital company was even set up under the Commerce and Industry Ministry in 1975 to guarantee bank loans to VC firms and the company offers 80% promises 80% guarantee to banks for such loans. In the same year, the Research and Development Enterprise Incubation Center, a legal corporation syndicate in nature was founded in Tokyo to provide financing guarantee to hi-tech SMEs. Besides, Japanese governments at different levels all established corresponding funds to support the development of venture capital industry. In UK, the government provides

risk capitals to enterprises directly or indirectly. For instance, the British Ministry of Trade and Industry earmarks 33% of the government payment fund as the special fund for hi-tech development purposes and 20% is used to finance the development activities of high-tech industries. *The Enterprise Enlargement Program* issued in 1983 even stipulated that individual investors could be exempted from tax payment. Due to these supporting measures, the British realized enormous development and by 1986, the British VC occupied 2.3 of the total VC in Western Europe. The French venture capital began in 1970s. Although the starting point is much later, the government ceaselessly increase the government budget's support to R&D.

## **2. Provide legal support**

The international development history of venture capital shows that legislation and supervision are guarantees for the healthy development of venture capital industry. Venture capital is an industry involving high risks, needing large investment, and producing high return. The government needs to foster sound VC development environment and first of the all, it should offer support to VC through legislation. Most western developed countries stipulate special articles in relevant laws to ensure the development of venture capital and make venture capital industry develop on the track of legal and standardization. In 1958, the US government issued the *SME Investment Act* and *Regulations on SME Investment Companies* and these laws and regulations effectively boosted the development of US venture capital industry. In 1980, the *Small Business Investment Promotion Law* was passed. And the *Equity Option Promotion Law* passed in 1981 permits that the equity option holders to postpone their right execution until the company's IPO. All these laws greatly promote the development of venture capital industry in the USA. Since 1980s, Japan has established a series of important laws, such as *Regulations on the Research and Development of Next Generation of Fundamental Technologies*", *Regulations on Creative Science and Technology Promotion*, and *High-tech Industry Intensive Area Development Promotion Law*. All these laws and regulations are related to new technology development. The *New Industrial Technology Outline* requires to promote new technology development through focusing on the kinds of advanced technologies—micro-electronics, new material and bioengineering—through fixing development and research topics, targets and development strategies. The *Law on Basic Equipment in Advanced Industrial Technologies* requires financing advanced technology developing enterprises through fully utilizing finance, subsidy, taxation and financial means. The establishment and implementation of these laws and regulations on high-tech development greatly promote the growth of venture capital industry in Japan. The *SME Establishment Supporting Act* and the *New Technology Budgetary Subsidy Ordinance* of ROK and the *Venture Capital Ordinance* of Taiwan all greatly promote the development of venture capital industry in that country (or region).

### **3. Offer preferential taxation treatment**

For the high risks and low success rate of VC, VC enterprises' fund-raising capabilities are weak. Therefore the governments of various countries / regions all adopt tax reduction or exemption to support the development of their VC industry. The tax policies mainly include the following aspects. First, through providing preferential taxation policies, encourage pension and insurance and other revenue various long-term fund to flow to and various financial institutions to invest in VC. Second, use preferential individual income tax and capital income tax policies to encourage private investors to invest in companies that are not public listed. Third, adopt tax policies to encourage investment in equity instead of bonds or bank savings as through bond or deposit interest deduction and making it more favorable to invest in equity.

The American government lowered its capital income tax rate on VC enterprises from 49% in 1970 to 28% in 1978, and further down to 20% in 1987. The Economy Recovery Taxation Law passed in 1981 fixes the tax relief on hi-tech development investment through legislation. Singapore always uses taxation encouragement to support venture capital in high-tech industries and offer a lot of subsidies. The VC organizations meeting the criteria for "Forerunner Service Providers" can enjoy up to 10 years of tax exemption. In 1984, government further stipulated that if Singaporean companies invest in hi-tech projects approved by the government and lose money in such projects, VC companies also allowed to deduct any losses caused from their purchasing shares in VC enterprises permitted by the government. Taiwan issued a VC Ordinance in 1983 and started to provide large quantity of taxation relief and subsidies to VC investment in high-tech industries. In 1985, the French government stipulated in the *No. 85-695 Act* that VC companies can be exempted from paying income tax for the revenue or net capital income they obtain from investing in companies that are not public listed. The upper limit for such exemption is set at 1/3 of their total profits.

### **4. Provide subsidies**

Providing various free subsidies to venture capital companies and enterprises is another effective measure used by western developed countries to support the development of venture capital. The US *Small Business Development Law* issued in 1982 definitely stipulates that the Department of Defense, National Science Funds and other department with over US\$ 100 million R&D budget should carry out Small Business Initiation Research (SBIR) program. Every year they should appropriate 1.25% of their total R&D budget to support innovations in VC enterprise. Furthermore and some US local governments (such as Chicago) also set up local science funds that specialize in providing subsidies to venture capital enterprises engaged in hi-tech development. In 1987, the British National Research and Development Company jointly set up the British

Technology Group (BTG). By 1994, BTG had provided UK£ 326 million subsidies to 430 hi-tech VC enterprises. Singaporean government stipulates that in principle, all enterprises investing in hi-tech industry and suffering loss for 3 consecutive 3 years can obtain 50% subsidy. Since World War II, the Japanese government has provided “Subsidy for Important Industrial Technology R&D”, “Technology Improvement Expenditure Subsidy”, “Subsidy for Non-governmental Transport Vehicle Development”, “Subsidy for Computer Development Promotion”, and “Subsidy for Energy Technology Development”.

### **5. Set up active secondary market.**

Secondary stock market is an ideal mechanism for venture capital withdrawal. To develop hi-tech and venture capital industries, effective withdrawing channel is indispensable. The prosperity of US high-tech industry and VC industry has close relation with the active NASDAQ market and Microsoft and many other world famous companies all grew up from NASDAQ market. Sweden and France set up secondary stocks market in 1982 and 1983 respectively. Since 1985, Singapore’s secondary market (SESDAQ) has always been playing a significant role in the IPO and business extension of SMEs in Singapore and other countries in Southeastern Asia. Japan set up a secondary counter market in 1995. In Hong Kong the startup market formally began operation in the fourth quarter in 1999. It will promote development of Chinese science and technology enterprises, SMEs, and private enterprises and boost the implementation and spreading of Hong Kong’s high-tech industrial policies.

All the VC development encouragement and supporting policies and measures of various countries’ governments effectively promote the VC industry’s development. The development of VC industry enables many private organizations finish the technology innovation boosting investment that should have been conducted by the government and replace the government’s role in VC provision. In western developed countries, risk funds are gradually replacing governmental VC and the governments’ direct investment in R&D is gradually decreasing, while the share of corporate R&D enterprises is going up. From 1990 to 1993, APEC countries’ governmental investment in R&D fell from 2.4% to 2.2% of their GNP and 60% of the R&D activities were financed by enterprises and 67% of R&D projects were completed by enterprises. Such a tendency indicates that the development of risk capital market increases R&D investment.

## **II. The Chinese Government’s VC Development Boosting Measures**

As a new thing, venture capital is thriving in China. Both the central government and local governments are offering powerful fund and policy support to high-tech industries and venture capital (VC).

## **i. Detailed measures taken by the Chinese government to boost the development of VC**

### **1. The government direct invests in and sets up VCs**

The central government allocated some fund and established a “Fund for Science and Technology-based SMEs”. The State Council offered RMB 1 bn grants and RMB 2 bn worth of loans to the Ministry of Science and Technology to set up a “Fund for Science and Technology-based SMEs”, which had formally started operation in June 1999. The fund aimed at exploring and establishing VC mechanisms, supporting the industrialization of science and technology research achievements, encouraging science and technology professionals to set up science and technology enterprises, speeding up the development of some SMEs with high science and technology contents, independent IPR, and market prospects, and making them the new driving force to national economy growth.

Although the Fund for Science and Technology-based SMEs is a special fund of the central government, it is operated according to external market economy rules. Its operation mode is through offer grants, loan interest subsidies, and capital investment to support the science and technology SMEs of various ownership and effectively attracting local governments, enterprises, VC organizations, and financial institutions to invest in science and technology SMEs. For instance, every year Sichuan Province grants RMB 50 million worth of special fund and Chengdu City provides RMB 25 million to match the national fund for science and technology SME development promoting purposes. Each year, Xi’an City offers RMB 10 million to support young science and technology talents to set up enterprises and provides credit guarantee to banks for such enterprises’ founders. According to exports, although the central government’s innovation fund is not large in size, it can stimulate investment from local governments and the whole society and undoubtedly it provides timely help to the development of Chinese high-tech industry that urgently needs fund support.

So far, all the RMB 1 bn grants to the Fund for Science and Technology-based SMEs has been paid and 1,280 projects have received support from the fund, primarily showing the fund’s good effects of boosting SME innovation development.

As the central government offers fund support for the forming of VC mechanism, local governments at various levels are also increasing input to establish their provincial (municipal) VC mechanisms and boost the development of local high-tech industries. They have sponsored and founded various official startup funds and VC organizations. It is reported that throughout the country, there have been over 100 startup funds set up by governments at different levels and in some places, local governments have also set up supplementary VC

guarantee funds. Under the guidance of government, VCs financed by institutional fund and resident savings have formed an enormous driving force boosting the rapid commercial application of China's high-tech research achievements. The major venture funds and venture capital companies are listed below.

### List of Venture Funds and VC Companies Funded by Various Local Governments

VC Organization	Foundation time	Money □RMB m□	VC Sources
Beijing High-tech Industrial Investment Corp. Ltd.	1998	310	Beijing Comprehensive Investment Company, the State Development Investment Company, Beijing State-owned Assets Management Company, Capital Steel Cooperation, and Tsinghua Tongfang Corp. Ltd.
Beijing Science and Technology VC Corp. Ltd.	1998	500	Beijing Int'l Trust and Investment Company-25%; Beijing Int'l Power Developing Investment Company-25%; CYTS-25%, Beijing State-owned Assets Management Company-8%, the State-owned Assets Management Company of Haidian District, Beijing,-10%, and Beijing Dadi Science and Technology Industrial Corp. -7%.
Shanghai Startup Investment Co., Ltd.	1998	600	Shanghai Municipal Government
Shanghai Innovation Science and Technology Group Company	1993	48	Shanghai Municipal Science and Technology Committee
Shenzhen Innovation Science and Technology Investment Co., Ltd.	1999	700	Shenzhen municipal government entrusts Shenzhen Investment Management Company to offer RMB 500 million, and other sponsors include SSB and Shenzhen Energy Company.
Shenzhen High-tech Industrial Investment and Service Co., Ltd.	1995	100	Shenzhen Municipal Science and Technology Committee
Shenzhen High-tech VC Co., Ltd.	1998	1,000	Shenzhen municipal government (50%), Zhongxing Telecommunications, Haiwang Groups, and other companies (50%)

Guangdong VC Group	1999	700	Guangdong Provincial Government
Jiangsu High-tech VC Company	1992	300	The Finance Department of Jiangsu Province
Zhejiang Science and Technology VC Company	1993	60	The Science and Technology Committee of Zhejiang Province (58%), Zhejiang □□□□□□(42%)
Chongqing Science and Technology VC Co., Ltd.	1992	13	Chongqing Municipal Finance Bureau, Chongqing Municipal Science and Technology Commission, Chongqing Municipal Science and Technology Development Area

## 2. Perfect laws and regulations and standardize the development of VCs

The central government has formulated a series of regulations and ordinances on the development of VCs. In particular, the General Office of State Council issued and implemented “*Transmitting Certain Opinions on Venture Capital Mechanism Made by the Ministry of Science and Technology and Other Departments*” on Dec. 30, 1999 (hereinafter referred to as “*Certain Opinions*”, which is the most important document governing VC development in China.

The “*Certain Opinions*” stipulate that “people’s governments of various provinces, autonomous regions, and municipalities should adopt practical and feasible measures on the basis of their local science and technology, economy, and market development level and combining their short-term and long-term targets and try to play a role in environment creation, market mechanism improvement, and domestic and overseas startup fund attraction, and actively and steadily boost the development of VC.” According to the above stipulation, many provinces and municipalities have made and issued some local regulations to boost their local VC development on the basis of their local conditions. Generally speaking, these local regulations are made on the basis of the State Council’s *Certain Opinions* and combines the local actual conditions. As a result, they bear some local characteristics. Some representative examples of such regulations are:

Shenzhen: *Shenzhen City’s Provisional Regulations on Startup Capital Investment in High-tech Industries*

Guangzhou: *Guangzhou City’s Certain Regulations on Boosting the Development of Venture Capital Industry*

Tianjin: *Tianjin Economic and Technology Development Area’s Provisional Regulations on Encouraging Venture (Startup) Capital Investments*

Hefei: *Hefei High-tech Area Administration Committee’s Provision Regulations on Encouraging and Attracting Startup Capital Investment in High-tech Industries*

Chengdu: *Chengdu High-tech Area’s Certain Regulations on Encouraging and Attracting Startup Capital to Invest in High-tech Industries*

Xi’an: *Xi’an High-tech Area Administration Committee’s Certain Policies on Encouraging and Attracting Startup Capital to Invest in High-tech Industries*

These local regulations have become guiding documents on administrating local VC development and are

of great significance.

### **3. VC organizations are permitted to take multiple corporate forms**

The central government stipulates that “VC companies can take such forms as limited company, limited corporations and other forms and actively try new operation modes” so as to encourage the creation of VC organization forms in line with China’s actual conditions.

Many regions, such as Beijing, Tianjin, and Chengdu, stipulate that VC organizations can take the form of limited partnerships. Beijing has set specific definitions on the term “limited partnership” and further offer detailed rules on limited VC partnership in the supplementary “Administration on Limited Partnerships”.

Here, it is necessary to offer a simple explanation on the term “limited partnership”.

The top difference between limited partnership and ordinary partnership lies in the fact that limited partners need not to be responsible for the liabilities of their partnerships and the limited partners just undertake limited responsibilities with their investment in the partnership. To guarantee such limited liabilities, expect under few conditions, usually the limited partners do not participate in the partnerships’ management. The ordinary partners carry out the partnership businesses, represent the partnerships in external business activities, and undertake infinite joint responsibilities to the partnership’s liabilities.

As an enterprise organization form, limited partnership combines the features of both limited companies and partnerships. First, to the limited partners, the stipulation of only undertaking limited responsibilities enable them cast aside the concern of undertaking infinite responsibilities and make them more willing to investment in the partnerships. Second, for the ordinary partners, as they are responsible for the enterprise’s operation management and their infinite responsibilities can effectively stimulate their enthusiasm, creativity, and sense of responsibility. Besides, the issue of agent appointment can be easily and fundamentally solved. Third, the management framework of partnerships is simple and the decision-making and implementation efficiency is high. Fourth, compared with other corporate organization forms, it is more likely for partnerships to enjoy preferential taxation treatment.

These features of limited partnership make more suitable for VC, a kind of special investment activities with high capital intensity and knowledge intensity, involving high risks, and producing high returns.

### **4. VC organizations are permitted to adopt flexible authorized capital systems**

In the payment schedule of registered capital, many places, such as Beijing, Chengdu, Guangzhou, Shenzhen, and Hefei etc. □adopt the authorized capital system that is commonly applicable in “foreign-funded enterprise”. Namely, VC organizations are allowed to set the investment promised by each shareholder in their corporate constitutions or contracts and such investment is not required to be fully paid before the VC’s establishment registration. The shareholders themselves can independently decide when the part that is not actually paid should be handed in step by step. Such installment payment can be made in various ways and is entirely up to the investors’ decision through negotiation. For example, the fund can be paid according to

established schedule or according to the project's actual progress. Shenzhen, Guangzhou, and Hefei even set some detailed regulations in this aspect. For instance, Guangzhou stipulates that "the registered capital of VC companies can be paid in installment, but it should be fully paid within 2 years after the issuing of business license. Besides, the initial payment should not be less than 50% of the registered capital and should be paid within 90 days after the issuing of business license. The registered capital of VC management companies should be paid at full amount within 90 days after the issuing of business license."

Currently, in China except for "foreign invested enterprises", strict legal capital system is adopted on all other enterprises. In other words, the enterprises can not pass the establishment registration process before their registered capital is actually paid at full amount and passes the government examination. Such a practice is aimed at ensuring that an enterprise has sufficient and fixed capital upon its establishment, so as to prevent commercial dishonest behaviors and increase the safety of social transactions. But the disadvantages are that it is liable to causing delay in enterprise registration process and the leaving unused of money. Such disadvantages are especially unfavorable to VC organizations and may force VC organizations to keep large amount of money under their account at the time of establishment and form increment pressure.

Adopting the flexible authorized capital system in VC fields lowers the accession barrier of VC industry and can benefit the rapid development of VC businesses in a short time.

## **5. Actively develop VC exiting channels**

In addition to allowing VC exiting through corporate mergers and acquisitions and the purchasing back of equity, the central government is actively preparing for establishing China Startup Stock Market to realize the public listing of high-tech venture enterprises. At the same time, it is also trying to boost Chinese high-tech enterprises make IPOs on such overseas secondary market as NASDAQ and Hong Kong startup market.

Under the conditions that secondary market can not be put into operation for various reasons, various regions are actively establishing local property right exchange markets to create conditions for the exiting of VCs. A typical example is

### **—Shanghai Property Right Exchange (SPRE)**

Shanghai Property Right Exchange is a large property right exchange in China. Last year, SPRE set a record and in 2000, almost 3,000 property right transactions were conducted here and sales amount was as high as RMB 48 bn, up 2.06 times and 1.74 times respectively from 1999. According to relevant agencies, SPRE's targets for 2001 are setting a new record high in transaction size and realize a transaction volume of RMB 60 bn in the year, up 25% from 2000. Besides, Shanghai Technology Property Right Exchange had also set a new target for its transaction volume in 2001, RMB 40 bn, double the figure of 2000. As a result, it was hopeful for

the transaction volume of Shanghai property right transaction market to exceed RMB 100 bn in 2001. To realize the target, first, SPRE cooperated with the Shanghai Municipal Foreign Economic and Trade Commission and opened an “express passage” to encourage foreigners participate in ownership restructuring. The “Express Passage” realizes the integration of property right transaction procedures and foreign investment approval and registration procedures. At the same time, SPRE cooperates with overseas investment banks and their branches in Shanghai to establish overseas intermediary agent offices and provide standard and effective services for attracting the entry of foreign investors and promoting Chinese enterprises’ entry international merger and acquisition market. Today, SPRE has actually become a nationwide “technology distribution center”. □Source: *China Business News*□

### —Shenzhen Int’l High-tech Property Right Exchange

Shenzhen Int’l High-tech Property Right Exchange, established on Oct. 14, 2000, was the first stock-joint property right exchange founded in China’s high-tech fields. The exchange was set up under the initiation of Shenzhen China Int’l High-tech Achievement Exchange Center. It is designed to form a property right exchange with strong intermediary servicing functions and speed up the commercial application of high-tech achievements through using standardized market operations. The exchange maintains close ties with the annual China International High-tech Fair and fully uses the project and fund advantages of CIHF to gradually develop into the biggest special market for technology and capital distribution and transaction.

## 6. Preferential taxation policies to VC organizations

To date, the central government has not yet specified preferential taxation policies to VC organizations in the “Taxation Law”.

Various local governments usually offer two kinds of preferential taxation policies to VC organizations.

A commonly practice is if VC firms invest in identified high-tech projects and the investment (or investment income) reaches a certain amount or rate, then they can enjoy the same preferential taxation policies as those to high-tech enterprises. VC firms and high-tech enterprises are different in nature and their production and operation activities have few similarities. It seems a little confusing to let the former enjoy the preferential taxation policies designed for the latte. But such a practice indicates under the situation that the central government delays the definition of special preferential taxation treatment to VC firms, local governments can only take such provisional measures and rigidly applies the preferential taxation treatment designed for high-tech enterprises on VC enterprises. Although this may not be suitable, they just use it for the time being.

The other preferential taxation policy is permitting VC firms to draw risk reserve at a certain proportion of their investment to supply their investment losses. For example, Hefie and Xi'an set the reserve rate at 3% and Chengdu adopts a 5% rate. The risk reserve drawn before taxation is listed as expenses of the term and hereby reduces the pretax profits and lightens the VC firms' tax burden.

## **ii. Comments on the Chinese government's VC development boosting measures**

In China today, governments at all levels have deeply realized the significance of VC to boosting high-tech industry development, the expansion of entire national economy, and industrial structure optimization. Their intentions are similar: trying their best to support the development of VC industry. The Chinese government plays an indispensable role in promoting the development of VC. It can be said that without the powerful support of governments at various levels, the Chinese VC could not have reached its current development level.

It is noticeable that local governments' support to VC development is more powerful than that of central government.

Below is a brief comparison on the VC promotion measures of the central government and Shenzhen and other local governments.

	<b>Central government</b>	<b>Shenzhen</b>	<b>Guangzhou</b>	<b>Tianjin</b>	<b>Hefei</b>	<b>Chengdu</b>	<b>Xi'an</b>
<b>The organization form of VC firms</b>	No mention about limited partnership			Mention limited partnership		Mention limited partnership	
<b>The capital payment of VC firms</b>	The registered capital must be paid at full amount before corporate registration	Authorized capital system, and with detailed regulations	Authorized capital system, and with detailed regulations		Authorized capital system, and with detailed regulations	Authorized capital system,	
<b>The exiting mechanism of VC</b>	The secondary market has not been opened yet		VC firms can withdraw and sell their investment through technology ownership transfer				
<b>Preferential taxation treatment</b>	Without	VC firms meeting certain conditions can enjoy the same preferential taxation policies as those to high-tech companies	VC firms meeting certain conditions can enjoy the same preferential taxation policies as those to high-tech companies	VC firms meeting certain conditions can enjoy the same preferential taxation policies as those to high-tech companies	VC firms meeting certain conditions can enjoy the same preferential taxation policies as those to high-tech companies; VC firms can draw risk reserve equal to 3% of their investment	VC firms meeting certain conditions can enjoy the same preferential taxation policies as those to high-tech companies; VC firms can draw risk reserve equal to 5% of their investment	VC firms meeting certain conditions can enjoy the same preferential taxation policies as those to high-tech companies; VC firms can draw risk reserve equal to 3% of their investment
<b>Other preferential treatments</b>	Without					Provide comprehensive preferential policies	

After all, VC is still a new thing in China and it is far from mature. In the formulation of national laws and regulations, as the central government has to consider the whole national economy development and social development situations, it looks to be more prudent and could only make progress step by step according to established criteria. Under the principle of supporting local VC development, local governments are more flexible and their policy flexibility is higher and more operable under the precondition of not violating the central government's relevant regulations. For instance, they make much greater progress in stipulations on the form of VC firms and the preferential taxation policies to be enjoyed by VC firms. Of course, the possibility does exist that in the future, a down-to-up promotion situation can be formed. In other word, the central government acquiesces in to finally confirm the various preferential policies to VC development through legislation.

### **III. Reflection on the role of government in VC development**

Western countries' VC development indicates that when risk capital is weak and has not formed an industry, the government is the major provider of VC and in some countries, once VC provided by national governments accounted for over 70% of their total risk capital. Meanwhile, the governments' support to venture capital is not limited to financial areas, but more importantly, the governments need to create sound market environment for the development of venture capital. Particularly□they mainly include contents in the following aspects.

#### **1. Establish development strategies and plans for VC industry**

We should view the significance of Chinese venture capital industry from height of knowledge economy and fully understand the role of venture capital industry in economic development, especially its role in knowledge economy development. In order to promote the commercial application of high technologies and increase the science and technology content in economic development, China must vigorously develop VC industry greatly and definitely make the development of VC industry as a basic policy for promoting science, technology and economy development, especially hi-tech industry development. Furthermore we should establish VC development strategies and plans that are in line with China's actual situations, so as to set up blueprint for VC development. We should also clarify the general guidelines, long-term targets and phase objectives for VC development as well as such macro issues as supervision and guiding mechanism and other supporting mechanism. This mechanism should be an component part of China's national economy and social development plans.

#### **2. Constitute government stimulation mechanism and strengthen the macro guidance and control on VC**

International experiences indicate that effective government stimulation mechanisms can encourage fund flow to hi-tech enterprises and boost VC development. As an important part of VC operation mechanism, the government stimulation mechanism pilot and adjust the development of VC industry mainly through direct government participation and influencing the investment in VC indirectly through issuing relevant policies. Major contents of such stimulation mechanism mainly include the following aspects. .

(1) The government's direction participation in venture capital. Venture capital is formed and developed under market economy system. However, the Chinese "socialist market economy system is still immature" (abstract from *Conference Report of the 15<sup>th</sup> CPC Session*), many systems that VC needs are still incomplete

and the mechanism is not established yet. The supporting conditions are not mature. The government's direct participation in venture capital can not just improve the credit of VC, increase investors' sense of security, induct funds from all corners of the society, especially the participation of public investment and corporate investment, and increase the socialization of venture capital. It can also enable the government to timely detect problems and adjust relevant VC policies so as to further promote the development of VC industry. The popular measures abroad can be used for reference and the government can offer credit guarantee, including government guarantee to bank loans. Through such measures, the government can stimulate the investment of lot of social capital through with a little fund and enable risk enterprises to raise VC funds from multiple sources.

(2) Provide preferential taxation treatment. Preferential taxation policies are an effective instrument to boost the development of high-tech industries and VC. Preferential taxation treatment to VC is realizing the support to VC through tax reduction and exemption and making the VC investors enjoy higher provision so as to attract more capital flow to high-tech industries in the form of VC.

(3) Provide finance support. That is to directly offer subsidies or other forms of monetary support to VC enterprises (this will attract the following up of VC companies' VC) to increase the profitability of risk enterprises.

(4) Provide financial support. The existing policy-oriented financial institutions should increase their loans to enterprises' technology innovation projects and induct commercial banks' fund support enterprises' technology innovation. And at the same time, favorable interest rates should be offers and the VC loan interests should be lowered or exempted to increase the power of VC enterprises. Besides, the government may also consider establishing high-tech policy-oriented banks to offer policy-oriented financing services to enterprises' technology innovation activities.

(5) Relax government administration. To increase the enthursiasm of VC organizations and enterprises, greater freedom should be left for them. In 1981, eight US semiconductor companies financed by VC organized a semiconductor-developing center. The American government did not restrict the behavior with anti—monopoly laws, but actively advocated it.

### **3. Perfect law and regulation formulation to standardize venture capital**

Formulate and improve relevant laws, regulations, and administrative rules to offer venture capital rules and laws to follow, minimize blindness and lower risks, increase reliability and transparency, and hence gradually lead it to the trade of legal development. There mainly should be laws defining high-tech industries and governing high-tech achievement transfer and equity investment in the form of technologies. This is

because the starting operation point of venture capital is hi-tech achievements. Legislation on enterprise ownership needs to be further improved because VC and risk enterprises are connected mainly through equity and only with definite ownership structure, can be cooperation go on smoothly. Speed up the formulation of “*Venture Capital Administration Ordinance*” capital to regulate the operation of VC and after some time of operation and experience accumulation, then begin the establishment of “*Venture Capital Law*”. Based on the characteristics of high-tech risk enterprises, try to amend the articles on intellectual property and equity transfer in the Corporate Law.

#### **4. Standardize and perfect securities market and consolidate the supporting conditions**

Venture capital is investment mainly made in the form of equity and clear ownership structure and protecting legal interests are its fundamental requirements. It should be easy for VC to flow in and out and this depends on a complete and standard securities market. Securities market is the basis of venture capital operation, and it is both capital market and equity market. A sound and standard securities market can offer more opportunities for high-tech risk enterprises to make IPOs and provide risk enterprises more fund-raising and transaction opportunities. Using international experience and practice as reference, we should set up small stock market or “secondary securities market” exclusively for hi-tech SMEs and issue stocks of hi-tech enterprise at lower criteria to perform securities or equity transfer. This means that more risk enterprises’ fund-raising methods will shift from debt to equity and that they can more easily raise low cost and low risk capital to provide sufficient fund guarantee for the operation of VC. At the same time, they also offer withdrawal channels for the recovery and increment of VC. As for local governments, they can develop and utilize the existing property right transaction markets to enable the VC realize withdrawal through equity transfer, which is also a feasible path. .

#### **5. Help the startup investment companies, high-tech enterprises, science and technology professionals, and financial institutions establish information exchange channels**

At present, the startup investment, as a new industry, is unknown not only to the ordinary public, but also to many high-tech enterprises and science and technology professionals. engaging Everyday startup investment companies in the USA receive many applications for project investment and from these applications, they select some projects with most promising market prospects as investment targets. Usually, only 1 to 2% of the projects applied can be selected. From this we can see that to boost the development of startup investment, it should not be the startup companies seeking investment projects, instead the investment projects should seek and take the initiative of contacting startup investment companies. To do this, it is necessary to create

opportunities for the communication between scientific research institutions, science and technology professionals, high-tech enterprises, and investment companies. But if only relying on the voluntary activities of non-governmental organizations, the communication will be slow and difficult. In the early stage of startup investment development, it is necessary for the government to create some favorable conditions for such communications. For example, the government can regularly hold startup investment fairs and startup investment information exchange meetings, to offer a place for the mutual communication between science and technology professionals, the financial circles, and the investors so that they can find business opportunities in the communication activities.

#### **6□ Actively train VC management talents**

The essence of VC is the control of investment risks. The targets of VC are usually “rising industries” with huge potential and development prospects and there must be professional management talents to perform strict management on the investment capital and investment targets. Whether VC can succeed or not has directly connections with VC managers. Such talents need to have multiple expertise and possess knowledge in business, science and technology, finance, and enterprise management and risk forecasting, handling, and bearing capabilities. Most VC experts believe that the most important factors to the success of VC are the personnel’s qualifications and capabilities. At abroad, most of such talents are MBA degree holders or entrepreneurs graduated from technology institutions. They maintain close information exchanges with colleges and universities and master the development tendencies of latest technologies. For this reason, they both satisfy the development demands of high-tech enterprises and boost the development of VC industry. The cultivation and training of such talents is a necessity. While relying learning from practical work, it is especially important to establish systematic talent training plans and depend on the experienced research institutions and management consulting agencies within the UN to cultivate a group of talented people with professional expertise and operation capabilities. In face of the current economy and technology globalization tendencies and from other countries’ experiences, “going abroad and returning with overseas education” can be considered an effective way to establish some quality VC management personnel in a short time.

In summary, considering China’s actual national conditions and especially the existing development of socialist market economy and VC industry, the government still plays an important and indispensable role in the development of Chinese VCs. It is still the significant “engine” in the development of Chinese VCs. But we should also clearly see that the internal development tendency of VC is that the government’s direct functions gradually decrease and shift to leadership, support, guidance, and organization. With the lowering of government comprehensive interference conception, leaving the wide free development space to the VC firms

themselves is also the common choice of governments in market economy. Therefore, in VC field, there is also an issue of government “withdrawal”. Of course, such withdrawal should be made at a right time. “Piloting and support, not comprehensive interference” will be the proper role the government should play in the development of Chinese VCs.