

Appendix X

Training Fund Managers for SME Equity Funds

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**Presentation to the SETC Conference on the Financing and Development of SMEs
May 14-15, 2002
Tsinghua University, Beijing, China**

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Private equity and venture capital finance is a significant but small professional field. There are relatively few players, compared with other areas of the financial sector. Furthermore, there are virtually no conventional paths to entry into the field. Most venture capital professionals enter the venture capital industry as a result of personal contacts, a track record of success in related fields, and luck. Few, if any, have entered the field directly as a result of having prepared for it in academic or formal training programs. Indeed, the few programs which focus on private equity and venture capital generally provide only an overview of the field for those who are not practitioners or a forum for discussion of particular issues among those who are already practitioners.

Current Sources of Training in Venture Capital

There are currently only three common formats for training in venture capital, none of which is focused exclusively on risk capital finance in emerging markets or on financing SMEs. These three common formats are:

University Programs: A limited number of universities offer full-term courses in private equity and venture capital as part of a curriculum for an advanced degree, most commonly as an optional course for a master's degree in business administration (MBA). Normally, a participant in such a course must be a full-time student in a two-year degree program.

Conferences, Seminars and Workshops: A small number of associations and other industry-specific organizations offer programs of three to five days in which experienced private equity and venture capital professionals present their views and findings on key elements of the practice, such as increasing "deal flow" and pricing equity investments. The best known among these are:

- *The Venture Capital Institute*, is a 30-year old program sponsored annually in the U.S. by the National Venture Capital Association (NVCA) and the National Association of Small Business Investment Companies (NASBIC). This five-day program is essentially a forum for practitioners in

the industry. It serves primarily the purposes of up-dating practitioners in current practices and issues in the industry and networking among industry professionals. In addition to the annual Venture Capital Institute event, its sponsors also offer an annual five-day advanced program treating issues in greater depth. The cost for participation in the Venture Capital Institute and its advanced course is approximately USD 5,000. (See www.vcinstitute.org).

- The *European Venture Capital Association (EVCA)* sponsors several two- and three-day programs providing both an overview and training for active and potential practitioners, similar to the programs of the Venture Capital Institute in the U.S.. (See www.evca.com.)
- The *Asia Venture Forum* is an annual meeting of industry practitioners in Asia, sponsored by the Asia Venture Capital Journal. While this forum is not intended to be a training program, it does provide significant exposure to current issues and thinking in the industry. (See www.asiaventure.com.)

Special, “Tailored” Programs: Some universities offer special two- to six-week, or longer-term, weekend “executive” study programs in financial areas related to venture capital. However, few or none of these programs are devoted exclusively to the practice of venture capital. The Wharton School of Business is developing a web-based program, in collaboration with Chinese universities, to provide training to both entrepreneurs and venture capitalists. This program is focused on training both the potential investee and the potential investor simultaneously, with the intent of eventually bringing the two parties together. (See www.globalclinic.org.) The Institute for SME Finance, a Washington-based organization promoting risk capital investment for SMEs in emerging markets and developing countries, provides on-site training and consultancy for SME fund managers. The Institute for SME Finance is also developing a case study-based training program focused on technical issues of risk capital finance for smaller businesses in environments where venture capital has not developed into a mature industry.

Recommendation

None of the programs described above will be fully adequate to the task of training fund managers for SME risk capital funds to be created under the SME Equity

Program (the “Program”). None of them provides the intensive, “hands-on”, China-specific, and SME-specific training for SME fund managers, the majority of whom will have had no prior experience in risk capital finance. Therefore, we recommend the establishment of a “Chinese Institute for SME Finance” (the “Institute”) as a key component of the Program. The Institute would operate as a semi-independent agency under the SETC, with funding to be partially arranged by SETC and partially provided by the participants in the Institute’s study program.

Underlying Assumptions

The Institute would be established within the context of certain underlying assumptions. The first of these assumptions is that the SMEs targeted by the Program will be predominantly in traditional industries and services rather than in areas involving advanced and proprietary technologies, as is currently the orientation of China’s venture capital industry. The second assumption is that most of the SME Equity Funds’ investments will be in relatively early-stage companies, managed by entrepreneurs who would need significant non-financial assistance from the fund manager. A third assumption is, once again, that the fund managers being trained will themselves be relatively inexperienced in risk capital investment.

An equally fundamental assumption of the Institute is that, while the practice of venture capital involves the same fundamental processes and principles at all levels, there are significant variations of these practices which are specific to the circumstances of SMEs. For example, exits from equity through acquisitions of the investee by another company (“trade sales” or “strategic sales”) or public offerings of the investees’ shares on the stock markets (“IPOs”) will be rare in the case of SMEs in traditional industries. The Institute must, therefore, train SME fund managers in maximizing the financial potential of management buyouts (“MBOs”) where the investee must repurchase the SME Fund’s shares.

Overview of the Institute

The Institute would be established by SETC exclusively for the purpose of training fund managers, their investment officers, and their financial analysts in managing funds created under the Program. The course of study would provide for an intensive initial session of six to twelve full days, introducing the fundamental elements of risk capital investment and fund management, tailored to investment in traditional SMEs. This initial session would be followed by six to twelve months of weekend sessions for new practitioners managing SME Equity Funds. Additional six- and twelve-day sessions would also be offered for more advanced participants, focusing less on instruction from trainers and more (though not exclusively) on presentations by current SME Fund managers. These advanced courses would serve the additional purposes of

strengthening networks among the fund managers and informing the Program of current issues and practices in the SME Funds established under the Program.

Case Study-Based Training

The case method is a technique for teaching and learning through analysis and discussion of actual events that have occurred. Every case study poses a problem faced at some point in the history of the case being studied. The reader of a case study is expected to assume the role of a key decision maker who must thoroughly analyze this problem, assess the issues and options, and make a defensible decision. The case, therefore, is designed to approximate the challenges faced by decision makers in the real world. The ultimate purpose of the case is to help the student, as a current or potential practitioner, to enhance his or her analytical and decision making skills and to communicate effectively the rationale for his or her decision

In advance of launching the Institute's training program, the Institute would prepare a number of case studies of investments in Chinese SMEs. The Institute would also obtain and/or prepare case studies from other emerging markets where there is a longer history of equity investment in SMEs. Each case would focus on a specific problem illustrating a particular element of the SME investment process. Prior to the commencement of the initial six- or twelve-day intensive session, case studies to be used in the sessions would be sent to the registered participants. Each participant would then be expected to thoroughly read each case in advance of the first day of coursework.

During the course sessions, participants would be divided into small groups of five to seven persons. The purpose of the study groups would be to pool knowledge and insight among the participants in each group in order to form a more thorough response to some of the questions posed by the case. Discussion and problem solving with the small groups would serve to facilitate participation by those who may be otherwise less comfortable speaking in front of the full class of participants in the training course. It would also serve to bring participants with diverse levels of experience to a more uniform level of understanding. During the group discussion, each group would appoint one or more spokespersons who would then called upon to present the group's findings during a subsequent discussion of the case by the entire class.

Classroom Instruction

The Institute would engage Chinese-speaking instructors with experience in finance to provide basic instruction in specific areas corresponding the case studies. For example, a classroom session in investment structuring would be used to complement, and would be complemented by, a case study focusing on a particular decision to be made in the structuring of the investment in the case. Other areas to be covered by both classroom instruction and corresponding case studies would include:

- identifying potential investments
- financial modeling and financial analysis
- due diligence
- valuation and pricing of investments
- post-investment business and technical assistance
- exiting equity investments
- fund management and fund operations

It will be difficult, if not impossible, to find full-time, Chinese-speaking instructors with practical experience in risk capital financing and the financing of SMEs. Therefore, in advance of launching the first training sessions for potential and current practitioners in SME Equity Funds, the Institute's instructors will receive special, case-based training in SME equity investment to complement their prior related experience. This training will include on-site exposure to both venture capital funds and operating SMEs.

In addition to the Institute's regular instructors, guest instructors from within and outside China would be brought in to discuss their personal experience in SME finance and venture capital.

Materials

In addition to case studies, the Institute would develop other materials of use to SME Fund managers participating in the course, including:

- a basic operating plan for an SME Fund,
- a basic operations manual for the operation of an SME Fund,
- sample investment agreements between a Fund and an SME investee,
- computer-based spreadsheet files for financial modeling,
- lists of resources for business assistance to investees, and
- other standard documents of particular use to SME Fund managers.

Weekend Instruction

Following the initial, intensive six- or twelve-day training course, participants would attend a series of sessions on weekends to broaden and deepen the participants' level of knowledge. As in the case of the initial, intensive sessions, the weekend sessions would include both current and potential fund management officers. In this way the on-going experience of current practitioners can be shared not only among other practitioners, but also among those who have not yet begun their work in SME Funds. Each weekend session would focus on a particular aspect of one of the broader topics

treated in the initial sessions. Participants who are current investors would be asked to prepare abbreviated case-studies of investments in which they are currently engaged in order to complement the issues focused upon by the weekend sessions.

The weekend sessions may be held, for example, either once or twice per month during a period of six to twelve months.

Additional Recommendations

Finally, within the broader context of the Institute, we would like to make the following additional recommendations:

- that “Institute” courses be made a formal part of the SME Equity Program;
- that the intensive six- and twelve-day courses begin to be offered in advance of initial capitalization of Funds under the SME Equity Program;
- that key personnel of any “licensed” SME Equity Fund be obligated to participate in the initial session and the course of weekend sessions to follow; and
- that the “Institute” form relationships with other programs (such as the Wharton Program) in order to reinforce training and provide new contacts in the risk capital industry.

These recommendations for the design and establishment of a “Chinese Institute for SME Finance” will be further discussed with SETC and potential participants in the Institute. There are many variations which can be implemented within the broad outline above. However, we believe that some similar vehicle for training fund management personnel will be crucial to the success of the SME Equity Program.