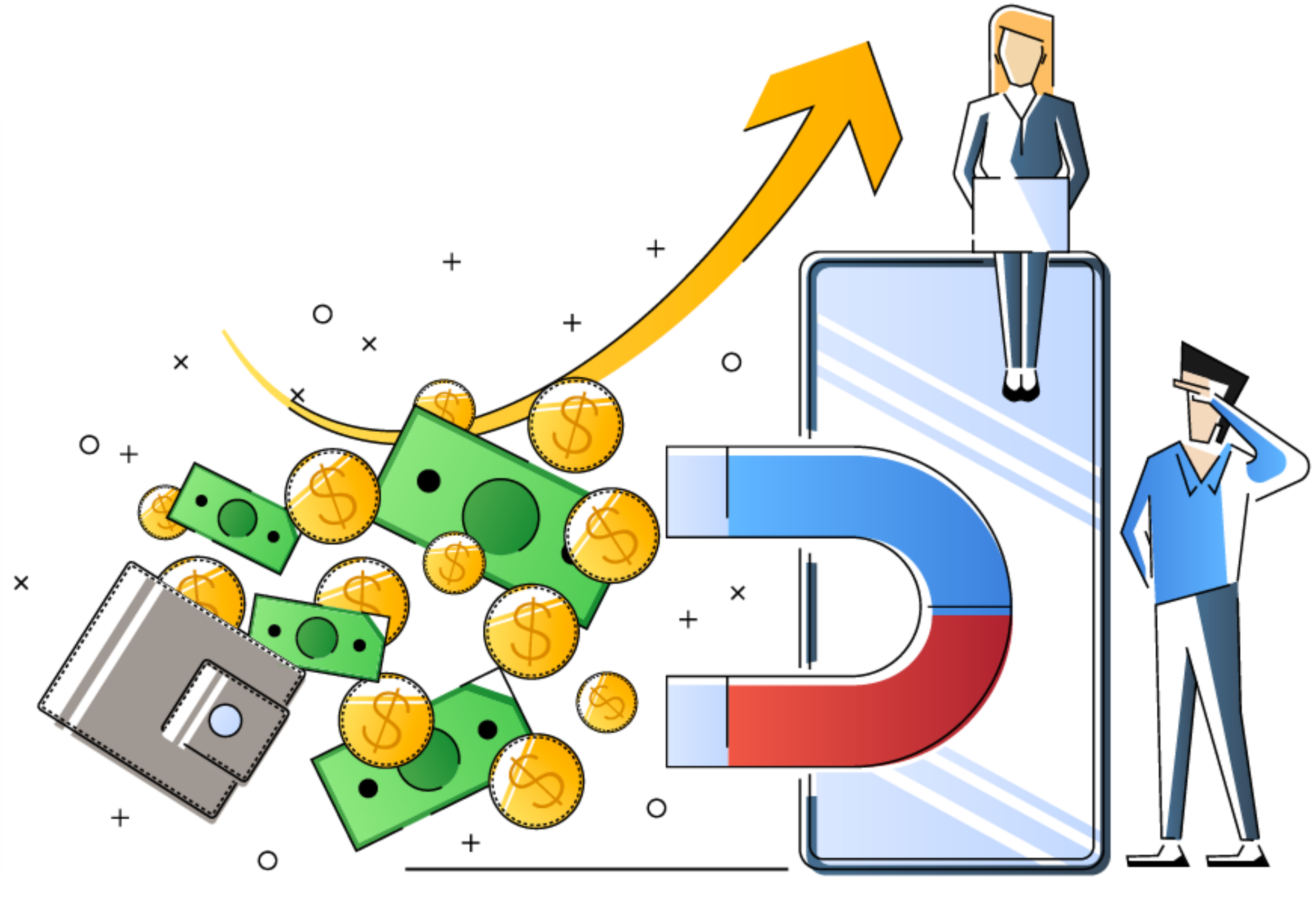


CROWDING IN VENTURE CAPITAL IN CHINA

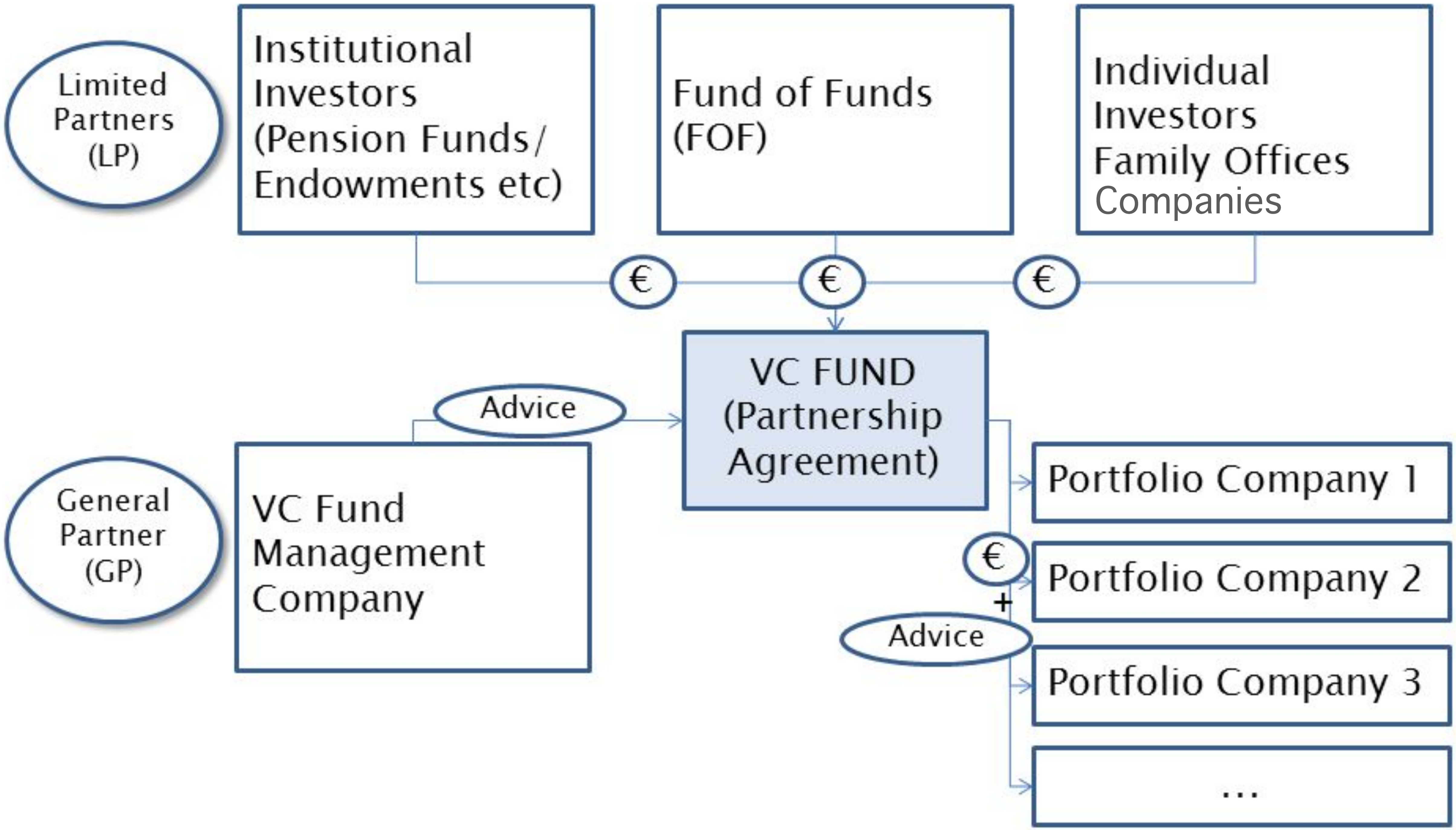
- by Celine Yue Fei

Discussion by Rik Sen (University of New South Wales, Sydney)

WHY I LIKE THIS PAPER

- Combines novel datasets
  - For a comprehensive set of VC funds can identify *all* Limited Partners (LPs), and the VC firm that is the General Partner (GP)
  - Comprehensive set of VC firm investments with deal participants
- Examines an interesting question: Can government investments *crowd in* private investments?
  - Prior literature in China shows crowding out in the context of credit
- *Interesting setting*: China's VC market is nascent but growing
- Interesting set of empirical patterns documented

Quick Overview of Venture Capital



EMPIRICAL FINDINGS OF THIS PAPER

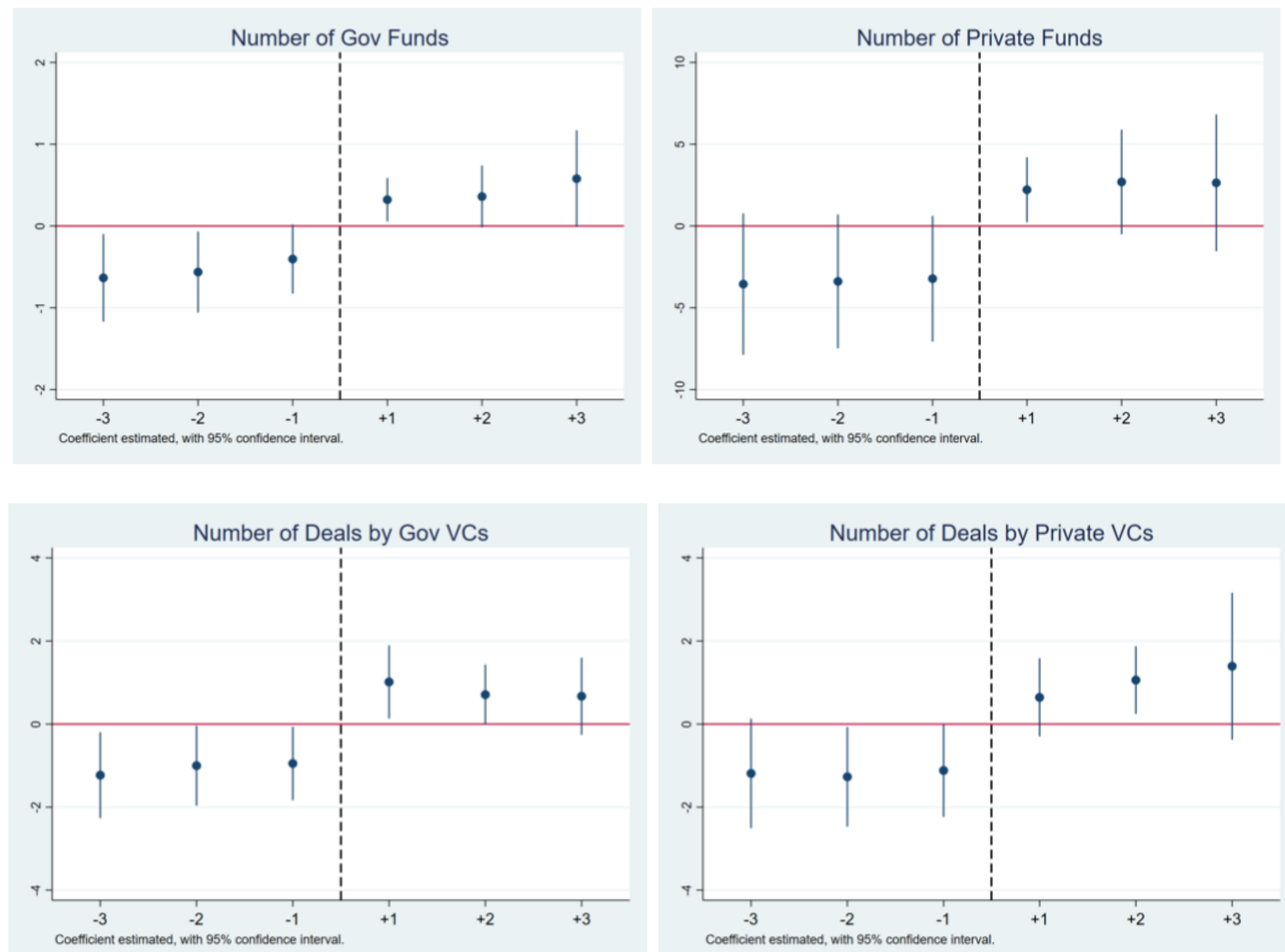
- Government program to invest in VC funds increased the number of VC funds, but also *increased* private investment
  - Increase in i) number of funds with purely private investors, ii) number of deals (investment in portfolio firms) involving non-government VCs
  - This effect is more pronounced in less developed regions and regions with more nascent VC markets
- Funds with government LPs attract more private LPs, and more first-time LPs
- … and more

COMMENT 1: UNDERSTANDING THE IMPACT

Government *Private*

No. of funds

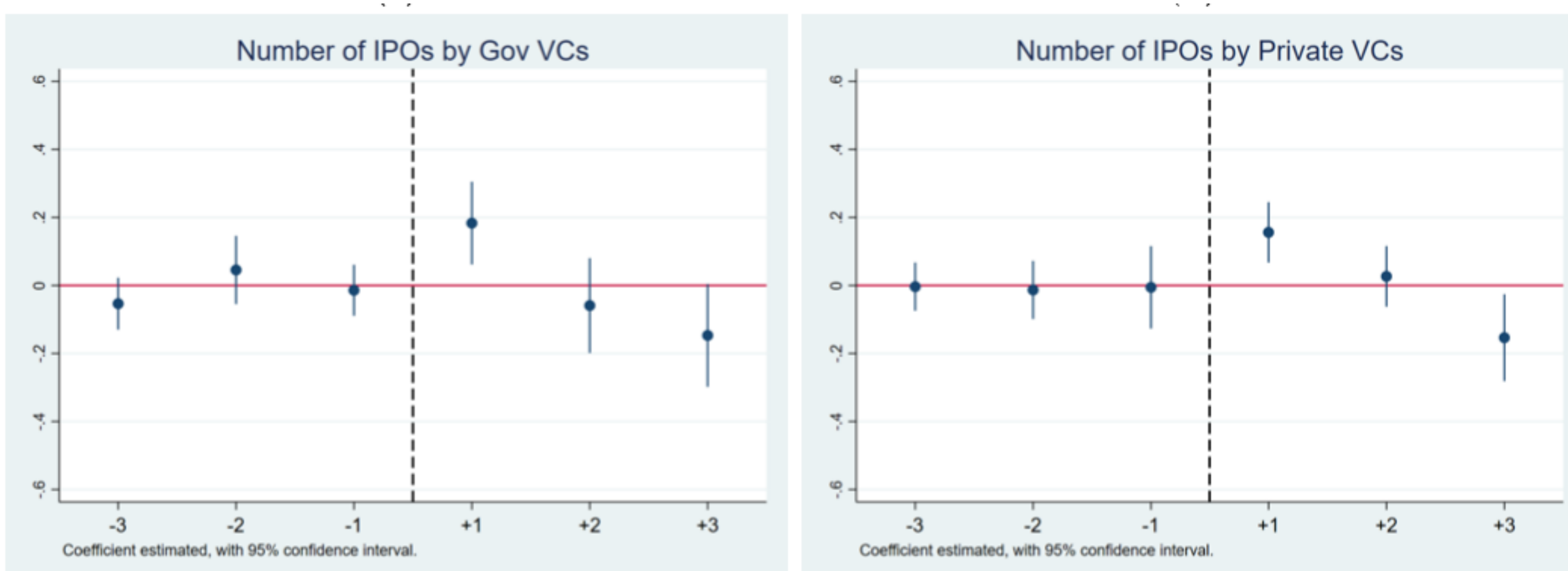
No. of deals



- ➤ Some effects in "Year 0" on number of funds and deals (govt. and private)
- ➤ Higher effects in "Year 1" and it remains at a similar level in Years 2 and 3

COMMENT 1: UNDERSTANDING THE IMPACT

- *Important Qn*: Are these extra VC investments *good* or *bad*?
- Only quality metric is the number of exits through IPOs

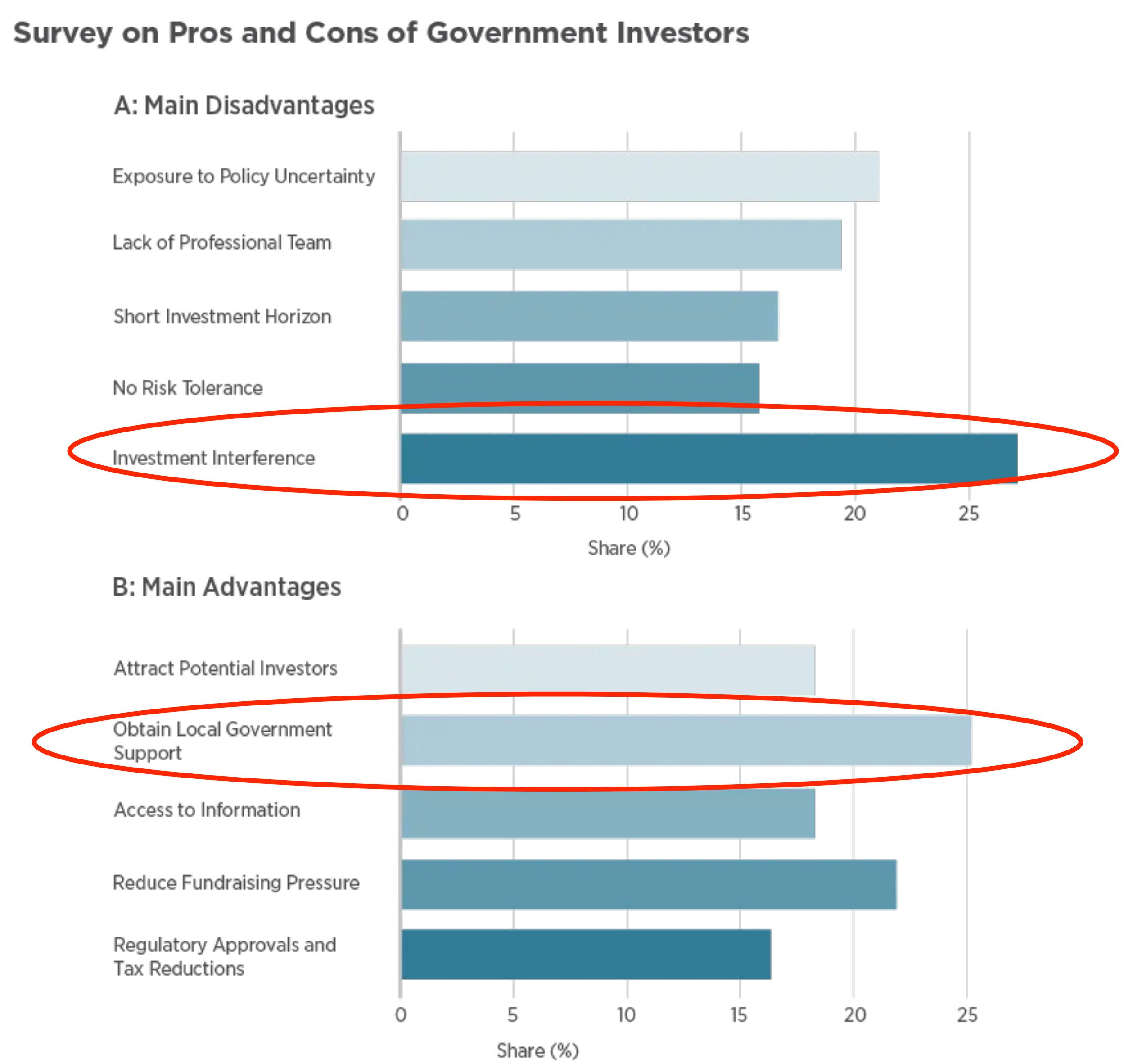


- Somewhat puzzling patterns:
  - Effect shows up in one year after policy — isn’t that too soon?
  - Effect goes away in Year 2 and Year 3 and even becomes negative

COMMENT 1: UNDERSTANDING THE IMPACT

- Potential explanation for the first pattern:
  - An Ernst & Young 2014 reports says that “*companies (receiving VC funding) in China are typically more developed, further along in their life cycle and positioned to exit within 18–24 months*”
    - The median time for a VC to exit a deal in the U.S. is more than 7 years
  - But this implies that VCs in China likely do not play an important role in funding *early-stage and uncertain* innovation
    - **Suggestion**: This should be explained more clearly to the readers
- Potential explanation for the second pattern:
  - Maybe with enough VC funds, portfolio firms can be sold to other VC funds and exit through IPO becomes less important
    - **Suggestion**: Check this if your data allow it

COMMENT 2: COUNTS AS OUTCOMES



- Colonnelli, Li, and Liu (2022) survey of General Partners
- This suggests an incentive to participate with government LPs but not invest much
- Implies a higher count, but lower investment amounts

- Relevant to interpretation of many results, e.g., govt LPs attract more private LPs
- **Suggestion**: Examine investment <u>amounts</u> , not just counts (of LPs, funds, deals)

COMMENT 3: WHAT ELSE COULD BE HAPPENING

- Local government officials have incentives to support a central govt. program in other ways, e.g., give subsidies or government contracts to VC backed firms
  - Wang & Yang, 2022: "*promotion-driven local politicians allocate more resources to ensure the [central government policy] experiments' success*"
  - A positive response from local government LPs suggests this could be true
  - **Suggestion**: If possible, examine government supplier contract data

- There was an Innofund program that gave subsidies to *small and innovative firms* (Wang, Li, and Furman, 2015)
  - Initiated in 1999, also administered by Ministry of Science and Technology, this program provides innovation funding to young entrepreneurial ventures in China
  - If the timing of regional focus is concurrent with the Innofund VC program, this could increase private VC investments to the firms targeted by this program
- **Suggestion**: Examine the regional stagger in focus of this InnoFund program

CONCLUDING THOUGHTS

- The paper uncovers interesting empirical patterns uncovered in firm benefits by combining novel datasets
  - Significant contribution!
- The implications drawn could be strengthened with more empirical support
- I recommend you read the paper

THANK YOU!

DEEPEN DISCUSSION WITH RESPECT TO PRIOR LITERATURE

- In the context of credit in China, there is evidence of crowding out
- Broadly two channels:
  - i) credit supply sucked up by government or State Owned Enterprises (SOEs), and
  - ii) supporting SOEs hurts the private competitors (while private suppliers of these SOEs are benefited)
- The first channel likely not relevant here
- The second channel might be operating in non-startup competitors; cannot be ruled out by the current results