Research on Problems and Countermeasures of Venture Capital Companies in China

Haoran Fu1,a,*, Zhe Wang1,b

1School of Economics, Anyang Normal University, Anyang, China.
a hao3681@foxmail.com, b 916010481@qq.com

Abstract

With the continuous development of China’s economy, venture capital has gradually developed in China since the 1990s. Venture capital can not only promote a country’s economic growth, but also play an important role in increasing employment. However, due to the late start, rapid development, short time and insufficient experience of China’s venture capital industry, many problems have emerged in its development, which has seriously hindered the progress of China’s venture capital industry. This paper summarizes and analyzes the problems in the development of venture capital industry, draws on the successful experience of some western developed countries in venture capital, and puts forward corresponding solutions. In order to promote the development and improvement of China’s venture capital industry and enhance the competitiveness of venture capital companies.

Keywords

Venture capital; The company; Development; Problems; Countermeasures.

1. Introduction

Venture capital, also known as venture capital, mainly refers to a financing way in which venture investors have some idle funds in their hands to provide financial assistance to some newly established high-tech industrial groups in pursuit of potential high returns and thus acquire shares in this start-up. In the process of providing financial assistance to these high-risk companies, venture capitalists will set up a professional venture investment team for the venture companies to provide scientific and reasonable suggestions and management services to the venture companies. It is hoped that after the invested company develops to a certain extent, it will withdraw its venture capital through public listing (IPO), equity transfer, acquisition, merger and acquisition, bankruptcy liquidation and obtain value-added income after the capital withdraws. In terms of the operation mechanism of venture capital, venture capital refers to the behavior of some investment institutions with professional investment teams to inject capital into high-tech enterprises with good future development ability. In addition, venture capital is the link to maintain the relationship among venture capitalists, venture enterprises and venture investment institutions. They have jointly formed a pattern of sharing interests and risks. In this situation, venture capital has promoted the progress of high-tech industry. Western developed countries have a history of 50 to 60 years of venture capital, and their development has gradually matured, but venture capital in China is still in the early stages of development. Our country is seriously short of professional and technical personnel related to venture capital, the law of venture capital is not perfect, and the withdrawal system of venture capital is not perfect, which are all important factors hindering the development and growth of domestic venture capital industry. Therefore, the country still needs to further solve these problems from various aspects to promote its long-term development.
2. Development Status

(1) The development process of venture capital in China
Since the reform and opening up, China’s economy has been open to the outside world and its economic policy has gradually relaxed. More and more foreign funds and advanced science and technology have been introduced into China. However, due to the lack of innovation ability of our people, the country’s productivity is seriously backward and the level of science and technology is still at the bottom. At this time, China’s venture capital has just begun to develop, so venture capital, which focuses on the development of high-tech industries, is springing up in China.
In 1985, Beijing established the first venture capital enterprise in China’s history, which was specially established for the development of high-tech industries. As the role of venture capital in promoting China’s economic and technological development has gradually increased, within the same year, China has successively established nearly 100 business centers, including about 30 science and technology parks. The government made relevant proposals a year later, which greatly promoted the progress of China’s high-tech industry and venture capital industry. In 1998, the proposal of “Accelerating China’s Venture Capital Industry” was put forward, which provided great convenience for the development of China’s venture capital industry [1]. The coming out of this proposal has stimulated the upsurge of venture capital investment by various domestic companies and brought venture capital into a new era. According to the successful experience of western venture capital, government support has played an irreplaceable role in the development of venture capital [2]. Therefore, in the 1990s, the Chinese government gave strong support to venture capital, and most of the funds for venture capital were invested by the government, eventually forming a government-led venture capital. By the end of the 20th century, the number of venture capital companies nationwide had reached more than 80 and the venture capital reached 3.5 billion yuan. From 2004 to now, venture capital has developed rapidly and has a certain scale.

(2) Characteristics of venture capital
① High risk and high return
Since venture capital is mostly investment in emerging high-tech industries, these technology groups need a large amount of capital investment in the process of research and development, production, testing and promotion, and there are many uncertain factors in the whole process, which may lead to the failure of the project. The venture capital is carried out according to the wishes of the investors themselves, without guarantee and mortgage. Once the project fails, the investors will bear all the losses. Correspondingly, if the project is successful, investors can smoothly withdraw their capital and earn several times the income.
② Relatively long investment cycle
Venture capital itself is an investment method that provides both financial support and technical assistance, and sometimes even participates in company management. Moreover, the target of venture capital is mostly the start-up enterprises. Only when the venture enterprises have matured to a certain extent can they withdraw funds and obtain value-added benefits through corresponding channels. The process of company development is very long. Some companies can mature in three to five years, while others may take eight to ten years to mature. In this process, investors should always pay attention to the development of enterprises and provide them with capital, technology and management services until the company can withdraw from venture capital. Therefore, it will take at least three to five years for venture capital to withdraw from the enterprise.
③ Take the form of a portfolio
As venture capital investment for a single project is mostly accompanied by high risks and high returns, so in order to reduce risks and make up for the loss of investment failure, investors will use the form of investment portfolio when making investments, choosing some low-risk low-return projects and high-risk high-return projects for portfolio investment.

④ Recycling of venture capital
Venture capital is generally invested at the initial stage of the establishment of the company, and exits when the company develops to a certain extent and obtains value-added income. Then investors can use this fund to continue to invest in other projects, thus forming an investment cycle.

(3) The current situation of venture capital
Compared with the mature market economy in western developed countries, China's venture capital industry started relatively late, so it is still in the primary stage of development. After 20 to 30 years of development since the 1990s, China's venture capital industry has also had a small scale. Not only have many new high-tech enterprises emerged in China, many local government departments have also set up business service halls to provide services for those high-tech enterprises that are in the early stages of their business, but also many foreign venture capitalists have invested in domestic venture enterprises. This is of great benefit to the development of our country's venture capital industry.

In recent years, China’s venture capital companies are springing up like bamboo shoots after a spring rain, and those with hundreds of millions of assets are everywhere [3]. However, in the process of investment, some risk enterprises have been gradually eliminated in the development due to their failure to form a scientific and reasonable risk investment mechanism, their weak ability to bear market risks, or their entry into the risk investment industry for speculation. However, at the same time, some companies have made reasonable and effective use of the venture capital market to standardize and institutionalize the company's operations, and have finally achieved success, such as: Stone Profits, Asian Credit Group, Dongfang Weibo and other companies.

Nowadays, due to the development of market economy and more intense market competition, China's venture capital industry has to change its mode. They have stepped out of the narrow sense of venture capital and gradually invested in a wider investment market. In the past, China's venture capital mainly invested in some traditional projects, but now it has been transformed into investment in emerging enterprises in Internet, software, new energy, medical and health industries. There are still many difficulties to overcome in this process of transformation.

### 3. Existing Problem

(1) Small quantity, small scale and single source of funds
Since the initial development of China's venture capital industry, most of them rely on the government's assistance, and the venture capital basically comes from the government's input. The venture capital from private enterprises is very few and the source of capital is too single. The purpose of venture capitalists to make venture investments is to increase the value of their invested capital through the development and growth of start-ups, and to obtain rich profits, while the investment purpose of the funds invested by the government is likely to change. However, if venture capital is to serve the government and show its will, the nature of venture capital will change. The supervision and management mechanism of state-owned venture capital enterprises is unreasonable and the corporate mechanism is too rigid, which hinders the supervision of venture companies and leads to the return or non-return of the funds invested in venture companies. Venture capital has actually become venture capital allocation, and under such circumstances, other capital investment has been wasted. Some domestic
enterprises with abundant capital, private capital and other capital cannot effectively participate in venture capital. As a result, the market will not be able to form a good competitive environment, and the efficiency of the investment and use of these funds will be difficult to improve. Although China has gradually relaxed the restrictions on the entry of funds from insurance funds and securities firms into venture capital in 2006, many financial institutions have started to restrict the amount of funds in order to effectively control risks, thus forming a phenomenon of small-scale capital investment.

Due to the small scale of individual investment funds, those venture capital companies have to choose some short-term and fast-track projects with relatively low capital demand and relatively low risks to invest. Because of this, it is impossible to design and form a reasonable investment portfolio, and it is also impossible to reasonably disperse investment risks. If venture capital does not have a good ability to resist risks, the benefits of venture capital enterprises will become worse.

(2) The investment environment is deficient

1. Lack of cultural environment and human resources

In our country, most enterprises maintain a relatively conservative thought in the environment of starting a business. They dare not innovate or take risks, which is what venture capital needs. Because the entrepreneurial environment in China cannot provide a good entrepreneurial environment for those start-ups, and because China does not support risk-taking practices, many venture capitalists dare not take risks. In addition, there are often some commercial and economic cases, and the credit environment of China's venture capital industry has been damaged, which have a great impact on the financing and withdrawal of venture capital.

Secondly, if we want to develop the venture capital industry well, we must have the assistance of many excellent venture capital talents. These venture capitalists should not only have professional business level, strong risk awareness, sensitive sense of smell, timely understanding of market information, seize good investment opportunities, but also provide professional consulting services for the operation of venture companies, recommend professional personnel for their efficient development, and, in some cases, invest in the company's operation and management. Judging from the experience accumulated in western countries with developed venture capital, venture capitalists should not only have the skills to manage companies, but also have the experience of venture capital, and these talents combine to form venture capital enterprises. Now it seems that our country's demand for such a comprehensive talents is still very strong, but the current talent training program is still far from meeting such a great demand. In addition, some organizations related to the venture capital industry, such as law firms, project evaluation centers, consulting agencies, etc. If there is no effective management system within these institutions or the internal staff do not abide by the corresponding professional ethics, it will increase the difficulty in selecting risk items. As too many companies now choose to list abroad, a large number of talents are sent to overseas companies, which has a certain impact on the talent market of venture capital in China.

2. Problems in legal environment

Up to now, the scale of high-tech industry in China has been quite large, and this kind of industry basically spreads all over the provinces. Although the development time of venture capital in China is not short, due to the lack of relevant practical experience, the legal environment in the development of venture capital is still quite poor, there are no formal laws and regulations related to venture capital, which makes the development efficiency of venture capital low.

The main forms of venture capital in China are company system, limited partner system and trust fund system [4]. Among them, limited partnership is the most widely used and the most effective form of organization. In the limited partnership system, the general partner of the company contributes about 1% of the capital and bears unlimited joint and several liability for
the operation of the company, while the limited partners of the company need to bear the liability to the extent of their capital contribution [5]. China’s economic and legal conditions are not perfect, and the legal system lags behind. At present, the partnership law can only be applied to companies whose partners are natural persons, but there is no corresponding law and regulation for other organizations and legal persons to become partners. In the partnership law, it is clearly stipulated that all partners should bear unlimited liability, but there is no provision of limited partnership. In this way, it is not only unable to protect the legitimate rights and interests of investors, but also relatively difficult to attract personal funds, and it is not conducive to venture capital enterprises to choose appropriate investment forms, and the incentive restraint mechanism is also difficult to use reasonably and effectively. Therefore, to improve the venture capital environment in China, we need to modify the scope of application and relevant provisions of the company law and the partnership law, so that the limited partners of the partnership can be recognized by law, and provide legal basis for the operation of the incentive mechanism.

In addition, the paid in capital system of company establishment can not adapt to the operation of venture capital. The United States and other developed countries use a commitment system for venture capital investment, that is, the amount of investment for a single project is agreed in advance, and only when the investor decides to make capital investment, can the capital be invested according to the original commitment amount. The advantage of adopting this system is that when there is no investment, the venture capital is not managed by the capital manager, and the value-added of the invested capital has nothing to do with the capital manager, but is considered by the original shareholders of the enterprise. Therefore, the fund manager can carry out phased investment management on the project according to professional methods without any other pressure. In China, the registration of venture capital enterprises is based on the paid in capital system, because the venture capital is in place before the project is selected. Managers not only have to bear the added pressure of the already in place venture capital, but also have greater difficulty in project selection, and also increase the risk of not investing that part of the capital. At present, China’s existing laws and regulations hinder the further development of the whole venture capital industry [6]. Article 12 of the company law stipulates that "where a company invests in any other limited liability company or joint stock limited company, in addition to the investment company and holding company prescribed by the State Council, the accumulated investment shall not exceed 50% of the net assets of the company.". Because there is no legal document or management method related to venture capital, the development of venture capital industry in China has been greatly restricted under the condition of company law.

③ Property rights trading market is not perfect
China’s property rights trading market is still relatively backward so far, and investors can only conduct stock trading in places like stock exchanges. Because it is difficult for most start-up enterprises to meet the requirements for A-share listing, small and medium-sized enterprises are limited to use this method for financing to some extent.

According to statistics, nearly 700 enterprises were listed in Shanghai and Shenzhen in 1997, but only 24 of them were listed in high-tech industries, accounting for only about 3.5% of the total number of listed companies in the two regions. There are two main factors that lead to this result: first, the listed scale of Chinese enterprises is relatively small. The total number of listed companies was 5.5 billion in 1995, increased to 10 billion in 1996, and more than tripled to 30 billion in 1997 compared with the previous year. Although the scale of listing is continuously expanding, there are only more than 800 million shares in each province and city. Second, there are too many companies eager to go public, while most of our country’s companies are in a shortage of funds at this stage, especially some large and medium-sized state-owned enterprises, which have formed relatively high debt ratio under the planned
economy system. In addition, a lot of equipment needs to be upgraded. They are in urgent need of a large amount of funds to invest in enterprises and inject new blood into the development of enterprises. With the deepening of the reform of state-owned enterprises, a large number of large and medium-sized state-owned enterprises will continue to raise funds for listing, which will occupy a large number of indicators in this region and lead to difficulties in listing high-tech industries.

The fundamental basis for the establishment of joint-stock companies in our country is the property right system. If joint-stock companies want to operate quickly and effectively, they must clearly define the property right and make the property right transaction free. With the continuous development and improvement of China's corporate system, the definition of property rights in many companies has become clearer and clearer. However, there are still some defects in the property rights system, such as the lack of active transactions in the property rights market, which hinders the flow of property rights. Although many areas in our country have set up property rights trading platforms now, it is still difficult to establish a nationwide property rights trading market due to the fact that many companies are not accustomed to trading online. The company's property rights trading market is seriously lagging behind, and the government has intervened too much in the few property rights transactions, which leads to the transaction in the property rights market not proceeding smoothly and freely, thus hindering the growth of venture capital industry. In addition, another important factor restricting the growth of venture capital industry is the poor circulation of legal person shares. Under the joint restriction of these two factors, venture capital is difficult to exit, which forms a grim situation in which venture capital is easy to invest in the company but extremely difficult to exit. Under such a situation, if venture capital cannot operate effectively, investors will not be able to get the expected returns and the operation of venture capital companies will inevitably be threatened.

(3) The exit way of venture capital is not perfect

Compared with other types of investments, the essential difference between venture capital and other types of investments is that venture capital has always been driven by the withdrawal of venture capital, and venture capital can make a new round of venture capital and obtain returns after withdrawal. Therefore, the most crucial factor hindering the rapid and effective development of venture capital industry is the withdrawal of venture capital, which directly affects the most essential interests of venture capitalists. Next, we will analyze the reasons that hinder venture capital from exiting the market from the following two aspects:

First, the withdrawal of domestic venture capital has been greatly hindered by laws and regulations as well as the corporate system. Due to the non-circulation of legal person shares in A-share market, the start-up time of the second edition market is still uncertain, and over-the-counter trading and over-the-counter trading are only allowed in A-share market, so other methods of legal person share transfer are also very difficult. In addition, most of the risk companies are small and medium-sized high-tech enterprises in the start-up period. These enterprises are difficult to meet the conditions for public listing in A-share market in terms of asset size and profitability. Therefore, venture capital is difficult to exit.

Second, from the perspective of exit mode. Under normal circumstances, when a venture enterprise grows to a certain extent and venture investors think they can get the expected reward, they will withdraw the funds originally invested in the venture enterprise. If the exit path of venture capital is not perfect, then venture capital will not generate value-added income, and it is even less likely to form a good investment cycle. At present, the exit channels of venture capital in the market mainly include IPO, repurchase, merger and bankruptcy liquidation, while the first public listing is the most effective exit mode for most investors [7]. However, because the conditions for domestic A-share public listing are too strict, many high-tech enterprises cannot meet such conditions, so it is almost impossible for these enterprises to withdraw
venture capital from the enterprises by means of initial public listing. As a result, it is difficult for venture capital to be cashed out by way of company listing, thus causing the cost of capital withdrawal by way of initial public listing to be too high. Therefore, it is still very difficult for venture capital to withdraw through IPO.

4. Relevant Improvement Measures

(1) Expand investment channels and scale
First of all, if domestic venture capital owners rely on government support, if the government invests too much, other capital that wants to enter the venture capital industry will be restrained. Therefore, in order to allow more funds from other fields to be invested in the venture capital industry, so that these funds and the funds invested by the government can form a risk-sharing model, it is necessary to continuously broaden the ways of capital entry and expand the scale of capital investment. Specifically, there are mainly the following two aspects: First, we should make full and reasonable use of private capital. Due to the influence of traditional habits, people in our country are used to saving funds instead of investing them, so the private capital in our country has not been fully and reasonably used. Therefore, the government can adopt some policies to encourage those individuals with idle funds to make venture capital, so that private capital can gradually enter the venture capital market with the help of the government, thus giving full play to the role of private capital. Second, absorb foreign capital. The development of venture capital industry in some western countries is 30 to 40 years earlier than that in our country, and their venture capital industry has basically developed to a mature stage, so those investors from abroad have both rich investment experience and sufficient financial support. Our country should continuously attract foreign capital and let our country’s venture capital market form a diversified market.

Secondly, it is very necessary for high-tech enterprises in their initial stage to choose various investment channels when raising funds. If you want to form a scientific, reasonable and effective investment and financing system, you must take the formation of a "multi-party investment, risk sharing and benefit sharing" venture capital operation mechanism as the main goal, in order to build a venture capital market with commercial investment as the main and policy investment as the auxiliary development, and constantly expand its scale, so that the venture capital market is more stable and has a larger scale.

(2) Further improve the risk investment environment
In order to improve the investment environment of the venture capital industry, we must do the following: first, find some companies with strong capital and help them step into the venture capital industry. In the places where risk companies are concentrated, we should find some securities companies with good reputation to conduct over-the-counter trading of property rights, and the government should set up a national unified property rights trading center. Second, improve the legal environment of venture capital, formulate relevant management regulations, and create a good legal environment for the development and progress of venture capital industry. Third, the establishment of a national credit system, including the establishment of a credit management system, scientific definition of enterprise credit data [8]. Fourth, provide necessary help for the development of venture capital industry, and establish relevant agency service and Consulting Center for the progress of the industry. These organizations can not only bring the latest news of market changes to the relevant three parties of venture capital in time, but also provide professional suggestions for them to make investment decisions.

(3) Develop talent training and introduction strategy
Because of the industry characteristics of the venture capital industry, there are also various needs for venture capital staff. Staff engaged in venture capital-related work should not only
have professional knowledge and skills, but also be able to capture risk information in a timely manner. As there is too much shortage of senior venture capital talents in China, it is necessary to draw lessons from the experience of foreign developed countries and work out an efficient talent training program for venture capital practitioners to expand the pool of venture capital practitioners and strengthen their professional skills. In addition, in order to train professional talents quickly and efficiently, it is necessary to provide them with sufficient funds and technical support, and to formulate a reasonable and effective incentive system. At the same time, it is also possible to send some personnel to countries with developed venture capital industry in the west, learn the operation mechanism of venture capital from senior talents in their countries, learn their awareness of venture capital, understand the current development of foreign venture capital, and then formulate measures to solve problems arising from domestic venture capital based on the learned experience.

(4) Improve the exit mechanism of venture capital
The withdrawal mechanism of venture capital can be improved through the following aspects: First, expand the capacity of small and medium-sized boards [9]. Because now the standard for capital entry in the new three-board market is very high, by contrast, the capital injection requirements in the small and medium-sized board market are relatively low. In addition, in order to create a good condition for the listing of small and medium-sized enterprises, it is necessary to improve the supervision and management mechanism, strengthen the supervision and management of small and medium-sized sectors, avoid some bad situations similar to speculation in the stock market, and then attract more investors to enter the small and medium-sized sectors. The second is to improve the Growth Enterprise Market. GEM is mainly formed to help those companies that are in the start-up period and have better development ability in the future. When some companies see these opportunities, they make use of the loopholes in GEM to make profits. Therefore, it is the most important thing to carefully examine the enterprises that want to enter the GEM market. Third, standardize the property rights trading market. Rely on Internet technology to build an orderly online property rights trading center, connecting some small and medium-sized property rights trading centers currently in existence, so that these scattered trading centers form a standardized online trading market. At the same time, it is necessary to strengthen the supervision and control of off-line property right transactions, and to combine on-line and off-line to create a nationwide property right transaction market with an orderly scale.

5. Summary
In general, venture capital plays an irreplaceable role not only in promoting China's scientific and technological progress, but also in China's economic development and prosperity. It can also strengthen China's ties with other countries. Therefore, in order to promote the rapid and effective development of the domestic venture capital industry, our country should absorb the successful experience of developed countries in the western venture capital industry and carry out a series of reforms on our country's venture capital: train a large number of professional talents and consultants related to venture capital [10]; Establish and improve laws and regulations and formulate relevant management regulations; Formulate a set of reasonable and effective incentive mechanism to promote capital investment from other aspects besides the government; Expanding the access of venture capital and the scale of venture capital investment; Find the most effective exit method for venture capital. The implementation of these reform measures will definitely enable China's venture capital industry to develop reasonably and efficiently. On this basis, venture capital can accelerate the commercialization of scientific research achievements, technology industrialization and the growth and development of high-tech enterprises in China [11].
References


