



# Venturing East: An Investment Roundtable

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Proceedings

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## Introduction

There have been a number of political demonstrations, yet, Hong Kong is reported to be making a smooth transition back into an integral part of the People's Republic of China (PRC). According to Ambassador Boucher, a Roundtable participant, Hong Kong remains a free society with free markets, run solely by citizens of Hong Kong. There has been almost no interference by Beijing, and lots of activity in local politics.

The proceedings from this Silicon Valley World Internet Center Roundtable focus on the new Hong Kong technology market exchange and cultural, financial and

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governmental decision factors in making investments to and from Hong Kong and the Far East. The Asian financial crisis and property market crash have necessitated that many investors

look beyond traditional real estate speculation and develop new horizons in technology and telecommunications. New projects include a government seed-funded science park and "cyberport," and a Disney theme park. Recently liberalized broadcast, media and telecom markets are seeing new competition by cable companies, cell phone price wars, an increasing number of Internet Service Providers (ISPs), and companies such as UUNet, Microsoft, Netscape and Yahoo opening Hong Kong-based operations.

While a new level of risk-taking is emerging, questions remain on how to create a vibrant business environment. The proposed Hong Kong stock market is slated to open in the fall with over 50 companies and needs to attract investment. There is some talk about affiliating with the NASDAQ, with joint listings and round-the-clock trading.

As Hong Kong and the Asian region are considering

how to attract involvement by major U.S. businesses and adapt U.S. business practices and products to the Chinese market, the Asian Pacific Economic Cooperation (APEC) is taking a leadership role in investigating regional issues and policy. APEC, which has a successful track record in policy-setting regarding tariffs and other key issues, will convene September in New Zealand to explore practical steps in promoting new businesses as well as to understand how they are founded, funded, overseas expansion, and licensing. APEC is also considering what roles government can play in encouraging and enabling increased venture investment in the Asian region.

## Why does cross-regional investment matter?

The pressure to go international is far greater today, underscoring the importance of promoting working relations between regions. It is especially acute in Information Technology (IT) with its shortened product cycles.

While 65% of high-tech investment dollars originate in Silicon Valley, there is fertile ground for IT investment in Asia as most companies have links to the U.S. Licensing IP is potentially very lucrative, but also considerably risky. In-depth, due diligence is required to assure that potential partners share the same motivations.

Looking ahead a generation, Elton Sherwin of Motorola commented that "...the relationship that Silicon Valley develops with the Peoples Republic of China and Japan will determine the future wealth of our children in California."

Specifically to Hong Kong, U.S. strategic interests include:

- Business opportunities, despite the downturn
- Showing that political and economic freedom work
- Law enforcement
- U.S. Navy port calls
- Stability in a vital region
- Hong Kong as a window into China's markets and growth.

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## How to replicate the success of Silicon Valley

Can the Valley's "buzz" be packaged and exported?

The phenomenon of Silicon Valley is the result of lots of little steps taken over 30 years. Stanford University, Hewlett-Packard, Intel and an entire set of decentralized institutions have organically grown up together in a fertile, dynamic field, promoting experimentation, continuous innovation and learning at a regional level. The absence of government involvement aided the freedom of development. Now, according to the roundtable group, the Valley is a relatively unstoppable economic engine.

Thomas Toy of PacRim Partners expressed concern about the large amounts of money the governments of Hong Kong and China are spending in an attempt to re-create Silicon Valley in a three year timeframe. "It just won't happen," he said, advising that it would be better to send people to Silicon Valley to see how it works, and export key pieces and concepts. There was a strong consensus that throwing lots of money to government programs will not work, but result in loss of capital and dissatisfaction.

The Renaissance provides a historical perspective: while it only lasted 20 years in Florence, it impacted the rest of Europe for over a century. Like Florence, Silicon Valley is a hotbed of creativity, a hub for the outward movement of ideas. The current 30-year cycle will make a similar lasting impact. Advice from the experts: take the flavor of Silicon Valley and move it to other areas.

## What cultural issues impact new business formation?

Raising capital is an integral part of Chinese society. Family and friends make large investments. In the Asian tradition, everything is linked to connections. Is the owner of a business politically well-connected? If not, the company has limited opportunities for growth.

However, there are more Silicon Valley-style venture capital (VC) emerging in Asia. For instance, in Taiwan's burgeoning semiconductor industry VC are known to raise over \$1 billion for a semiconductor lab, something even a powerful family cannot do.

Exit strategies of Asian companies are often not aligned with the interests of angel and venture capital. In Hong Kong and much of Asia, the goal of the entrepreneur is to pass the company along to the children rather than to position a company for IPO or acquisition.

However, there is a parallel of the Hong Kong family enterprise to corporations with regards to spin-out companies. For instance, there is a growing trend to spinning out the son for undertaking riskier kinds of business, much analogous to corporate spin-outs.

Neptotism makes it difficult for companies to hire and fire at will, which can be a fatal burden for a small start-up. In a 40-person com-

pany, two wrong hires can be deadly.

An unfortunate and often component of entrepreneurial activity is failure. Start-ups suffer a high attrition rate, as unproven ideas, products and teams do not always succeed. Silicon Valley's culture tolerates failure, positioning it as a learning experience and growth path. In addition, corporate bankruptcy laws protect individuals from financial devastation.

In Asian cultures, however, failure carries severe social and legal penalties. This makes it difficult for an entrepreneur to continue on the next venture and much less attractive to undertake risking a start-up in the first place.

## What can the government do to assist in economic growth and entrepreneurship?

**Tax codes and accounting rules are key.** Take a warning from the Dutch, whose tax codes systematically discourage high risk venture and angel investments.

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**Transparency.** Once you leave the English-speaking world, it is almost impossible to get audited financials. This is a key deterrent to VC, as a company must have absolutely rock-solid financials before getting acquired or going public. The Sand Hill Road crowd will take risks in technologies and markets, but not in government issues.

**Rule of Law is key to Silicon Valley VCs.** While Hong Kong as a port city operates under rule of law, the larger Chinese nation does not. Concern with abuses, that the emerging market will not offer liquidity but only quick flips: this is what has happened in several other markets such as Vancouver. The U.S. has its share of abuses as short squeezes by day-traders can result in billion dollar fluctuations. Speaking frankly, one VC said that to litigate a case in China, one must violate U.S. law. The side who pays the judge the most wins.

**Rules and governmental oversight are needed** for the new Hong Kong market to gain the trust and confidence of investors. For instance, perhaps the government should rule that a company must be profitable for 3 years before listing.

**Laws concerning ownership of companies** is another crucial area. If the law says foreign ownership of companies is limited, seed capital from the U.S. will be very limited. Restrictive ownership laws force investors into liquid portfolios not rooted into the community development. Hong Kong has historically been moved by property, driven by short term profits. How do you nurture projects with long term impact?

**The role of women is crucial.** Entrepreneurship often requires two-income households. How can you build your economy if half the population is locked out? The rights of women are key to trade. In this respect, California and Silicon Valley will have a competitive advantage that will last decades. Taipei enjoys the advantage of having many U.S.-educated women.

**Incubators.** In Europe, government-sponsored incubators did not work all that well. But, having the government

focus on the market environment to support entrepreneurs worked much better.

**Tariff barriers should be a red flag.** California imports are getting shut out of the market. One VC was blunt in his analysis: "If it is good for Cisco, it is good for your economy," meaning that any attempts to restrict routers, access to the Internet, or the telecom industry, is putting a country's economy at a disadvantage.

### **Other suggestions from the Roundtable:**

- Accounting rules are needed.
- Keep English as a second language. Do not regulate English out of the curriculum.
- Focus on the university. Stanford and UC Berkeley are key components of Silicon Valley history.
- Do not discriminate against the high achiever, different learners. Support the late bloomers.
- Privacy laws. Privacy has kept the entertainment industry free of profits, and makes many software and service companies shy away.
- Focus on what is particularly appropriate for Hong Kong. Which markets have fundamentals that are particularly suited to Hong Kong? Not broad arm waving about creating a high-tech corridor, but pinpoint key opportunities that are uniquely advantageous to Hong Kong, including value-added telecommunications services. There are currently over 140 Internet Service Providers in Hong Kong. Hong Kong also has more fiber optics per square mile than anywhere in the world. The Asian telecommunications industry is \$65 billion.
- The market drivers will need to be so compelling that anything the government might do to slow things down will not matter that much.
- Other kinds of incremental innovation besides the Silicon Valley model, can drive success.

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*Proceedings written by Ms. Kitty Wells, Director of Programs, Silicon Valley World Internet Center.*



