

ASIA

**The changing nature of Asian venture capital
Where to make a buck these days?**

[Anupam Srivastava, Investment Manager at Intel Capital, gives his view on the current Asia Pacific VC landscape]



Anupam Srivastava

It is tempting to believe that the current slump in venture returns is rooted in a cyclical economic downturn, compounded by excess liquidity from the early part of the decade, which often funded the fifth and sometimes sixth start-up in a segment. In some quarters, there remains faith that, once credit eases, equity markets will rebound, reopening the tech IPO window and bringing VC returns back to normal. This faith is misplaced.

While some of the slump can be attributed to a cyclical economic downturn, one major factor that hasn't been considered is the disappearing premium traditionally paid for high-end technology products. Technology has become commoditized faster than ever over the last decade. While more efficient production and lower-overhead online distribution can help offset margin impact, cost declines have lowered entry barriers and intensified competition. Technology is getting cheaper. For example, microprocessor prices have declined more than any of the 1,200 products tracked by the US Government's Bureau of Labor Statistics.

What does this mean for venture returns in Asia?

Recent trends have shown us that the cost arbitrage party is over. The Asian semiconductor industry and Indian IT services industry are prime examples

that can better fulfil this need than incumbent travel agencies.

High-end technology premiums have disappeared, and with that, VC returns have slumped. While capital costs are declining, labor costs are increasing, pressuring returns in businesses – BPO, software services – that arbitrated the cost spread.

The plight of Asian semiconductor start-ups is manifested in the commoditization trend sweeping PCs, digital handsets, media players and IT infrastructure. Take wireless-HD video transmission, for instance – a host of VC-backed start-ups raced to develop silicon that would transmit pictures and videos from cellphones and laptops wirelessly to ubiquitous home plasma and LCD TVs. After surmounting significant engineering challenges – including disparate standards, wireless isochronous communication and latency – start-ups who actually made it to market had to sell their silicon into \$40 handsets, \$250 netbooks, and \$300 HDTVs. Thin end-product margins made it tough to achieve immediate ROI.

This commoditization trend is now being repeated in other once-hyped segments: LEDs, software-defined radios, and DTV tuners, to name a few cutting-edge areas. Commodity new product introductory (NPI) pricing of technology goods is one of the biggest reasons why cutting-edge products from Taiwanese and Korean start-ups are unable to command the historical premiums required for venture returns.

Where should one look for venture returns in Asia?

While the economic downturn and commoditization of technology have played a part in dampening Asian VC returns, favorable shifts in government policies and emerging social trends are creating exciting opportunities for techpreneurs and venture investors.

'Going green'

• Clean technology or 'cleantech' is an industry where Chinese companies have unprecedented opportunity to play higher in the value chain, because of sizeable domestic demand and availability of government credit. While overcapacity and inventory write-offs have triggered a stunning collapse in the global PV solar industry, investors should note the PV industry's similarity to the semiconductor boom/bust cycle, and recognize the investment opportunity in companies best positioned to survive the downturn.

The nuclear household opportunity

• Nuclearization is fragmenting joint family income into constituent incomes, which are growing at differing rates, and possess different spending profiles. One opportunity presented by this societal trend is in online leisure and entertainment, where vacation purchases are shifting from a single expensive annual extended family vacation to affordable, impulsively-bought weekend getaways purchased several times a year. Online travel is a flexible, scalable model

that can better fulfil this need than incumbent travel agencies.

Profiting from Inclusive growth reforms

• Inclusion is the policy buzzword in China and India, as reforms shift focus from absolute growth to inclusive growth for social stability. Financial inclusion policies create opportunities in alternative payment models to debit/credit cards in traditionally cash economies; in online non-institutional micro-lending; and in emerging financial exchanges for risk management of agro-commodities. As policymakers target universal healthcare, point-of-care will extend beyond clinics to the field, fueling huge need for healthcare IT – portable medical imagers, cheap test kits, and healthcare IT as a service. Finally, universal education policies should create investment opportunities in local job portals, in distance learning and certification, and in IT finishing schools.

Is the future local?

Opportunity exists in simply studying local needs to see if technology can be the answer. However, can super-normal returns be made despite the decline in Asia's cost arbitrage? Yes, if technology investors are willing to embrace the opportunities afforded domestically, or to look beyond the usual suspects. Expect venture returns to cluster around domestic trends, even as returns from technology exports moderate. As always however, be willing to get in early and get in cheap, or risk losing out altogether.