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ScienceDirect
Technovation 27 (2007) 721–731
technovation
www.elsevier.com/locate/technovation

Management and governance of venture capital: A challenge for commercial bank

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Abstract

Venture capital (VC) improves the nation's innovative capacity by making investments in early stage businesses that offer high potential but high risk. This paper is concerned with the venture investment fund programmes in Thailand. In particular, the study describes and analyses the VC management of the Small and Medium Enterprise Development Bank of Thailand (SME Bank), the bank set up to help small businesses realise their entrepreneurial potential. Currently, SME Bank is gearing towards helping technology-based businesses create new innovations. The role of technology financing is the great challenge for SME Bank as the bank needs to garner the integrated financial and entrepreneurial support as well as a network of alliances. The paper proposes the model of VC management for changing the innovative environment to create the tech economy. Innovative initiatives at SME Bank would be useful for economies in other developing countries to launch programmes supporting the diffusion and commercialisation of innovations.

Keywords: Small- and medium-sized enterprise; Venture capital management; Technology-based businesses; Technology commercialisation

1. Introduction

Venture capital (VC) is important to innovation in terms of making investments in early stage businesses that offer high potential but high risk. This paper is concerned with the venture investment fund programmes in Thailand. In particular, the study describes and analyses the VC management of the Small and Medium Enterprise Development Bank of Thailand (SME Bank), the bank set up to help small businesses realise their entrepreneurial potential. Currently, SME Bank faces the challenge of helping technology-based businesses to support the creation of new innovations. The bank has initiated many activities to assist, promote, and develop Thai small- and medium-sized enterprises (SMEs). In extending the bank's lending-based services to VC financing, SME Bank is taking higher risks on start-up ventures. It had set aside capital to support the entrepreneurial start-ups in the technology sector. In other words, the bank has committed in extending the supply of capital to technology-based businesses to facilitate the process of developing and commercialising technologies which would help drive the country's economy.

Following on the introductory section, there are four further sections. Section 2 reviews the concepts of VC management, the structure of VC financing system, technology management of small firm innovations, and the innovation diffusion models to provide a theoretical background for an empirical discussion. The Triple Helix model to encourage economic growth and development is outlined for the analysis. Section 3 describes the VC management as a challenge for commercial banks in Thailand. It gives an overall picture of investment fund programmes to encourage the development of new technology companies in the Thai VC industry. The innovative activities undertaken at SME Bank to support technology-based businesses as well as the bank's initiation of Economic Value Added (EVA) programmes to improve its business performance are also discussed. Section 4 discusses the VC financing and management as well as the

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doi:10.1016/j.technovation.2007.05.010

VC model to promote innovations. Managerial and technological implications as well as conclusions are drawn in Section 5.

2. Theoretical framework

2.1. VC management and the structure of financing system

VC is a major source of financing for firms in their early stages of development. It is a high-risk, high-return investment to support business creation and growth. Start-up firms in the high-technology industries are characterised by a high degree of uncertainty. They often face the difficulties in getting access to finance and therefore, the provision of risk capital by VC firms plays an important role in the process of technology financing. The VC industry has become a significant element of the corporate financial services sector in virtually every major economy (Bygrave and Timmons, 1992; Megginson, 2002). This form of investing brightens entrepreneurial companies' prospects by relieving the capital constraints.

The structure of VC financing system involves the stages of raising funds, sourcing investments, making due diligence on potential investments, executing the investments and exiting the investments (Fig. 1).

In the process of seeking investments, a VC firm sends a prospectus to potential investors in order to raise the requisite capital. This process is concerned with seeking investment commitments of capital from various types of institutional investors, e.g. pension funds, insurance funds, banks, trading companies and corporations, endowment funds, foundations, and private individuals. VC investors generally consider a number of factors before making high-risk investments to commensurate opportunity for high returns. The factors include management team, business plan and the proven technology for making the venture investment. VC firms review business plans in order to evaluate the growth prospects and assess the compatibility of the investment request against their investment policies.

The next stage of VC process is a request for more information whereby a VC firm would arrange a meeting with the company management. The decisions for making investments are largely influenced by VC managers' perceived risks and targeted returns. After the investment decisions are made, due diligence would be performed. The due diligence stage involves a thorough study of the targeted company carried out by the venture capitalists who assess the firms on the basis of the weighted investment criteria. The aim of the due diligence process is to reduce the investors' risk by weighing the issues and challenges stated in a business plan. Nevertheless, the VC firm may seek to renegotiate or abandon the investment if negative factors are revealed during this process.

If the due diligence evaluation produces a favourable result, the investment agreements would then be prepared. The parties (the entrepreneur and the investor) would finally make a shareholder agreement to establish practical operating rules. In the VC management, the demanding venture capitalists would require seats on the board of directors so that they could monitor the firms. The venture capitalists generally spend 100 h on each company and visit the company 19 times on average (Sahlman, 1990; Muzyka et al., 1996). The monitoring process in every stage is important for the successful management of a VC investment. Finally, the venture capitalists would consider exit strategies as a crucial factor of venture funding (Black and Gilson, 1998). The common exit mechanisms to VC investments are sale of the stock through an initial public offering (IPO) or sale of the firm through a trade buyer.

VC organisations raise money from individuals and institutions for investment in early-stage businesses. The research undertaken by Kortum and Lerner (2000) within the American manufacturing sector revealed a relationship between VC funding and innovation. According to the study of Sahlman (1990) on the structure of VC organisations, there is a relationship between venture capitalists and their portfolio companies. The crucial role of the venture capitalists in managing portfolio companies is to help raise additional funds, perform strategic analysis, and recruit management team. The research results show that weak senior management is the dominant cause of venture failure (Sahlman, 1990; Gorman and Sahlman, 1989).

The VC literature suggests that a VC industry could raise funds and thrive on a sustainable basis if new scientific and

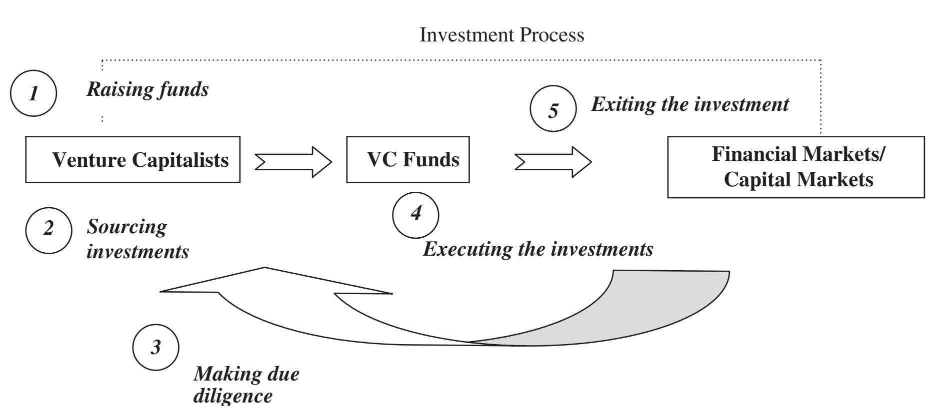

Fig. 1. The structure of VC financing system. *Source*: The author's design.