DEAL #1: Fintech company WeLab raised $160m in investments in its 2016 Series B round

DEAL #2: Hong Kong travel technology startup Tink Labs raised $125m in a new round of funding from FIH Mobile

Why Hong Kong's venture capital is losing steam despite market potential

The past twelve months have been a mixed year for Hong Kong's Venture Capital (VC) landscape, with the sector weathering an environment characterised by uncertainty in the global markets.

In 2017, experts are in agreement that Hong Kong, in terms of venture capital (VC), has a huge potential not only to remain as a startup and VC hub for Asia and the Pacific, but also to find its niche in the VC industry to reach the summit. The past year has been as divisive and polarising as in any other year for global political economy over the past decade, with mounting uncertainties in the global capital market and the world economy with major shifts in political economy following the results of the United States elections as well as the landmark Brexit vote that will see the United Kingdom eventually cut ties from the Eurozone.

These developments have, more or less, affected the outlook and confidence of investors as well as the trajectory of global market activities among different economies in the coming months. Although many economies in Asia and the Pacific remained strong and gaining momentum, there are spaces for improvement.

An example of this is the venture capital landscape of Hong Kong, a traditional financial and commercial hub in the Asia-Pacific region. Whilst the special administrative region has been blessed with geography — given its proximity with mainland China and its relentless march towards economic growth — and culture, with its British colonial past giving the territory a global outlook with a competitive command of the English language, Hong Kong's VC landscape potential, despite growth over the past years, remains unfulfilled to its maximum.

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In this article, we'll look at how Hong Kong's venture capital scene looked like last year compared to other traditional VC hubs in Asia and the Pacific, the challenges startups continue to face in Hong Kong, what needs to be done to address these challenges, and how the sector will ride out the rest of 2017 through the eyes of experts and industry practitioners.

Regional overview

Asia-focused venture capital fundraising slightly declined to $13.3b — after peaking midway at $14.5b — from the $14.1b raised in 2015 given the uncertainties on interest rates on top of instances of market volatility surrounding the Asia-Pacific region's venture capital landscape last year. Cumulatively, over 300 funds have been raised in the region since the start of 2014, according to data from Preqin.

China have the lion's share of venture capital funds in the region over the past three years. VC funds focusing on China accounted for the majority of cumulative capital from 2014 with 138 China-focused funds raising $27.6b worth in total capital. India-focused funds, meanwhile, accounted for 49 raising $4.9b over the same period. In general, outlook is on the positive side. Hong Kong will continue to be a financial hub for Asia and the Pacific and, to some extent, for global startups looking to find the light of day in penetrating the mainland Chinese market or mainland startups looking to expand in the global market.

"In particular, China has played a central role in the growth of the Asian market, and is now beginning to rival Silicon Valley as a hub of venture capital activity," says **Felice Egidio,** head of venture capital products at Preqin in a statement. "However, venture capital fund managers across Asia will have to prove that they can provide the strong returns that investors demand in order to ensure that the current boom in fundraising can translate into a long-term ascendancy." But outlook for Hong Kong's VC landscape may turn out to be average if persisting challenges remain unresolved.

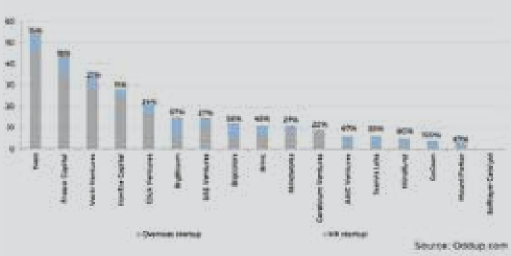
Hong Kong's VC landscape

Despite the rather inconsistent regional and global economic performance and outlook, Hong Kong remains a vital financial and commercial hub for Asia and the Pacific. This is true in the venture capital scene in the special administrative region — which can be considered as a microcosm of the rest of the region. "The Hong Kong venture capital scene continues to be strong when compared with the rest of Asia," says **Padraig Walsh**, Partner at Bird & Bird Asia Pacific. "Many venture capitalists in Hong Kong also look to invest in other jurisdictions in Asia and do not limit themselves to the Hong Kong market, meaning that Hong Kong is still very much a hub for pan-Asian VC investment."

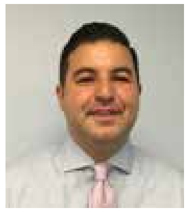
Alex Norman, an Associate for Bird & Bird Asia Pacific, added that in terms of hot sectors, technology verticals remain very popular with investors, particularly in financial technology (fintech). For instance, reports estimate that Hong Kong investments in fintech amounted to $165m last year, from the $125m in 2015. "Hong Kong's proximity to manufacturing bases in mainland China has also made it a popular destination for companies in the [Internet of Things] space," he says.

Hong Kong has also been firming up its position as a lucrative destination and permanent base for various startups to thrive and prosper. Walsh notes that there's

Where the investors are investing?



Sources: Oddup.com, StartUpshk.com



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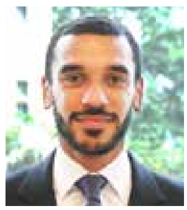

Alex Norman

Patrick Yip

a "burgeoning ecosystem of startup accelerators" and incubators, among others, which are increasingly calling Hong Kong home. According to reports, the number of startups in the special administrative region grew by about 245 to 1,926 last year.

"The startup community has been developing space last year, with a number of coworking spaces, accelerators, and incubators opening their doors," adds Walsh. "A relatively new development is that corporate-backed accelerators have also begun to spring up in Hong Kong, including accelerators backed by Accenture, AIA, Swire, and DBS."

2016 VC deals

Some of the more successful venture capital deals last year are in fintech. In the spring edition of this year's journal of the Hong Kong Venture Capital and Private Equity Association, HKVCA mentioned about WeLab, a fintech company founded in 2013, which raised $160m in investments in its 2016 Series B round.

Another deal is Hong Kong travel technology startup Tink Labs raising $125m in a new round of funding from FIH Mobile Limited to scale its idea of a designated mobile device provided with the hotel room for guests to use for free, eliminating the need to buy local SIM cards to makes calls, send messages, and use data.

Other deals include AM730 Startup Fund's investment of over HK$10m in the P2P diamond exchange; Horizons Ventures, a private investment arm of business magnate and currently Hong Kong's richest man Li Ka-Shing, $15m funding of German insurance technology startup Friendsurance; and Credit China Fintech Holdings, a Hong Kong-based firm, entering into a $30m agreement and investment in BitFury, a leading bitcoin and private blockchain infrastructure provider and transaction processing company.

Walsh notes that these deals show how "investors continue to have a strong appetite for technology-based companies. Technology verticals, such as fintech and traveltech, are booming." Hong Kong will also continue to attract startups who is in the early stage of product development given the territory's proximity to low-cost electronics and other hardware factories — particularly on the Internet of Things — in mainland China.

Stumbling blocks

Despite these rosy outlooks and positive statistics, Hong Kong's startup ecosystem and venture capital landscape remain hounded with stumbling blocks along the way. "Hong Kong's venture capital scene hasn't demonstrated the consistent long term returns and success stories to justify the attention of big money," said **Peter Guy,** a former international banker and a columnist for the South China Morning Post (SCMP), in an article. "Most of the so-called venture capital outfits in Hong Kong are really private equity only interested in China. There is insufficient angel and seed funding in this city."

Walsh, meanwhile, suggested that some of the tumbling blocks are structural, with the limited available capital based on the specific needs of certain startups, despite Hong Kong being home to some of the wealthiest names in the Asia-Pacific region. Another is standard of living. "There are structural issues in the VC scene that need to be addressed," he says. "There is a relatively limited pool of VC funds targeting Series A market. Unlike in some other jurisdictions, regulation prohibits equity crowdfunding. Seed and pre-Seed investment relies predominantly on angel investors. Follow on funding or new Series A investment is challenging."

To be fair, Walsh suggested that in terms of some of the intricacies of venture capital, Hong Kong is still learning. "Hong Kong is still finding its feet in terms of Series A, Seed, and pre-Seed investments, as traditionally conservative institutional investors have focused on later stage companies who are revenue positive and who are further in their life cycle."

Some hindrances also appear to verge on the policy level. **Carman Chan**, founder of venture capital fund Click Ventures, in an interview with SCMP, shared that whilst some other VC hubs across the globe are introducing more open policies, Hong Kong, in a way, remains "restrictive" and "regulated". **Patrick Yip**, national M&A deader for Deloitte China, says that the "VC industry is generally more about new startup companies especially in the tech[nology] sector and I don't see Hong Kong as an attractive destination for VC investors compared to places such as Shenzhen or Singapore."

Helping hand

Whilst these challenges remain a stumbling block for Hong Kong's venture capital landscape to realise its full potential, experts recognise some of the existing and anticipated policy efforts that the Hong Kong government have been implementing and will implement. Walsh says that there have been "very interesting development at a governmental level, as the Hong Kong government strengthens its support for startups, evidenced by the Hong Kong Chief Executive announcing a HK$2b fund to boost investment in innovation and technology." He adds that there is also talk of possible deregulation in relation to equity crowdfunding for early stage companies, "although little appears to be changing from a regulatory perspective at present."

"It remains to be seen if Hong Kong will have a 'big bang' moment with regards to funding for early stage companies, and, without some form of deregulation, we expect that growth in the startup sector is likely to be steady rather than explosive over the next 12 months," says Walsh, pertaining to some of the other initiatives to support startups by the Hong Kong government including the Innovation and Technology Venture Fund. In terms of this year's outlook, Deloitte China's Yip notes growth for Hong Kong's venture capital landscape may just remain average.

In terms of sector, Walsh remains firm that the technology sector — particularly fintech — will continue to be popular, given the "encouragement by the Hong Kong government through its various initiatives." Another factor of this is the proximity of Hong Kong to factories and other facilities in mainland China, particularly in Shenzhen, considered as the 'Silicon Valley' of hardware.

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SINGAPORE VIEW

Over half of 2017 deals were in tech

Venture capital in Singapore has been robust in 2016 despite global uncertainties surrounding the sector, with fears that it would prompt investors, series funders, and even startups themselves to be more cautious, on top of other reasons. Valmiki Nair, senior associate at Dentons Rodyk & Davidson LLP, notes that the initial momentum for Singapore VCs last year slightly slowed down due to uncertainty over global markets and the lack of potential "next big disruptive idea" from startups, with only one or two startups doing the heavy lifting both in Singapore and the rest of the Southeast Asian region.

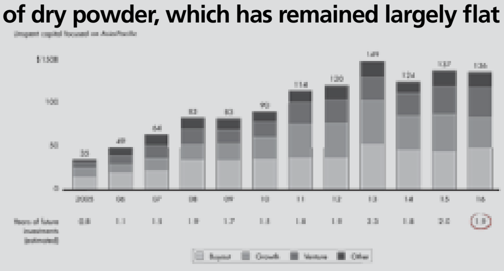
"Many of the startups that had potential to become great had already managed to close relatively large rounds of fundraising and did not require further funding for expansion in the year," he adds. "Startups based in Singapore have also been cautious about overspending to fund expansion efforts given the uncertainty over interest rates, market volatility, and changing politico-legal landscapes in nearby nations." But Lisa Theng, managing partner at Colin NG & Partners LLP, says that numbers remain positive with VC investments in Singapore achieving historic figures with 100 deals with an aggregate value of $3.5b recorded in 2016, compared to the 81 deals valued at $2.2b for 2015.

Experts are in agreement that technology remains the driver of venture capital growth in Singapore and, in large part, the region. According to a report by global valuation firm Duff and Phelps, the technology sector accounted for the majority of deal volume at 53% and deal value at 34%.

Mega deals

Sandra Seah, joint managing partner at Bird & Bird ATMD, however, notes that this strong performance in VC in Singapore was mainly due to the two "mega" deals last year that saw Chinese online giant Alibaba acquire Lazada, an e-commerce platform in Southeast Asia, for $1b as well as the $750m raised in ride-sharing/ride-hailing application Grab's investment round of funding led by Japanese conglomerate Softbank."The [Alibaba-Lazada] deal affirms the potential of Southeast Asia as an emerging market and may signal a tendency to fund mature businesses to secure larger returns," says Seah, adding that "the deal also serves as a reminder to startups of the value of striking partnerships and scaling up beyond their home markets to attract VC interest" which is timely given the momentum towards the achievement of the ASEAN Economic Community.

Asia Pacific funds are sitting on an ample supply of dry powder, which has remained largely flat



Source: Preqin