Venture Capital in China

An overview and analysis of trends shaping Chinese VC activity

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Key takeaways

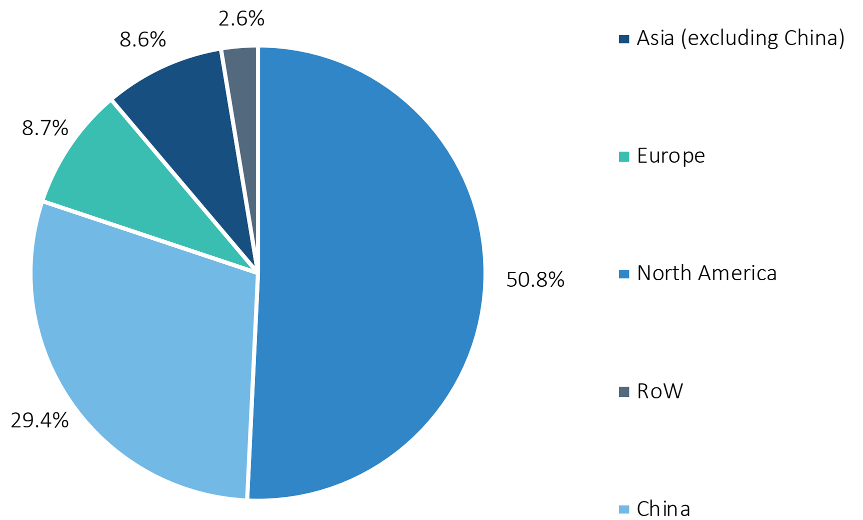
- Global investors are pouring increasing amounts of capital into China's startup ecosystem, with 29.4% of global VC directed into Chinese startups in 2018.
- China has undertaken major entrepreneurial initiatives including a massive national technology incubator, seed funding, and a series of funds-of-funds (FoFs) to develop the entrepreneurial and technological ecosystem in China.
- China's largest tech firms (including Baidu, Alibaba, and Tencent) are using expansive platform strategies to saturate every moment of Chinese consumers' digital lives, acting as one-stop shops for all entertainment, shopping, finance, and other needs.
- Although exit paths for Chinese startups are limited, evolving regulations, investor strategies, and new high-tech boards leave us with an optimistic outlook.

Published on March 18, 2019

Introduction

China has seen a meteoric rise in technological innovation and VC activity in recent years. The country has established a major entrepreneurial ecosystem with domestic startups attracting massive levels of VC and with Chinese firms making sizable venture investments around the globe. In 2018, over 29.4% of global VC was directed into Chinese startups. We expect this proportion will only increase as the ecosystem continues to mature, and as both domestic and foreign investors look to China for not only its immense market opportunities but also its increasing rate of technological innovation.

2018 global VC deals ($B) by company HQ location



Source: PitchBook

Top Chinese VC deals ($B) by size (since 2006)*

Company	Close date	Deal size	City
Ant Financial	June 7, 2018	$14.0	Hangzhou
Didi Chuxing	August 1, 2016	$8.5	Beijing
Didi Chuxing	June 15, 2016	$7.3	Beijing
Didi Chuxing	April 28, 2017	$5.5	Beijing
Didi Chuxing	February 7, 2018	$4.6	Beijing
Ant Financial	April 26, 2016	$4.5	Hangzhou
Meituan-Dianping	April 1, 2018	$4.0	Beijing
Meituan-Dianping	January 19, 2016	$3.3	Beijing
Weltmeister	April 16, 2018	$3.2	Shanghai
Didi Chuxing	September 7, 2015	$3.0	Beijing
Pinduoduo	April 11, 2018	$3.0	Shanghai
ByteDance	October 26, 2018	$3.0	Beijing

Source: PitchBook
*As of March 11, 2019

Top Chinese VC-backed companies by total VC raised ($B) to date (since 2006)*

Company	Close date	Total VC raised to date	City
Didi Chuxing	July 17, 2018	$29.8	Beijing
Ant Financial	June 7, 2018	$20.4	Hangzhou
Meituan-Dianping	April 1, 2018	$7.3	Beijing
ByteDance	October 26, 2018	$6.1	Beijing
Weltmeister	March 8, 2019	$5.0	Shanghai
Ele.me	August 21, 2017	$3.3	Shanghai
Pinduoduo	April 11, 2018	$3.1	Shanghai
JD.com	March 10, 2014	$2.8	Beijing
Ping An Healthcare and Technology Company	December 1, 2017	$2.7	Shenzhen
Ofo	March 13, 2018	$2.5	Beijing

Source: PitchBook
*As of February 5, 2019

Top Chinese VC-backed companies by post-valuation ($B) (since 2006)*

Company	Close date	Post-valuation	City
Ant Financial	June 7, 2018	$150.0	Hangzhou
ByteDance	October 26, 2018	$75.0	Beijing
Meituan-Dianping	April 1, 2018	$30.0	Beijing
Kuaishou	January 16, 2018	$19.0	Beijing
Pinduoduo	April 11, 2018	$15.0	Shanghai
SZ DJI Technology Company	May 6, 2015	$8.0	Shenzhen
Jiedaibao	January 25, 2016	$7.6	Beijing
JD Digits	January 16, 2016	$7.1	Beijing
Meicai	October 10, 2018	$7.0	Beijing
Meituan	January 20, 2015	$7.0	Beijing

Source: PitchBook
*As of February 5, 2019

History of VC in China

Given the Chinese government's communist underpinnings, many would be surprised to learn that China has been developing a VC ecosystem for over 30 years, and that a sharp rise in deal activity beginning in 2013 has propelled it into the second largest country in terms of venture deal value, according to PitchBook transaction data. China planted the seeds for VC in the early 1980s and into the 1990s with a variety of programs intended to develop domestic science and technology infrastructure; to spur economic, social, and defense development; and to achieve specific economic objectives. The most lucrative of these programs is Torch, which has developed into one of the largest and most successful mass entrepreneurial incubators in the world and has led to much of China's modern technological domination.

Torch

China's high-tech revolution truly began with the launch of Torch, initiated in 1988. This government-funded initiative was launched to foster entrepreneurship and technological innovation in China. Created by MOST (the Ministry of Science and Technology), Torch established high-tech innovation zones across the country with the purpose of centering resources, money, and talent. This allowed for the comingling of researchers, technology firms, large conglomerates, and government entities, thereby cultivating collaboration and growth. High-tech innovation zones include:

- Science and Technology Industrial Parks (STIPs) designed to commercialize research and emerging technologies
- Productivity Promotion Centers (PPCs) providing incubation services such as consulting and product testing
- Technology Business Incubators (TBIs) developed to provide incubation services (e.g. office space, education, advisory services) to support the growth of Chinese tech startups[1]

Torch has been an excellent innovation generator and has been critical to the early incubation and growth of large international tech companies such as Alibaba, Baidu, ZTE, Lenovo, and Huawei. As Torch startups grew, Chinese banks stepped in to provide late-stage investments, and "by 1991, 70% of the Torch funded startups were getting bank financing for expansion and later stages of the new ventures, with local governments acting as guarantors."[2] Aside from the innovation zones and incubation resources, the Torch program eventually expanded to include seed funding (the Innofund) and FoF activities.

1: "Torch Program in the Past 15 Years," China Through a Lens, September 17, 2003
2: "China's Torch Program – The Glow That Can Light the World (Part 2 of 5)," Steve Blank, April 11, 2013

Innofund

In 1999, the State Council launched the Innovation Fund (Innofund), a new initiative providing seed funding to small and medium-sized technology-based enterprises (SMTEs) with capital raised from local governments, enterprises, investors, and financial institutions.[3] Innofund has backed over 30,000 projects and provided over RMB 19 billion to Chinese tech startups.[4] The fund continues to provide seed funding to Chinese researchers and technology startups through the form of grants, loan interest subsidies, and equity investments, and it was developed to support the commercialization of technology research and to help tech startups bridge the financing gap until they are ready for larger investments.

State-sponsored VC funding

In the mid-1990s, technology and IT infrastructure became some of the first areas in which the government allowed venture investments. Both foreign and government-backed VC became a popular way for local governments to fund projects. Venture funds were encouraged by the government to invest primarily in state-owned enterprises with the goal of raising production and quality to international standards.[5] One such local government-backed VC firm, Shanghai Information Investment (SII), was founded in 1997 with the mission to fund companies developing the IT infrastructure of Shanghai.

Early foreign PE and VC investors were limited by the government as to which sectors were open for investment. Over the past two decades, however, the government has slowly relaxed sector limitations, and venture money has flowed in from investors looking to exploit an underfunded market. IT, healthcare, and life sciences have become three areas of significant interest to PE and VC investors. In 2007, MOST launched the first of many state-owned "guidance funds" to stimulate growth and attract more capital into technology startups. The funds act as both FoFs investing in VCs focusing on sectors of interest and as co-investors alongside other VC firms. By 2018, there were at least 2,041 guidance funds in operation, with total funding reaching RMB 5.3 trillion ($791.79 billion).[6]

3: "China Science and Technology Newsletter, No. 20-21," MOST, January 30, 2014
4: "Government Subsidized R&D and Innovation Outputs: An Empirical Analysis on China's Innofund Program," Stanford Journal of Economic Literature, Yan Guo & Kun Jiang, February 2014
5: "Venture Capital in China: High Technology Investing in an Emerging Economy," David Ahlstrom, Kuang S. Yeh & Garry D. Bruton, 2007
6: "'Macroscopic Observation,' No. 25, 2017: Development Status, Problems and Countermeasures of China's Government Guidance Fund," Bank of China, September 29, 2017

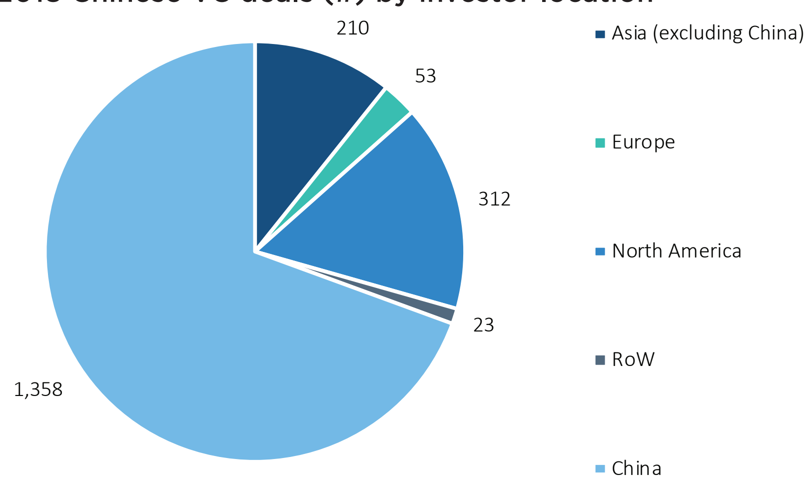
Foreign RMB funds

In 2018, foreign VC funds participated in 30.6% of venture investments into Chinese startups. Foreign deal volume in China is up 32.9% YoY according to PitchBook data, and we've seen steady growth in activity over the long term. Although foreign firms have historically invested primarily with US dollars, today an increasing number of foreign VCs are raising or are considering raising funds in China using its local currency, Renminbi (RMB). There are several contributors that make RMB funds attractive to foreign investors:

- Foreign RMB funds have become more attractive with the passage of favorable regulations such as the Foreign-Invested Venture Capital Enterprises ("FIVCE Regulation"), which permits the incorporation of VC terms commonly used in the US into foreign RMB funds.[7]
- The launch of two stock exchanges (ChiNext launched in 2009 and the National Equities Exchange and Quotations exchange launched in 2012) expanded exit opportunities for RMB funds.
- RMB funds allow investment from domestic LPs who otherwise face limitations in making foreign investments.

Most importantly, RMB funds have fewer restrictions on which sectors can receive investment, less regulatory oversight, and greater exit options including the ability for the portfolio company to exit via IPO in domestic stock markets. Currently the government does not allow firms with foreign backing (i.e. non-RMB funds) to exit on domestic exchanges. A draft foreign investment law was submitted during the second annual session of the 13th National People's Congress (China's Two Sessions political gathering) in March 2019 that aims to make China a more attractive and fair business environment for foreign investors.

2018 Chinese VC deals (#) by investor location



Source: PitchBook

7: "Introduction to RMB Funds," Investment Fund Law Blog, 2007

Chinese tech giants (Baidu, Alibaba, Tencent)

Like US tech titans that go by the acronym FAMGA (Facebook, Apple, Microsoft, Google, Amazon), China has its own set of internet giants known as BAT (Baidu, Alibaba, Tencent) that dominate the majority of Chinese screen time and ecommerce spending. Unlike FAMGA, however, these Chinese tech firms have pervasive platform strategies that extend into virtually all sectors of the internet through organic and inorganic expansion. This stands in contrast to ventures such as Facebook Pay, Amazon Music, and Google Plus, examples of platform expansion attempts that have met limited success in the US market. Each of the BAT firms started with singular business objectives. Baidu was a search engine, Tencent was a messaging app, and Alibaba was a B2B ecommerce marketplace. As Chinese consumers rapidly adopted internet and mobile technology, the BAT firms expanded into new business models to address consumer needs.

Together the BAT trio now has a market cap of $956.4 billion (Baidu with $56.4 billion, Alibaba with $476.4 billion, and Tencent with $415.6 billion as of February 28, 2019) and have made over 920 verified VC investments through a variety of vehicles and subsidiary companies (Financial Times alleges that Tencent and Alibaba have over 1,000 combined investments not including Baidu).[8]

Through government support and sheer size, the BAT companies command significant sway in Chinese VC and in the Chinese economy. At least 19 of the 71 Chinese unicorns are backed or controlled by BAT companies. Significant investments in unicorns as well as smaller tech startups are part of the platform-based strategies that these firms have adopted to expand horizontally and to permeate the daily lives of Chinese users. Continued investment in Chinese startups allows the BAT firms to increase the stickiness of their platforms and to act as a one-stop shop for all entertainment, shopping, finance, and other needs.

BAT has strong alliances with Chinese local governments, which is a strong tailwind for growth, but brings up potential privacy and security concerns that could deter investors from considering an investment in a competitor. With the support of the Chinese government, BAT firms are advancing China's technological capabilities, with investments across sectors and into a variety of emerging technologies including VR, cloud, robotics, and more.[9] MOST publicly charged the BAT firms with the objective

8: "China is winning the global tech race," Financial Times, Michael Moritz, June 17, 2018
9: "China Recruits Baidu, Alibaba and Tancent to AI 'national team,'" South China Morning Post, Meng Jing & Sarah Dai, September 25, 2018

of accelerating the country's technological leadership in three specific areas: Baidu to focus on autonomous driving, Alibaba to focus on smart cities, and Tencent to focus on computer vision.

Autonomous driving is a prime example of a sector receiving heavy investment from all three BAT firms. Alibaba, which is developing AliOS, an in-car operating system, has invested in at least four self-driving car manufacturers (Xpeng, Banma Technologies, Cenntro, and Weltmeister), as well as a variety of auto startups addressing issues such as parking, car sales, financing, and insurance. Autonomous driving aligns with the objective of establishing smart cities because the adoption of intelligent automobiles (mobile-connected devices) will achieve societal efficiencies such as optimized traffic flow and vehicle sharing to maximize utilization.

BAT-backed autonomous driving startups

Company	Post-valuation ($M)	BAT investors	City	Country
Cambricon Technologies	$2,500	Alibaba Group	Beijing	China
WayRay	$500	Alibaba Group	Zurich	Switzerland
Kneron	$40	Alibaba Entrepreneurs Fund	San Diego	US
Xpeng	--	Alibaba Group,	Guangzhou	China
Nio	$3,200	Baidu Ventures, Tencent Holdings	Shanghai	China
Lunewave	$14	Baidu Ventures	Tucson	US
Changsha Intelligent Driving Institute	--	Baidu Ventures	Changsha	China
In-Driving	--	Baidu Ventures	Wuhan	China
Idriverplus	--	Baidu	Beijing	China
Nio	$5,000	Tencent Holdings	Shanghai	China
Zoox	$1,550	Tencent Holdings	Foster City	US
Cyngn	$640	Tencent Industry Win-Win Fund	Palo Alto	US
Momenta	$1,000	Tencent Holdings	Beijing	China

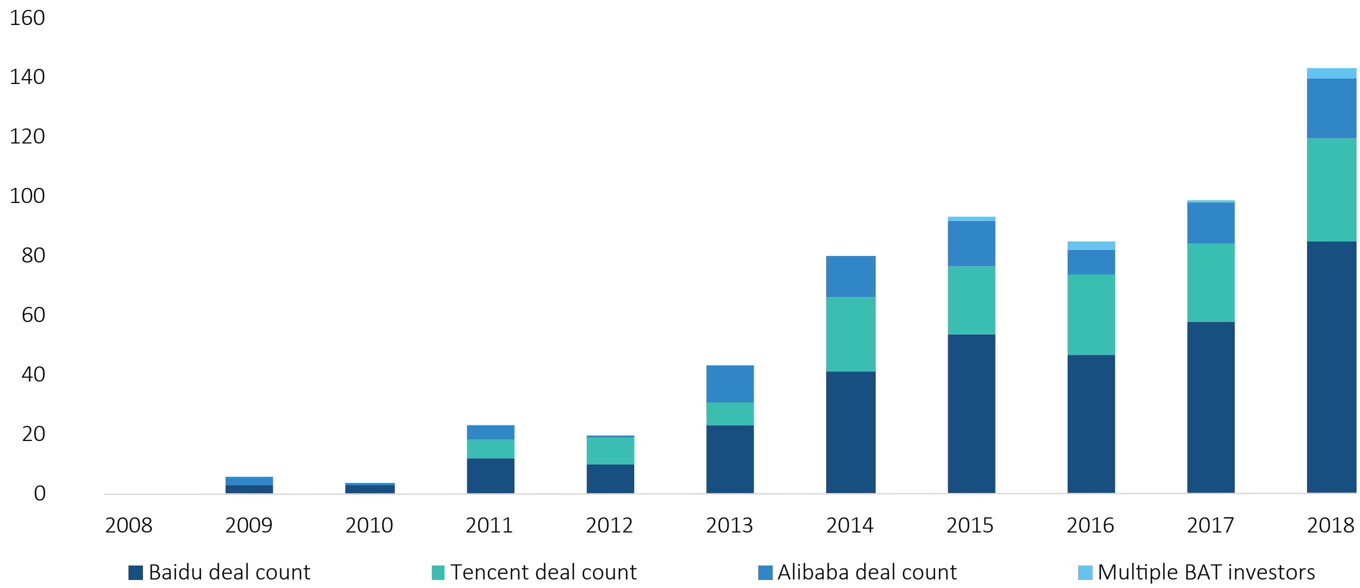
Source: PitchBook

Top BAT-backed unicorns by post-valuation ($B)

Company	Close date	Post-valuation	City
Kuaishou	January 16, 2018	$19.0	Beijing
Bitmain	June 19, 2018	$12.0	Beijing
Manbang Group	April 24, 2018	$6.5	Beijing
Lianjia.com	January 9, 2017	$6.0	Beijing
WeDoctor	May 9, 2018	$5.5	Hangzhou
Ubtech	May 4, 2018	$5.0	Shenzhen
Xpeng	December 26, 2018	$3.6	Guangzhou
Ximalaya	July 1, 2018	$3.5	Shanghai
VIPKid	June 21, 2018	$3.5	Beijing
Kuaishou	March 23, 2017	$3.0	Beijing

Source: PitchBook

Chinese VC deals (#) with participation from BAT investors



Source: PitchBook

Factors driving Chinese VC trends

VC in China has seen a dramatic rise over the past decade with many new investors emerging, startups launching businesses, and a growing market of consumers with disposable income and new channels to spend it. Aside from these trends, the unique growth story of VC in China can be partially explained by the following five factors.

Evolution of workforce and promotion of entrepreneurship

China is home to the largest education system in the world and has seen steady growth in its educated population, with 7.4 million university graduates in 2017.[10] This population constitutes a necessary talent pool for growing tech startups and a source of new entrepreneurial businesses. China's economy is evolving from labor-intensive, low-end manufacturing to high-end and innovation-driven startups. For years, China has produced more STEM graduates than all western countries combined.[11] Torch has been remarkably successful in creating and nurturing innovative tech startups, and a burgeoning number of domestic venture capitalists have been quick to invest in high-growth opportunities.

10: "Number of University Graduates in China Between 2007 and 2017 (in thousands)," Statista, 2019
11: "The Countries With the Most STEM Graduates," Forbes, Niall McCarthy, February 2, 2017

Easing regulations and pro-VC policies

Provincial and local Chinese governments have experimented with preferential tax treatments that encourage both foreign and domestic VCs to invest in startups in their districts. In 2017, the national Chinese government announced its own preferential tax polices (Circular 38) for VCs and angel investors that have helped to motivate more capital flow into the VC market and supply the capital needed to fund the growing number of technology startups. Additionally, various government organizations have enacted new regulations and guidelines to protect intellectual property, attract tech talent, and provide entrepreneur-friendly tax incentives, among other pro-business policies.[12]

Growth of China's economy

China's GDP was $12.2 trillion in 2017, closing in on the size of the US. The Chinese government has invested heavily to prioritize the development of the domestic economy. GDP growth was in the double digits in the last decade and has continued to grow at 6%-8% annually over the past six years (6.9% in 2017), with a slow decline in growth projected by the IMF through the next five years.[13] Investment is one way the government encourages economic growth through avenues such as government guidance funds. We expect continued government investment as well as increasingly investment-friendly policies to be enacted as the government pulls levers to continue GDP growth.

New wealth spawns wave of consumers and investors

Economic development in China has led to a sharp growth in the size of China's middle class, rising from roughly 3 million in the 1990s to over 500 million today, just 20 years later. This puts China's middle class roughly on par with that of the US, with more growth on the horizon. Rising wealth continues to change spending habits, with consumers earning more disposable income. As Shaunak Mazumder of Morningstar notes, "Growing nations that have seen their GDP per capita grow rapidly over time from $5,000 to over $10,000 experience a similar change in population spending, from basic needs such as food, clothing and housing, towards insurance, education, healthcare, travel, banking and other services."[14]

12: "China's Venture Capital (VC): Bigger Than Silicon Valley's?," Insead, Ariel Lu, Jessie Chen & Frank Fu, April 20, 2018
13: "China: Growth Rate of Real Gross Domestic Product (GDP) from 2011 to 2023," Statista, January 2019
14: "Profiting from China's Growing Middle Class," Morningstar, Shaunak Mazumder, June 15, 2018

The group above the middle class is beginning to swell too. According to a report by consulting firm Capgemini, China's high-net-worth-individual population increased 11.2% in 2017, reaching 1.3 million people with investible assets over $1 million.[15] Chinese investors have limited attractive investment options. Domestic stock markets have high volatility, and the government limits foreign currency exchange (thus all foreign investment) to $50,000 per person annually. This makes investing in domestic (or foreign-owned, RMB-denominated) VC an especially attractive vehicle to diversify and grow assets.

Mass mobile internet adoption

Over the past 10 years, mobile internet has been a major driver of innovation in China. With an estimated 677 million Chinese citizens owning smartphones (Statista, 2017),[16] and 802 million internet users, 98% of which are mobile, the mobile ecosystem has flourished, leapfrogging developed countries with the adoption of mobile technologies in a variety of use cases.[17] China's mobile users are unique in that the country largely skipped the adoption of credit cards and personal computers, so many Chinese people's first exposure to the internet is through mobile devices.

Because of this, many tech startups have designed software that is not just mobile-first, but mobile-only, meaning they are optimized for mobile devices and often have advanced functionality not yet common in the West. The most popular use cases for mobile in China include payments, social media, gaming, and shopping. China is leading the world in the progression toward a cashless society, with citizens using mobile pay at restaurants, public transportation, and even hospitals.[18] According to PwC's Global Consumer Insights Survey 2018 China Report, 2017 mobile commerce comprised 77% of all ecommerce, up from 29% in 2013, and it's projected to grow to 80% this year.[19] The level of consumer acceptance of mobile internet is a clear draw for startups and investors in search of sizable market opportunities, especially in trending verticals such as fintech, ecommerce, ridesharing, and AI & machine learning.

15: "Capgemini's Asia-Pacific Wealth Report 2018," Capgemini, Sam Connatty, November 28, 2018
16: "Number of Smartphone Users in China from 2017 to 2013 (in millions)," Statista, July 2017
17: "China Now Boasts More Than 800 Million Internet Users And 98% Of Them Are Mobile," Forbes, Niall McCarthy, August 23, 2018
18: "Going Cash Free: Why China Is Light Years Ahead in the Online Payment Revolution," Post Magazine, Zigor Aldama, July 20, 2018
19: "Global Consumer Insights Survey 2018 China Report," PwC, Tom Birtwhistle, 2018

Risks, regulations, and exit considerations

Despite the multitude of factors attracting VC investment, there are several key risk factors worth taking into consideration.

Regulations and government oversight

Government oversight is a major factor that affects all stages of the VC investment lifecycle. Regulation of VC and PE is primarily handled by the China Securities Regulatory Commission (CSRC) and the China Asset Management Association (CAMA). Local governments administer their own regulations as well. While central government regulations limit investment and exit options, opaque and selectively enforced local policies present the largest risks to investors.

Domestic trade protectionism is high in China, complicating non-market (regulatory, legal, political, and social) considerations and sales strategies. A 2012 study indicated that tariff-equivalent domestic trade barriers for all goods and services were 61% in 2002 and appeared to be rising.[20] Due to the rapidly evolving regulatory environment in China, it is possible that domestic barriers to change may have shifted since this study. Trade barriers in China take a variety of forms, such as local purchasing quotas, commercial registration licenses, and even prohibition through administrative decree. The primary takeaway is that domestic sales growth may be slower and more challenging than expected. This highlights the importance of forging relationships with local government officials, as Chinese local officials have significant leeway to interpret laws and regulations, and positive relationships can create lower barriers to trade. The Chinese even have a special term for personal connections and relationships as it applies to business called "Guanxi."

Lack of regulatory transparency

One significant challenge to investing in China is the lack of predictability and transparency in the Chinese business environment.[21] For investors and operators, an inconsistent interpretation and application of laws and regulations presents a substantial risk. Regulations may see stricter enforcement due to recent political or economic events or might be selectively enforced given the presence of a competitor firm with stronger ties to government officials. One reason many

20: "Measuring Trade Barriers: An Application to China's Domestic Trade," Anna Wong, January 1, 2012
21: "Outbound Investment from China and Private Equity Investing in China," Simon Luk, March 7, 2013

parties choose to partner with SOEs and other government entities is to better navigate opaque regulations.

Evolving contracts

Unlike in western countries, contracts in China are not set in stone and are treated as evolving documents. Continued negotiations and changes to these documents are expected as the business evolves. This will likely come as a surprise to foreign VCs who expect consistency and stability in the agreement.[22] This may come into play when reviewing the client contracts held by portfolio companies or investment opportunities. This could even affect the VC's term sheet or other investment documents. Investors will be best served by expecting and preparing for these revision requests.

Overestimating market size

Contrary to the popular conception that China is a single market opportunity of nearly 1.4 billion consumers, the country is in fact composed of 34 (including Taiwan) distinct provinces, each with unique consumer behavior and economic considerations. Based on the regionalism concerns addressed previously (see: Regulations and government oversight), market sizing is more challenging than at first glance. It's true that a 1.4 billion population with a rapidly growing middle class presents an immense market opportunity, but domestic trade barriers and localized regulations add frictions that likely shrink most opportunity sizes.

Investment sector limitations

Foreign VC investors are limited in the sectors in which they can invest. Recently, regulations have begun to loosen up in some sectors that are less sensitive to government oversight. Sectors of high sensitivity and regulation include media and content, culture, financial services, and social networking. Big Data and IT infrastructure are also highly regulated. The financial sector is one area that is loosening up, fueled by the government's eagerness to attract more capital and boost the economy. Local banks were recently permitted to accept foreign investment.[23]

Exit market considerations

Worth mentioning on its own, exit paths for Chinese startups are limited, depend on investor fund structure, and involve intense government oversight and onerous restrictions. Most

22: "Venture Capital in China: High Technology Investing in an Emerging Economy," David Ahlstrom, Kuang S. Yeh & Garry D. Bruton, 2007
23: "China Pledges to Allow More Foreign Investment in Financial Sector by Year-End," Reuters, Kevin Yao, April 10, 2018

founders prefer to go public in the Hong Kong stock market because it is well regulated, international, and close to home markets. The Hong Kong stock market (HKEX) recently added dual-class shares.[24] This is attractive to technology companies that have shares with different voting rights that were previously barred from the exchange. Unfortunately, HKEX has not been performing well over the past year. Most companies on the exchange have dropped in value from their IPO price. The Hong Kong market is known to be volatile, although less so than China's domestic stock markets (SSE & SZSE).

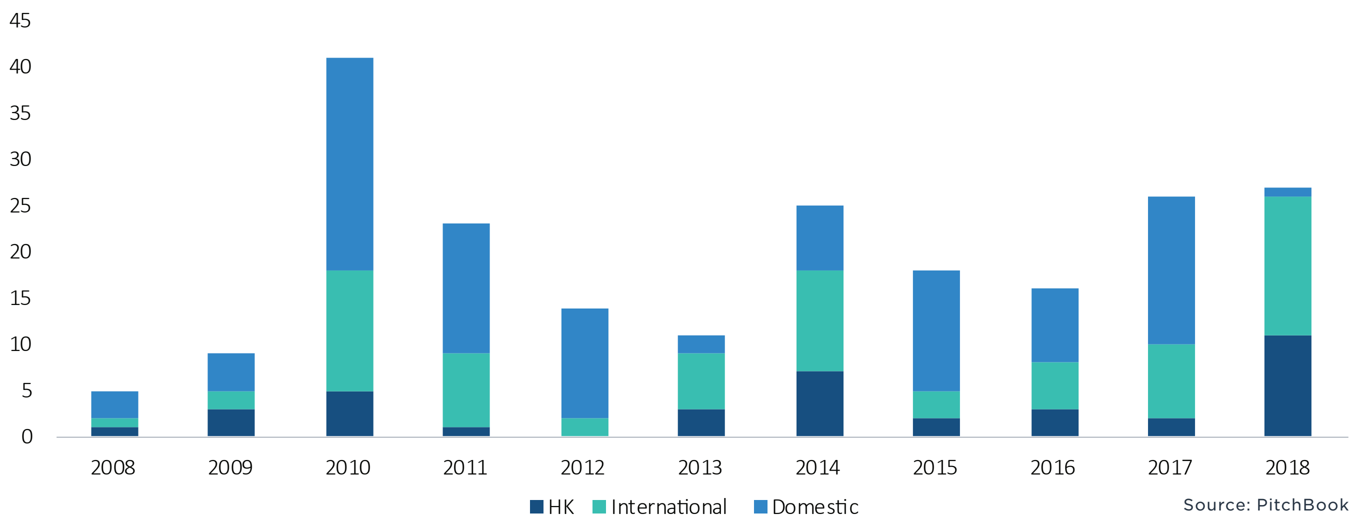
Aside from volatility, the Chinese stock markets are heavily regulated, and the IPO approval process is long and unpredictable. Qualification requirements can be subject to short-term policy concerns, adding to the unpredictability. Many companies wait two to three years for CSRC approval. IPO registrants are required to meet collateral requirements, which can be a challenge for asset-light software firms. Due to these restrictions, foreign exchanges are often considered as a backup option. To that end, the second-most desirable markets are the major US stock markets. When listing on foreign exchanges, some companies conduct a full overseas listing, and others opt for reverse mergers. Historically, the frequency of reverse mergers has been closely tied to the changing IPO policies of the CSRC.[25] Reverse mergers are less ideal because they add excessive costs and uncertainty for investors. Acquisitions are another exit opportunity for Chinese startups, although it is a less desirable option with lower returns on average than IPOs.[26]
One last area worth addressing is Hong Kong's and China's Stock Connect program allowing foreign investors to purchase equities on domestic exchanges though "A-shares." Launched in 2014, A-shares have become an exciting path for retail investors to invest in mainland companies. This program does not appear to have had an impact on exit options because most tech companies continue to list on Hong Kong or foreign exchanges. China has attempted to lure large Chinese tech firms (e.g. Baidu, Alibaba, JD.com) back to the domestic markets through the creation of Chinese Depositary Receipts (CDRs). These bank-issues certificates allow foreign-listed stocks to be listed on China's domestic markets. Thus far, the major tech firms have reportedly resisted listing via CDRs.

Exits of Chinese tech firms have trended down over the past three years but have not halted entirely. The majority of Chinese tech IPOs in 2018 went public on the Hong Kong exchange (e.g. Xiomi, Meituan, and Jia) and the American New York Stock

24: "Hong Kong Adds Dual-Class Shares, Paving Way for Tech Titans," Bloomberg, Benjamin Robertson, April 24, 2018
25: "The Cost of China's IPO Regulations on the Functional Efficiency of Its Financial System," VoxChina, Charles M. C. Lee, Yuanyu Qu & Tao Shen, November 1, 2017
26: "Research on Venture Capital Investment Exit in China," Modern Economy, Vol. 10, No. 02, Wenjie Fan, February 19, 2019

exchange and NASDAQ board (e.g. Nio, Bilibili, Huya). But from an investor perspective, VC funds that invest in Chinese startups using foreign currency (e.g. USD) are prohibited from investing in certain industries and from portfolio companies exiting onto Chinese stock markets. To that end, China's NASDAQ-esque ChiNext board on the Shenzhen Stock Exchange presents a more attractive domestic IPO option for tech startups. Inaugurated in 2009, the board is dedicated to high-tech Chinese firms, making the ChiNext board a viable exit option for startups backed by RMB-funds. President Xi Jinping announced in November 2018 that the Shanghai stock exchange will be getting its own high-tech board, expanding domestic exit options even further. Recently announced guidelines indicate that IPO registration on this board will be more company-friendly than other boards.[27]

Chinese VC IPOs (#) by exchange category

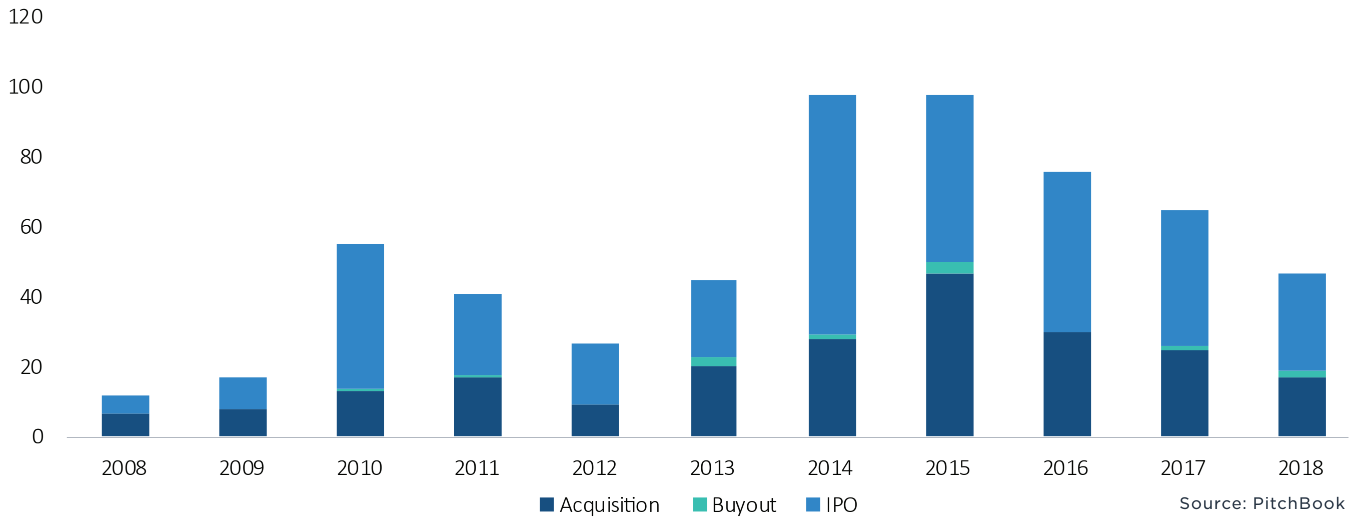


Source: PitchBook

Many foreign VCs, who are restricted from exiting on Chinese exchanges when investing with foreign capital, are choosing to raise foreign-invested RMB funds to increase access to investment opportunities and maximize exit opportunities. Funds based in RMB are able to invest in a wider range of sectors and portfolio companies are not restricted from listing on domestic exchanges. Shifting regulations regarding domestic exits and RMB funds leave us with tentative optimism regarding exit opportunities for Chinese VC-backed firms in the future.

27: "China Speeds Final Rules for Start of New High-Tech Board," Caixin, Zhang Yu & Leng Cheng, March 2, 2019

Chinese VC exits (#) by type



Source: PitchBook