THE DIFFICULTIES OF RAISING CAPITAL IN MAINLAND CHINA

Based on an interview with Mr. Goa of Han's Laser Technology, located in Shenzhen City in the People's Republic of China.

In the United States, the liquidity of our markets promotes entrepreneurship, innovation and corporate growth. Most entrepreneurs, steadfast in their efforts, can usually access the financing they need. However, in other countries accessing capital can be a long and arduous process with limited options. I gained a greater appreciation for the structure of our banking system and the liquidity of our markets, when I interviewed Mr. Goa the founder of Han's Laser Technology, located in Shenzhen City in the People's Republic of China. The company was founded in 1996 and has since has grown to $90 million in revenues, employing over 1500 people.

Funding Options for Entrepreneurs

In China, the availability of capital for entrepreneurs is scarce and often the seed money comes through personal relationships. In the case of Hans Laser, the $50,000 start-up capital came from a customer deposit; provided through a long-term relationship that Mr. Goa had formed while working in Hong Kong. According to Jones Day, an international law firm specializing in foreign business transactions, companies are often funded by personal loans obtained through the principles. This is an important point to consider when doing business in China. Due diligence to uncover such financing agreements is crucial, as these transactions are often not documented and can only be discovered through exhaustive investigation. Even with the best efforts, there is still an inherent risk.

Financing the Next Stage of Growth

Obtaining growth capital in China is very complicated. Investments are controlled by state owned enterprises, which according to state capital regulation the investing enterprise must maintain a controlling interest in the company. Valuations are void of intangibles, due to the governments desire to avoid what they term as "suspicious trading". The elimination of intangibles would be fatal to many companies in the United States, where high valuations are founded on intellectual property.

By 1998, Han's Laser had grown to $1.5 million in revenue, $400,000 in net profit, with approximately 20 employees. Mr. Goa realized that he could not reach the next stage of growth without a large infusion of capital. He secured the first venture capital funding in 1999 through a state-owned company. Based on a valuation of $1million in net assets, void of intangibles, the investment of $510,000 provided the investor with a 51% majority ownership and Mr. Goa's assets where valued at $490,000.

Mr. Goa had three options: sue the investor, wait to see who purchases the company or give up control of Han's Laser and start over.

Once obtained, the funding provided the company the needed stimulus and it quickly grew to $10 million in sales with total asserts valued at $2.5 million.

The terms set forth in the agreement were aggressive by US standards but Mr. Goa was desperate for money and agreed to the conditions. He did however, set forth a provision to buy back 2% of the equity if the overall assets reached $2.5 million. Once the agreement was signed, it took nine months to secure the funding. If forced to wait for almost a year, many US companies either would have been out of business or would have lost their competitive advantage.

In spite of the growing success, the company faced serious internal problems. The investor's relatives were using the company as a means to promote their individual wealth; embezzlement became rampant. Mr. Goa's complaints to the investors were unheeded. Left with no alternative, he decided to try to buy back his shares. After much discussion, it was decided that he could purchase the 46% for $2.2 million, with a required $1.1 million deposit. However, before the deal could be finalized, he learned that the buy back contract had to be authorized by the government, which deemed it had to go to auction for the highest bidder. Mr. Goa had three options: sue the investor, wait to see who purchases the company or give up control of Han's Laser and start over. He took the risk and convinced a public company to sponsor him. Han's Laser was purchased by Mr. Goa for $3 million. As President, Mr. Goa took a leadership role and the company began to take off once again.

In 2001, he decided to take the company public to obtain additional funding. In the last ten years, only 1200 companies were traded on the China Stock Market. Government regulation is heavy and the process is slow and cumbersome. After 22 months and the filing of over 1000 documents, the company finally went public and was able to raise $30 million in funds. The current market value is $170 million.

In spite of its inherent difficulties, China's size and fast-growing economy offers a vast array of opportunity and cannot be ignored. Perhaps its entry into the World Trade Organization will hasten its transformation into a free market economy. Additionally, the decision on July 21st to abandon the dollar peg and revalue the currency by 2.1% is a positive step in the right direction. The entrepreneurial spirit in the People's Republic of China is just beginning to develop and I found the untapped opportunity to be intriguing. However, the government's control makes investment difficult and tainted with unknown risk.

Written by Lori Williams-based on her experiences while visiting China.