The way forward

As viewed by WI Harper Group's Peter Liu

Peter Liu meeting with Taiwan President Ma Ying Jiu at C100 official visit 10 July 2009

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"You've all seen the Chinese economy, you've all read about it, but we're actually dealing with it," Peter Liu, the founder and chairman of San Francisco-based venture capital firm WI Harper Group, tells *Swiss Style*.

Undoubtedly, these newspaper readers are inclined to think of large state-owned firms and government price fixing when they think of the Chinese economy. Thanks to several critical decades of reform and influential pioneers like Liu, China and Taiwan today are also hotbeds of innovation and opportunity.

Born in Beijing, raised in Taiwan and educated at the University of California-Berkeley, Liu was first invited in 1985 by the Taiwanese government to start a venture capital enterprise in Taipei. Since then, Liu has spearheaded the birth of the venture capital industry in East Asia, founded WI Harper offices in San Francisco, Beijing and Taipei, and helped raise seven China-related investment funds for his company.

Today, WI Harper's portfolio includes over 100 key firms in high-growth industries such as information technology and healthcare, including Focus Media, DivX, Beijing Xin Wei, Vizio, Creative Technology, Commerce One and Intraware. Recognized as one of the world's highest performing venture capital firms, WI Harper and its portfolio companies have won numerous awards in international business forums, including "Best Venture Capital Institution" at the China Venture Capital Forum in 2006 and the "Technology Pioneer Award" at the World Economic Forum Davos Meeting in 2009.

Recently, the firm announced the appointment of Kai-Fu Lee, the founding President of Google China, as Chairman of the Advisory Board of WI Harper Group, beginning October 2009 *(see following article)*.

Peter Liu offered to share the story of WI Harper's rise to success, his insights into the evolution and current challenges facing the Chinese economy and his predictions of what the future holds for China and Taiwan. »»»

Now and then

When asked to describe how he developed a fledgling initiative into a world-class venture capital firm, Liu attributes much of his success to the political and economic climate in Taiwan and mainland China in the last two decades of the 20th century.

"I was in the right place at the right time," says Liu. "The mid-80s to mid-90s were the prime time for growth in Taiwan. The Taiwanese government at the time took all the right steps to promote economic development – good monetary policies, active promotion of capital markets and development of specific platforms (like semiconductors, liquid crystal display, personal computers, etc) for growth."

During those years, the Taiwanese authorities supported the emerging venture capital market, in particular with policies such as the Taxation Pioneer Status, a tax exemption incentive given to encourage venture capitalists to invest in key start-up firms. "These initiatives enabled venture capital to become a development vehicle for the entire country," says Liu.

Venture capital enterprises played an especially important role in building Taiwan's IT infrastructure over these two decades, laying the foundation for growth in a variety of other sectors. "IT became the backbone of Taiwan's incredible economic growth," Liu explains. "Venture capital was a catalyst for development because it was able to mobilize the latest technology from Silicon Valley. Starting from the IT platform, we quickly branched out into other Taiwanese industries such as manufacturing and assembly."

Meanwhile, significant economic reforms were also taking place in mainland China, a world that had been completely dominated by state-owned enterprises until the late 1970s. Slowly but surely, the Chinese authorities were taking steps to liberalize the region's markets and transfer national firms to private ownership – steps that eventually fuelled China's spectacular growth and allowed Liu to open a WI Harper office in Beijing in 1992.

Says Liu, "When you're operating something as new and innovative as venture capitalism and you're dealing with a transitioning economy like China, the timing is everything. This could only have been done during that crucial period of reform in the 1990s."

Elaborating further, he says, "China is one of the few socialist countries that made a smooth transition from a centrally planned to a market economy. In this way, it is a learning model for other transition economies like Vietnam and North Korea. When you think of China right now, you think of the private sector, which now constitutes 75% of the economy as compared to 0% in 1978. This is truly an economic miracle."

Advantages and stumbling blocks

At a time when much of the Western world is becoming destabilized and spiralling ever deeper into a pit of despair and financial chaos, Asian business leaders are rolling up their sleeves and getting resolutely down to work.

Although most analysts pinpoint the export sector as the key driver of the Chinese economy, Liu claims that China's most important advantage moving forward is the potential size of its emerging domestic market. "China is now painted as the factory of the world because it is dominated by its exports," says Liu. "However, if you look at China's key export sectors in appliances, furniture and other manufactured goods, the key is the Chinese' low real wage and a large amount of surplus labour. The domestic value added on Chinese exports is also very low at an estimated 20%. China therefore needs to refocus its growth on the domestic economy."

Liu also names specific precautions that China must take as it moves forward, namely the need to balance capital payments and to curb the new wave of speculative stock trading. "As of now, China has an excessive capital account surplus," Liu explains. "It is sitting on nearly US$ 2 trillion in foreign investments. Chinese companies need to make some major acquisitions in order to maintain the balance."

Due to its large trade and capital surpluses, the Chinese economy suffers from excessive liquidity. Renminbi deposits are accumulating at home because Chinese investment far exceeds domestic consumption, while the inflows of foreign capital reserves keep pouring in. China's excess liquidity and capital imbalances can lead to many economic ills in the long run, in particular the risk of inflation for Chinese corporations.

Liu is above all concerned with the asset price bubble looming over the Chinese stock market, the result of a new wave of speculative trading in short-term assets. "The most serious problem facing the Chinese stock market today is the very short holding period," says Liu. "Although the price to earnings ratio is not too high, short-term speculation has inflated prices and created a situation in which profits are not sustainable in the long run. In order to help deflate the bubble, the Chinese government needs to give shareholders more incentives to increase their asset holding period." »»»

Peter Liu
Founder & Chairman,
WI Harper

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Peter Liu and South Korean President Lee Myuan-bak at the World Economic Forum East Asia Conference 19 June 2009

Liu suggests that one such policy incentive could be to cut the costs of issuing cash dividends for Chinese corporations. "Increasing cash dividends could encourage shareholders to hold on to long-term equities, because these dividends represent additional income for consumption," he explains. Shareholders receiving an extra stream of income from cash dividends are less compelled to take advantage of speculative prices to dump assets on the market. In this way, efforts to increase cash dividends wean investors off, as Liu puts it, the "psychology of a free lunch."

The future of Chin-Wan

Despite the problems confronting the Chinese economy today, Liu is confident that greater intercountry cooperation within East Asia will move the region forward to ever-higher levels of innovation and economic performance. "Chin-Wan is the new buzzword in the air today," says Liu. "China and Taiwan are collaborating today and making peaceful progress. Moving forward, this collaboration is going to lead to huge economic growth."

In particular, Liu believes that greater collaboration between Taiwan and mainland China will be a critical factor in the latter's sustained growth and progress as the two economies move forward into the 21st century, since economic partnerships with Taiwan will greatly benefit China's emerging industries and increase its long-run technical capacity.

"What China is missing out on today is the shortage of integrated circuit (IC) design capabilities," says Liu. "IC design is largely limited to Taiwan, where companies like Media Tek and Himax lead the industry. Collaborating with a country that has already developed solid IC infrastructure is therefore very bene-ficial to China's emerging telecommunications and healthcare industries."

According to Liu, the collaboration with Taiwan could also help Chinese corporations increase their foreign investments, move operations abroad and absorb some of China's huge capital account surplus. "As you know, the Chinese government now has excessive investment capital," says Liu. "The Chin-Wan collaboration is an opportunity for China to broaden investment activities into Taiwan, Hong Kong and the East Asia region. We can definitely expect to see this in the years to come." «««