China's Investment Industry

May 2020

Industry Introduction

While much of the world reeled from the dot-com bubble burst in 2001, China's VC industry was setting the foundation for a strong future. Companies like IDG and Shenzhen Capital Group were investing in now-giants Baidu and Ctrip.

While the industry has grown into one of the largest in the world, growth has slowed over recent quarters and investors are beginning to look to government initiatives for inspiration.

In an increasingly frosty global environment characterized by volatile trade practices, China is looking inward to further boost domestic R&D spending while initiating numerous policies to maintain its global leadership in technology and smart manufacturing innovation. In response, this is driving capital across a spectrum of industries, with a particular concentration in healthcare, IT & technology, and AI.

Key Statistics

4%
VC deal CAGR, 2011-2019

206
# of Chinese Unicorns, 2019

$100 billion
Top valued startup globally, Bytedance

27%
Annual VC investment vol. CAGR, 2014-2019

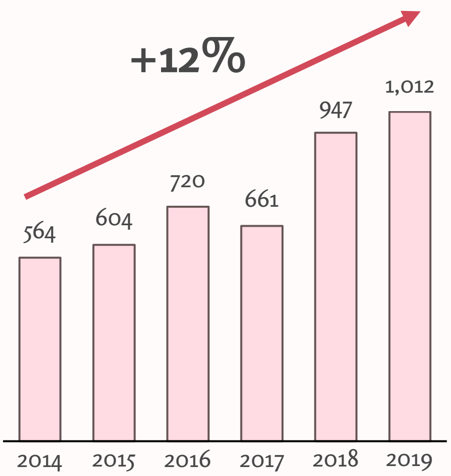
Recent vs. Historical Performance

Average investment value in China's VC industry has increased at a double-digit CAGR since 2014, with Greater China boasting a staggering US$600 billion in private equity and venture capital AUM.

However, VC investment in China fell from US$302 billion in 2018 to US$258 billion in 2019, a drop of 14.6%. Furthermore, despite peaking at US$17.4 billion in 2018, US VC investment in China reached six-year lows in 2019 at under US$4 billion. As US-China relations continue to chill amid a coronavirus-stricken global environment, these figures are likely to sink further.

The 2019 capital winter in China claimed the lives of as many as 336 Chinese startups – including several unicorn, and these figures will only be further exacerbated by the impact of the coronavirus. VC investment in the country's tech sector shrank by 30% in Q1 2020, with VCs funneling US$16.8 billion into tech enterprises during the first three months, down from $24 billion in the same period last year. The total number of deals contracted too, falling by 45% to 634.

Average VC Deal Value in China
(US$10k)



Tradition Meets Innovation

The distribution of Chinese unicorns can offer insight into the most popular industries in China over time. Chinese unicorns compete in a myriad of markets, spanning the traditional automotive and entertainment media industries to the newer e-commerce and fintech industries.

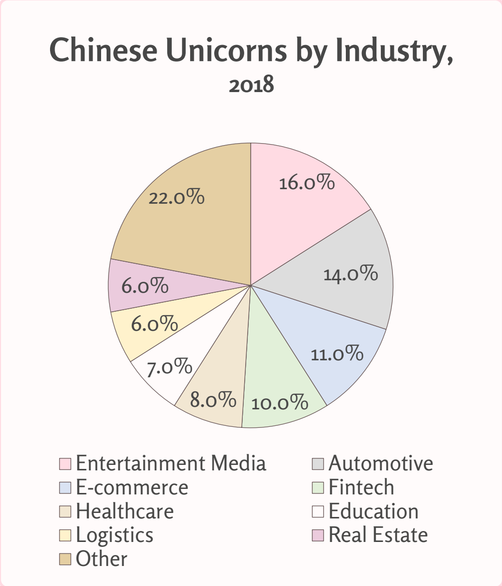
Historical investment data shows that the automotive, healthcare, and real estate industries have consistently ranked at the top for investment, having received a total of US$2.98 billion during Q1 2019.

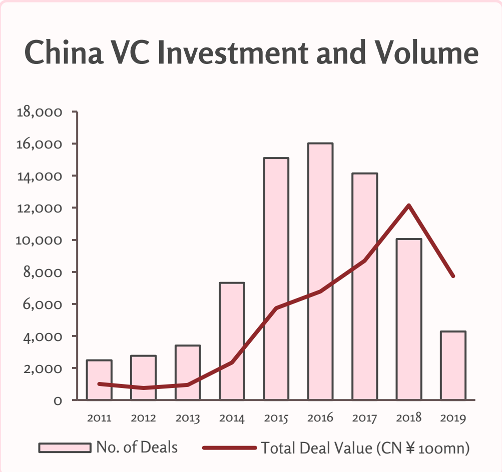
Future growth industries will be largely determined by government initiatives like 'Made in China 2025,' which encourages individual cities to invest in companies that drive manufacturing and supply chain innovation. In addition, policies like the New Generation Artificial Intelligence Development Plan contain plans to invest US$150 billion to transform China into the leading AI power in the world by 2030. While these government supported industries are likely to grow quickly, it remains to be seen how private VC funds will respond.

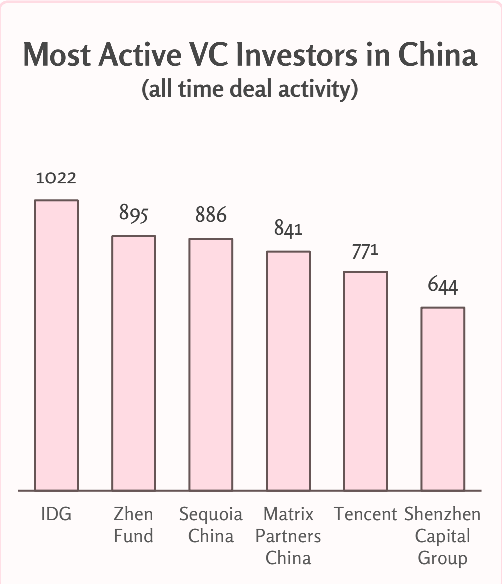
What Comes After the Peak?

Given the quick growth of the Chinese economy, the number of VC institutions has increased in lockstep. Between 2005 and 2016, total VC institutions in China grew from 319 to 2,045, with the industry reaching a peak at 16,000 pre-IPO investments in 2016 – approx. 3,000 more than in the US. Total deal value itself did not peak until 2018 at US$479.6 billion. Poignantly, since reaching the peak, VC investment in tech startups dropped 51.5% YoY in Q4 2019.

Though China is making progress towards its economic recovery, the country is still challenged by sluggish global demand. China may be on the road to labor recovery, but labor does not equate to production. In response, China is placing its bets that relaxing financial market regulation will help newer domestic exchanges like the Kechuang Stock Exchange and New Third Board become competitively positioned to attract new capital from global investors as US regulators place more restrictions on Chinese companies abroad.







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About the Author

Erik Stahle graduated from Hamilton College in 2018 with a major in Economics and minors in Chinese and Spanish. With a professional background in strategy consulting focused on market entry, he is passionate about China's economy and innovation landscape. During his time living in China, Erik developed a particular interest in China's VC industry and political economy. He trended on Douyin in the past year and is a huge nerd for Chinese rap music and mega-app platforms.