



**The Indus  
Entrepreneurs**



**Center for International  
Private Enterprise**

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*Draft Regulations for Private Equity and  
Venture Capital Funds*  
Business Policy Roundtable

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**PROGRAMME**

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| 10:00 a.m. | Registration & Tea   |
| 10:30 a.m. | Recitation from the Holy Quran   |
| 10:32 a.m. | Welcome by Moin M Fudda, Country Director, CIPE Pakistan   |
| 10:37 a.m. | Opening remarks by Ali Ansari, President,<br>TiE Karachi Chapter   |
| 10:45 a.m. | Key issues in the regulatory framework for<br>Venture Capital/ Private Equity<br>Sohaib Umar, Chairman Advocacy, TiE Karachi Chapter |
| 11:00 a.m. | Presentation by Christopher Lane Davis<br>Special Counsel, McCarter & English, LLP, USA  |
| 11:30 a.m. | Address by the Chief Guest, Mr. Salman A. Shaikh,<br>Commissioner, SECP  |
| 11:45 a.m. | Roundtable Discussions   |
| 1:00 p.m.  | Findings & Recommendations   |
| 1:15 p.m.  | Concluding Remarks by the Chief Guest  |
| 1:30 p.m.  | Lunch / Close  |

# *Draft Regulations for Private Equity and Venture Capital Funds*

## **Introduction**

Venture Capital and Private Equity (VC/PE) are globally established asset classes with an industry size of over US\$200bn and returns typically exceeding the public market returns. Venture capital and private equity offer multiple benefits to investors, companies seeking capital, and the economy at large. There is a direct link between a country's stage of economic development and the size and sophistication of its VC/PE industry.

The last ten years have seen the tide of VC/PE funds flow increasingly towards emerging markets such as China, India, Korea, and Brazil. Though Pakistan started late, the Securities and Exchange Commission of Pakistan (SECP) has been on the forefront in its efforts for the development of this sector and has notified draft regulations for the sector. After perusing the draft rules, the private sector is of the view that VC/PE will grow in Pakistan best if applicable global best practices are followed in developing a regulatory framework, instead of creating a completely new indigenous model or following regional examples from countries which are themselves still evolving in the sector.

The Business Policy Roundtable being jointly organized by the Center for International Private Enterprise (CIPE) and The Indus Entrepreneurs (TiE) Karachi Chapter on 24<sup>th</sup> October 2007 aims to provide a platform to the stakeholders such as VC/PE funds, investors, and the Securities and Exchange Commission of Pakistan, to discuss the draft regulatory framework and analyze it in light of international best practices.

In view of the significance of the subject, TiE has invited Mr. Christopher Lane Davis, an attorney and consultant specializing in matters relating to venture capital, private equity, and investment partnerships. He has been involved in the private equity and venture capital industry for over twenty years. Additionally, he has been a consultant on matters related to the venture capital and private equity industry to government agencies in the U.S. as well as in a number of emerging markets.

## **Definitions**

**Private Equity (PE):** Private equity is any type of equity investment by a third party (other than original promoters/sponsors) in an asset in which the equity is not freely tradable on a public stock market. The investment is primarily for growth, turnaround, buyout, start-up, or other purposes. The main objective is to unlock value from these businesses by increasing sales, reducing costs, balancing the capital structure, and enhancing their valuation by eventually selling them to another company or listing them on a stock exchange.

**Venture Capital (VC):** Venture capital is the name given to early stage and start-up investments. Venture capital is a subset of private equity, but has grown big enough in the last 20 years to become a separate asset class.

## **VC / PE in Pakistan**

The SECP introduced venture capital rules for the first time in 2001. Due to the non-existence of a limited liability partnership (LLP) structure in Pakistan, the rules adopted a company structure where the roles of general partner (GP) and limited partner (LP) were performed by the VC Company and the VC Fund respectively. Both the entities were granted income tax holidays for a limited time period (expiring in 2014) in order to offer them the same tax advantage as in an LLP model. Three companies have been licensed over the last six years under the 2001 VC rules.

### Regulatory Perspective

It is globally recognized that VC/PE is a high risk business; therefore, its growth potential can only be unleashed in an environment where a strong legal framework exists. Moreover, defining the extent of the regulatory regime within a country's legal framework is equally important.

In the U.S., the capital gain tax reductions in the 1970s allowed the VC/PE industry to take off. Since the U.S. is the largest and most successful market in the world in attracting VC/PE investments, other countries typically developed systems along the lines of the U.S. model. It was in the 1990s that emerging markets realized the economic benefits of having a robust VC/PE industry and started making necessary changes in their legal and regulatory frameworks to facilitate VC/PE growth.

Research shows that countries that have seen success in attracting VC/PE business are those that have adapted a minimal regulatory regime, favorable laws on fund formation and operation, favorable income tax treatment, little or no restrictions to institutional investors' fund investment, relatively developed capital markets (to facilitate exits), favorable laws on mergers and acquisitions (to facilitate buyouts), reasonable standards of corporate governance, a strong judicial system, and an open economy with a large private sector presence.

### Key Challenges for VC/PE Sector in Pakistan

The first venture capital fund was formed in Pakistan in 2002 under the present VC rules. A number of private equity initiatives have been announced by various local players in the last two years while some international and regional private equity funds have also started to look at possible entry into Pakistan. The country's economic growth favours the entry of focused PE and VC funds into the market. There are, however, serious challenges on political and regulatory fronts. It can be argued that a favourable regulatory framework could prove to be just the right catalyst to bring global names into Pakistan and to encourage more domestic players to launch VC/PE initiatives.

To identify the key issues, TIE and CIPE organized a focus group meeting on 11<sup>th</sup> October 2007 that was attended by M/S Athar Naseem Shaikh (AMZ Ventures), Farrukh H Khan (BMA Capital), Muhammad Sajid (JS Private Equity), M Akmal Jameel (Pakistan Private Equity Management Limited), Adil Matcheswalla (Speed Pvt. Limited) and Sohaib Umar (TMT Ventures Limited) in the VC/PE arena. Following is a broad list of key issues that the VC/PE industry actors in Pakistan would like to pursue with the Securities and Exchange Commission of Pakistan to assist the SECP in adopting a regulatory framework conducive to sector growth in the country.

- Consider adapting global best practices and structures while developing the regulatory framework.
- Objectives of developing the regulatory framework should be clearly defined, keeping in view the unique requirements of the VC/PE sector, which are different from mutual funds or investment banking sectors.
- The legal structure for the VC/PE sector should be developed based on a balance between international best practices and domestic laws.
- In accordance with international trends, restrictions on pension funds and insurance companies on investing in the VC/PE sector should be reconsidered.
- Since the Companies Ordinance is the governing law for VC/PE companies, the regulatory framework must comply with the existing legal framework.

- Internationally, a Fund Management Company (FMC) can be established with a capital investment of US\$ 100,000 or less. However, in Pakistan the minimum capital requirement for establishing a FMC is proposed at US\$ 4.2 million (PKR 250 Million) by the draft rules, which appears too high.
- Since FMCs operate on long-term contractual arrangements with investors, the requirement for renewing licenses on an annual basis should be reconsidered.
- Internationally, there is no minimum or maximum number of investors generally specified, and the proposed limits of 10 and 50 respectively should be reconsidered.
- Globally, the concept of charging a monitoring fee by the regulator is not in practice.
- The proposed rules are silent on a clear mechanism for transitioning existing VC funds/companies to the new rules.

While the SECP has received comments on the draft regulations, it is hoped that the roundtable will provide an opportunity for the Commission as well as the Private Sector Stakeholders to share their viewpoint and to provide feedback through an open dialogue to ensure sustainability and growth of this sector in Pakistan.

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*Center for International Private Enterprise (CIPE), is a non-profit organization, founded in 1983, and an affiliate of U.S. Chamber of Commerce, with its headquarters in Washington, DC, USA. Since its inception, CIPE has supported more than 1000 local initiatives in 100 developing countries, involving the private sector in policy advocacy and institutional reforms, improving governance, and building understanding of market-based democratic systems.*

*CIPE has also established a field office in Karachi, Pakistan, where CIPE's primary role is to support efforts to improve the business environment through advocacy and policy dialogue. CIPE also coordinate as well as assist in public outreach and educational programs that will provide materials on corporate governance, entrepreneurship & market economics to policymakers, educators, entrepreneurs, & the business community.*

*The Indus Entrepreneurs (TiE), was founded in 1992 in Silicon Valley by a group of successful entrepreneurs, corporate executives, and senior professionals with roots in the Indus region. There are currently 12,000 members in 45 chapters across 10 countries. TiE's mission is to foster entrepreneurship globally through mentoring, networking, and education. Dedicated to the virtuous cycle of wealth creation and giving back to the community, TiE's focus is on generating and nurturing our next generation of entrepreneurs.*

*Besides its flagship event, TiECon--the largest professional conference for entrepreneurs, TiE now has a wide range of programs including Special Interest Groups (SIGs), TiE Institute, Deal Flow Meetings, TiE Young Entrepreneurs, and, most recently, TiE Women's Forum and CEO Forum.*