

Theoretical overview on European and Kazakhstan Venture Capital

Mesut Yılmaz

Süleyman Demirel University, Almaty-Kazakhstan

Венчурлік капиталдың ұлттық экономиканың ұдайы өндірісіндегі функционалды ролі жобаларды жүзеге асыру жағдайларын қалыптастыруда екендігі дәлелденген. Соңғы екі он жылдықта венчурлік капитал нарықтарының бүкіл әлем бойынша кең таралғаны көрсетілген. Тәуекелдің жоғары болуынан инновациялық компаниялар дәстүрлі көздерден қаржы ала алмайтындықтан, венчурлік капитал көмегіне жүгінетіні айқындалған. Венчурлік қаржыландырудың дәстүрлі қаржыландыру түрінен айырмашылығы капитал иесінің жобаны жүзеге асырғанда кең құзыретке ие болатындығы пайымдалған. Венчурлік қаржыгер консультативтік, басқарушылық және басқа да іскерлік қызметтер көрсететіні, сондай-ақ жобаны жүзеге асуына араласатыны жөнінде қорытынды жасалған. Қазақстанда венчурлік капиталдың даму болашағы негізделген.

В статье раскрывается экономическое содержание венчурного капитала, который в отличие от банковского кредита предоставляется под перспективную идею. Доказывается, что функциональная роль венчурного капитала в механизме воспроизводства национальной экономики состоит в формировании условий для реализации проектов. Последние два десятилетия рынки венчурного капитала широко распространились по всему миру. Автор отмечает, что инновационные компании из-за повышенного риска не могут получить финансовой поддержки из традиционных источников и поэтому прибегают к помощи венчурного капитала. В отличие от традиционного венчурное финансирование предполагает широкие полномочия владельца капитала при реализации проекта. В статье делается вывод о том, что венчурный финансист оказывает консультативные, управленческие и прочие деловые услуги, а также может вмешиваться в процесс реализации проекта. Обосновываются перспективы развития венчурного капитала в Казахстане.

1. Venture Capital

Venture capital is a significant source of funding for start-up and small and medium sized enterprises (SMEs) that have a limited operating history. There is no access to capital markets for SMEs. A venture capital firm (VC) typically looks for new and small businesses with a perceived long-term growth potential that will result in a large payout for investors. The formation and growth of small and medium sized enterprises is recognized as one of the most important factors for economic growth. Access to equity capital (Venture capital) is often emphasized as a critical conditions for SMEs and new venture start-ups to be able to pursue growth opportunities.

Because of a limited life history and a lack of steady cash flows, young firms that are in the beginning of a growth phase often have problems accessing traditional debt capital. Financing the firm with the capital of the entrepreneur is generally not an alternative because these resources are usually either already used or too small. Furthermore, fast developing new firms can seldom compound the capital needed for fast development themselves. Finally, equity financing is a more suitable way of financing growing young firms' investments and expansions than is debt, because the latter has the disadvantage of increasing a firms' financial risk (mainly due to amortizations and interest rates). The difficulties of finding growth capital for entrepreneurial firms are often referred to as the equity gap.

Besides the equity gap, small firms with high growth potential also tend to suffer from a competence gap. The development from idea to mature company increases the complexity of firm management and constantly raises new demands on the management of the firm. It is by meeting the need for capital and competence that the venture capital market has found its niche. The ability to bridge these competence gaps is in fact a prerequisite for the existence of the venture capital market.

Venture capital firms are firms that are specialized in co-investing equity with the Entrepreneur to fund an early stage (seed and start-up) or expansion venture. Doing that implies that they need not only to contribute with growth capital, but also with the necessary competence to help the entrepreneurial firm to grow.

The well-known successes of venture capital supported firms have given the U.S. venture capital model an international reputation that other countries seek to emulate. The North American venture capital industry has played a major part in developing several of the most successful American companies, such as Microsoft, Apple and Intel. Bygrave and Timmons emphasized the importance of the venture capital industry: «Venture capital has played a catalytic role in the entrepreneurial process: fundamental value creation that

triggers and sustains economic growth and renewal. In terms of job creation, innovative products and services, competitive vibrancy, and the dissemination of the entrepreneurial spirit, its contributions have been staggering. The new companies and industries spawned by venture capitalists have changed the way [in] which we live and work.»

Over the last two decades, venture capital markets have emerged widely around the world. The European venture capital market is today not far from the size of the U.S. venture capital market. According to recent statistics from the European Venture Capital Association (EVCA) nearly €15 billion was invested by venture capital companies located in Europe in 2005 (EVCA, 2006).

2. Venture Capital Investment Process

There have been venture investments that have been incredible successful such as Apple computers, Tandem and Genetech. These investments achieved in excess of 100-folded returns when they went public. There have been spectacular failures too. Cases where venture capitalist have been unwilling to write off a loss and continued to throw good money. Evidence show that failing venture investment are more likely than unlikely. Out of the more than 400 US venture capital companies, only the top 50 or so are very successful. Nethless to say, the venture business is not an easy business. Venture firms has recognized this precarious situation of their investments and as a result they take their time in collecting as much information as possible to make better decisions. Taking it from the top, the venture firm investment process starts with deciding if they will invest or not. They basically only have two alternative ways to go; either invest or not invest. This utterly simple way of thinking is displayed in the below figure and the resulting outcomes;

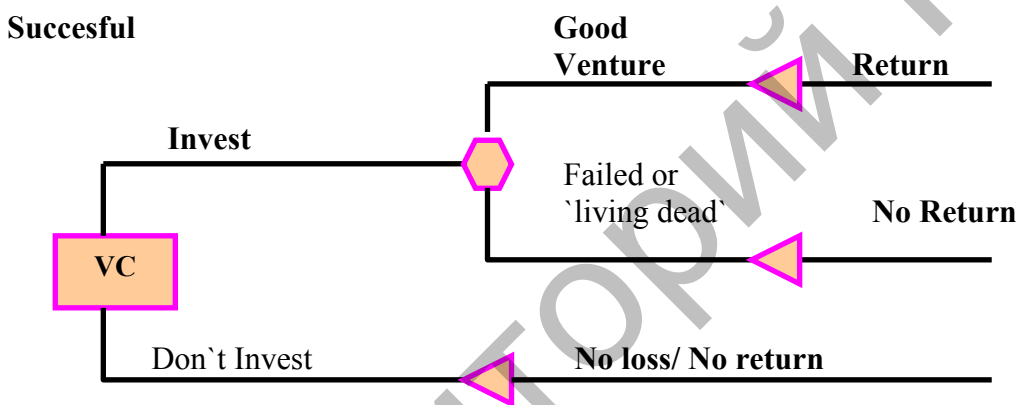


Figure 1 Venture capitalists decisions (Zacharakis and Meyer, 2000)

The preferable outcome would obviously be to invest in a successful venture that provides the venture capitalist with good returns and capital gains. The worst case scenario, on the other hand, would be to have a failing venture that offers no return. The venture capital firm will basically lose all or at least a big part of their investment capital. So the venture capitalists have to be really careful and cautious to avoid this pitfall. How does the venture capital firm make their decisions in regards to their investments? Fichera (2001) states that venture capitalists follow a specific process known as the VC process in making their decisions. The VC process is as follows;

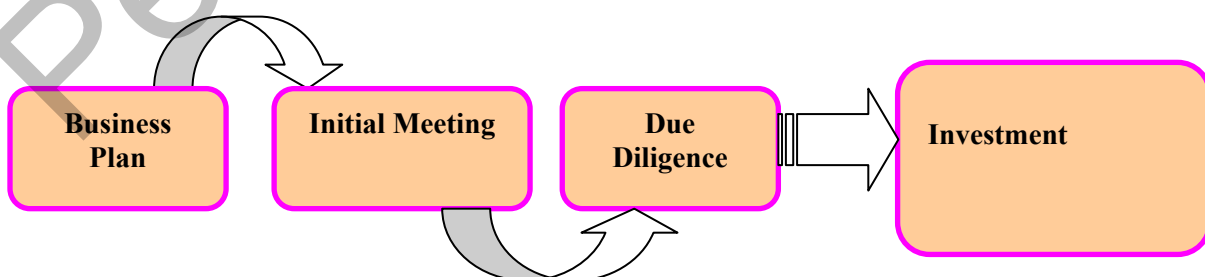


Figure 2 The VC process (Fichera, 2001, p. 292)

The first step in the VC process is screening business plans, followed by a personal meeting with the entrepreneur and then the conduct of due diligence. Due diligence is the procedure of verifying the facts about the company under investigation. It could include interviews with key personnel, suppliers, customers, competitors, thorough review of relevant document, visit to the factory and so on. The purpose is to achieve a complete understanding of the company, its past, present and future as seen from every possible perspective. It is a drawn out process that normally takes several months to complete. To receive funding new ventures must pass the initial screening; review of the business plan.

3. Venture Capitalist (Risk Taker)

The most striking aspect of the investments to venture capitaling is the risk taken. Since more return is associated with more risk it is very natural for the venture capitalists to take the risk. That is why there have been several studies on the risk aspect of such investments. Although different studies suggested different classifications of the risk component many of them are mentioning similar points. For instance Gupta, Chevalier, and Dutta (2003) have worked on the the following categories of risk: promoter, product, technological, marketing, financial, implementation (operational), organisational, strategy and environmental. Other types of risks can be classified into one of the stated categories. Any one of these components may lead to the collapse of the whole project or may threaten the success of the venture capital.

There are many stochastic processes that can provoke these categories and all of them must be observed and analyzed carefully and completely. The factors that can be manipulated (endogeneous) should be under control throughout the whole process. All these steps require the cooperation of the venture capitalist and the entrepreneur. The venture capitalist should have the advantage of stage-financing to leave the project with the loss incurred on one side, but on the other side innovators must be offered some incentives to initiate such projects. After all, there are many projects coming to the minds of the experts in numerous sectors and industries but the realizations of the projects is very hard. This requires some management teams that have to work for several years efficiently. The projects invested will seldomly yield huge amounts of profits and some will leave the venture capitalist and the entrepreneur with loss of money, energy, and hope. But the overall picture reveals that the total return out of such businesses is much higher than the total cost incurred.

Another point to mention is the expertise of the venture capitalists to select the projects to invest. The venture capitalist deviates from the ordinary investor in that the venture capitalist provides assistance in some processes of business like marketing, management, and financing, Venture capitalist has to keep an eye on the projects advancement to intervene immediately.

Another potential risk that must be taken by the venture capitalist is moral hazard. Since the objectives of the venture capitalist and the entrepreneur may be different, contracts must be designed and the mechanisms must be designed properly to prevent the moral hazard to both sides. Different versions of this problem are analyzed by game theorists many times and the case can be handled by a double-sided moral hazard due to the asymmetric information. The relationship between the two sides resembles the conflicts of the interest between the agent and the principal. Game theory has introduced some very handy mechanisms to the literature that can be adapted to contracts between the principal (the venture capitalist) and the agent (entrepreneur). The financial contract has to be arranged in a way to guarantee the optimal behavior of the entrepreneur.

4. Conclusion

In Kazakhstan, Joint Stock Company 'National Innovation Fund' was established according to the Resolution of the Government of the Republic of Kazakhstan as of May 30, 2003 with one-hundred per cent participation of the government in its authorized capital.

Between 2003–2006, the amount of venture capital used (in million \$) was 640 in Kazakhstan. The number of projects was 10. And the share of the National Innovation Fund's share is 81.2 million \$.

Looking ahead, the Innovation Fund is currently engaged in negotiations to buy a foreign high-tech company. With a ten-year strategy for the National Innovation System, 2005–2015, the Fund is fully committed to promoting economic diversification in Kazakhstan.

As Kazakhstan sets its compass towards rapid entry into the ranks of the world's fifty most competitive countries, the National Innovation Fund and the National Innovation System, whose strategy NIF follows, are essential elements in attaining this goal within the allotted time-period. Under vigorous leadership, with expert advice and guidance from Kazakhstan's scientific and technological community, NIF hopes to fulfill its mandate to promote and support the growing sophistication of the country's scientific and industrial pro-

duction. To date, its choice of projects has been good — a standard the Fund aims to maintain unwaveringly in the future.

The Kazakhstan has to create many new jobs. The advancement of venture capital in Kazakhstan is therefore charged a very critical role.

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