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VENTURE CAPITAL FINANCING: PARTICULARITIES AND OPPORTUNITIES

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ABSTRACT

Venture capital is a way of financing generally used to support companies and small business enterprises and innovative enterprises. It is becoming a very popular source of capital for new companies or enterprises that do not have access to capital markets, bank loans or other credit instruments. Venture capital provides financing during the various stages of the company's life cycle. For the small and medium sector, venture capital financing is one of the most accessible and efficient.

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Introduction. In recent years, venture capital financing is one of the well-known modern ways of financing, especially in the USA and the European countries, for the financing of small and middle innovative enterprises. This modern way of financing small business has its origins in the United States of America (USA) from about the 50-s of the XX-th century after what it gained popularity and spread to European countries as well.

The term "venture capital" means the financing that investors give to start-ups and to small innovative businesses, which that represents a long-term success potential. The source of funding in this case comes from investors, investment banks and other financial institutions.

Venture capital, as mentioned in studies in this field, can take both monetary and non-monetary form, such as for example the managerial practice or technical expertise. American and European practice have shown that venture capital funding has had a beneficial impact on innovative start-ups with potential for quick development. The areas of success of venture capital financing are related to the field of advanced technologies and IT.

Obtained results. Venture capital is a modern financial instrument, widely used in international economic practice, for the financing of a start-up business, its development or redemption by the investor when restructuring the property. The notion of venture capital was "borrowed" in the Romanian economic language from English, hence the name "capital venture" which implies the presence in the investor-entrepreneur relationship of the element of "adventure" and risk [1, p. 101]. Studies carried out in the field of financing through venture capital, as well as according to some authors such as Erhan L., Dumitrescu V., Kotelnicov V., Stefanova Iu., highlight a number of common features of this financing, such as:

- venture capital is directed to small enterprises and those with advanced technologies, which are oriented towards the elaboration of innovative market projects;
 - venture capital is granted on a medium and long term and cannot be withdrawn before the accomplishment of the project;
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- The investments are made in companies whose shares are not listed on the market yet, but still represent a growth potential;

- venture capital financing is usually carried out for a period of 5-7 years, with priority given to innovation companies with a clear growth potential, but which still do not show considerable profits in their activity;

- venture capital is primarily intended to support non-traditional and original ideas on the market, which on the one hand increase the risk and, on the other hand, offer a competitive advantage.

Risky investments for IMM-s play the role of a catalyst, which attracts also other types of investments, after the initial ones have been justified and capitalized already by the of increasing sales revenues, profitability, expanding the sales market, etc. [1, p.102].

According to Robinson and Van Osnabrugge, Venture Capital is the financial capital provided to young and innovative companies, where both risks and potential returns are increased. The venture capital offered by business angels tends to be more speculative and earlier than that traditionally offered by the formal venture capital industry [2].

The studies conducted by the Organisation for Economic Co-operation and Development (OECD) characterise the development of the venture capital industry as an important framework condition for fostering innovative entrepreneurship [3]. The main features of venture capital, as presented by the Organisation for Economic Co-operation and Development, are [3]:

- ✓ The risk is divided between the venture capital fund and the entrepreneur;
- ✓ The period for which the investment is made is usually between 3 and 7 years;
- ✓ Investors are strategically involved in business development, advising entrepreneurs in order to maximize long-term return on investment;
- ✓ Before the financial analysis of the investment, investors evaluate the market in which the company operates, the strategy and the management team;
- ✓ This category of investors is not primarily aimed at obtaining gains from the distribution of dividends, but at the gains that can be achieved on the exit from the investment. At this last stage, the company is listed on the stock exchange or sold to another investor.

Regarding the international practice on venture capital financing, a distinction can be made between two aspects, totally different in this field, the European practice and the American practice of venture capital financing. The main features of a venture capital investment in Europe are [4]:

- Average investment of 2-3 million Euros;
- Long-term financial investment (investment time horizon of 10-15 years);
- Non-liquid assets (barriers to exit without a transferable market);
- Active participation to help start-ups in the growth phase;
- Predicting a high return on investment due to a high risk and/ or a strategic interest;
- Payment of a fee to the investment manager (20% of the investment);
- Specialized skills and dedicated management team.

Venture capital funds can either invest exclusively in companies in the country where they are registered or have a multinational dimension. By 30 June 2018, 42% of venture capital funds supported by the EU had a multinational dimension. Regarding the amounts invested in enterprises by venture capital funds supported by EU, studies show that Member States that were attractive for venture capital benefited the most from EU intervention instruments. France, Germany and the United Kingdom stand out, as they represent 50% of these investments. As these are the Member States with the largest economies in the EU, such a concentration does not help to encourage a European venture capital market. Until the first half of 2018, none of the EU-backed and centrally managed venture capital funds have invested in Cyprus, Malta, Slovenia or Slovakia, whereas in Bulgaria, the Czech Republic, Hungary, Poland and Romania, limited investments were made, in a total volume of 29 million Euros [4].

Venture capital financing initially involves research into the area in which it will be invested afterwards. This is determined by the fact that venture capital involves the investment of larger amounts of money in fewer companies, this basic research being very important. Most venture capital professionals have had previous experience, often being capital research analysts; others have a Master of Business Administration degree (MBA). Venture capital professionals also tend to focus on a particular industry. A venture capitalist that specializes in healthcare, for example, may have previous experience as healthcare analyst.

After the examination of the type of the company in which the investment is to be made, the company or investor will use the financing. These funds can be provided simultaneously, but subsequently the capital is given in tranches. The undertaking or investor then takes an active role in the company which receives financing, to consult and monitor the progress before releasing additional funds. After a period of about five – six years after the initial investment, the investor leaves the company, starting a merger, acquisition or initial public offering. Venture capital is also a way in which the public and private sectors can build an institution that systematically creates business networks for new companies and industries so that they can progress and develop. This institution helps identify promising new companies and provides them with financing, technical skills, consultancy, marketing know-how and business models. After the integration into the business network, these companies are more likely to succeed, as they become "nodes" in search networks for product design and construction in their field [5, p.62].

Venture capital funds are investment funds that manage the money of investors who seek private equity in small- to medium-sized enterprises with strong growth potential. These investments are generally characterized as very high-risk and high-return opportunities. Venture capital is a type of equity financing that gives entrepreneurial or other small companies the ability to raise funding. Venture capital funds are private equity investment instruments that seek to invest in firms that have high-risk and high-return profiles, based on a company's size, assets, and stage of product development. Venture capital fund seeks private equity investments that have the potential of generating large positive profits for its investors. This normally means the fund's manager or managers review hundreds of business plans in search of potentially high-growth companies. The fund managers make investment decisions based on the prospectus and the expectations of the fund's investors. After an investment is made, the fund charges an annual management fee of about 2% [5, p.40].

In Romanian legislation, some references are made to the term venture capital fund. Thus, venture capital funds can be defined as undertakings for the collective investment in transferable securities, which mobilize financial resources from private, Romanian or foreign persons. According to the regulations from the field of venture capital financings, "the venture capital fund is an undertaking for the collective investment in transferable securities, set up as a closed-end fund or as an investment company, by mobilizing financial resources from individuals or legal persons, persons under private law, Romanian or foreign persons"[6, art.2].

Practice has shown that venture capital funds make a decisive contribution to the professionalization of funded small and medium-sized start-up enterprises. They can also impose direct management control and can often require top management changes. According to data presented in a study conducted in Romania in the field of venture capital financing, venture capital funds usually focus only on a few industries: digital economy (Information and communications technology (ICT), internet, electronics), health sector (biotech, medical technologies, life sciences). In the ICT sector, software accounted for 70% of venture capital funding. The preference of venture capital for consumer services and ICT can be explained by immediate and direct contact with the consumer, which allows for quick feedback on the possibility of the investment yielding rapid results. Although it can be risky for investors, the above-average return associated with these investments is an element of increased attractiveness. For new companies or enterprises with a limited operating history (less than two years), venture capital financing is becoming increasingly popular - even essential - for raising capital, especially if they do not have capital market access, bank loans or other financial instruments. The main disadvantage is that investors usually obtain shares or stocks in the company, so they can influence the decision-making flow of those entities.

Various studies show that 67% of investors consider a priority the management team being capable of carrying out a sustained effort; 67% of investors also consider the management team's knowledge of the market as a priority; 31% of investors consider the leading skills of the entrepreneur to be the priority and, somewhat surprisingly, only 28% consider investment returns to be the main success factor [5, p.74].

The basic objective for innovative start-ups is to find a capital investor able to support the beginning of the business with large amounts of money, and this criterion is best fulfilled by the venture capital fund. This type of capital is attractive for small, new companies, which are unknown on the market, unable to raise this capital on the market or through bank loans. Although there are several possibilities and models for financing start-ups, including Business Angels or acceleration/

improvement programs, venture capital has proven to be more appropriate for this type of entrepreneurship.

Research in this field has shown that venture capital often includes financing for small businesses, which are in the start-up phase and with potential growth and development in the future. Venture capital financing stimulates economic growth through the creation and expansion of innovative businesses; new jobs are created; investing in research and development is increased and entrepreneurship, competitiveness and innovation is supported. International practice highlights venture capital financing as one of the most advantageous and efficient forms of support for small and medium-sized enterprises in the market penetration phase.

During the last 5 years, over 122 billion US dollars have been invested in European start-ups. 2019 is a record year for European start-ups, companies have collected over 36 billion US dollars, which is a maximum for the last 5 years, or about 7 billion US dollars more than in 2018. The annual increase in venture capital financing in the period 2015-2019 constituted 25%. Starting with 2015, the volume of funds collected by European start-ups has practically increased twice.

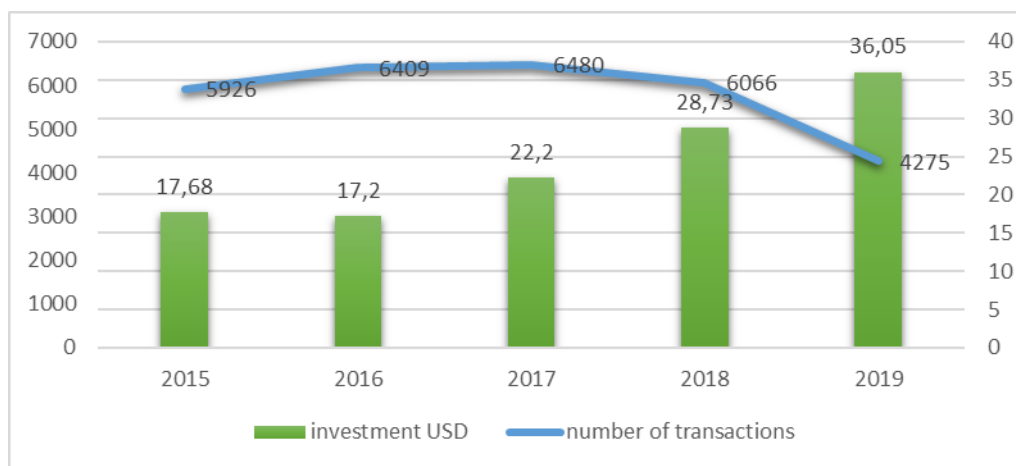


Fig. 1. The volume of investments in European start-ups and the number of transactions in the period 2015-2019 [7]

From Figure 1, we can see the doubling of venture capital financing over the period 2015-2019, i.e. a significant increase from USD 17.68 billion in 2015 to USD 36.05 billion in 2019. At the same time, the number of transactions by which venture capital was insured increased slightly over the period 2015-2018, from 5926 to 6066 in 2018. For 2019, the number of transactions decreased to 4275. According to these data we can found that, even if the number of transactions decreased, a higher level of volume of financing was ensured, being guaranteed the needs to be financed for the applicants.

As is well known, the world leaders in venture capital financing are the USA, followed by China. Despite the fact that the European continent has much lower comparative values than the two world leaders, in recent years there has been a considerable increase in venture capital financing in this area, especially in northern Europe. The leader of northern Europe is the United Kingdom. Sweden, which is part of the countries from northern Europe, ranked fourth in 2019. Western Europe received USD 14.9 billion in funding in 2019 [7]. The top three leading countries in this regard are Germany, France and Switzerland, which are among the top six countries in terms of volume and number of funding.

Figure 2 shows that the largest share of venture capital financing in Europe is approximately 51,7% for northern Europe, where the volume of financing in the 2014-2019 period rose 3,5 times, i.e. from USD 5,84 billion in 2014 to USD 18,63 billion in 2019. Western Europe has a share of about 41,4%, registering an increase of about 3 times in the period 2014-2019, from USD 5.59 billion in 2014 to USD 14.93 billion in 2019.

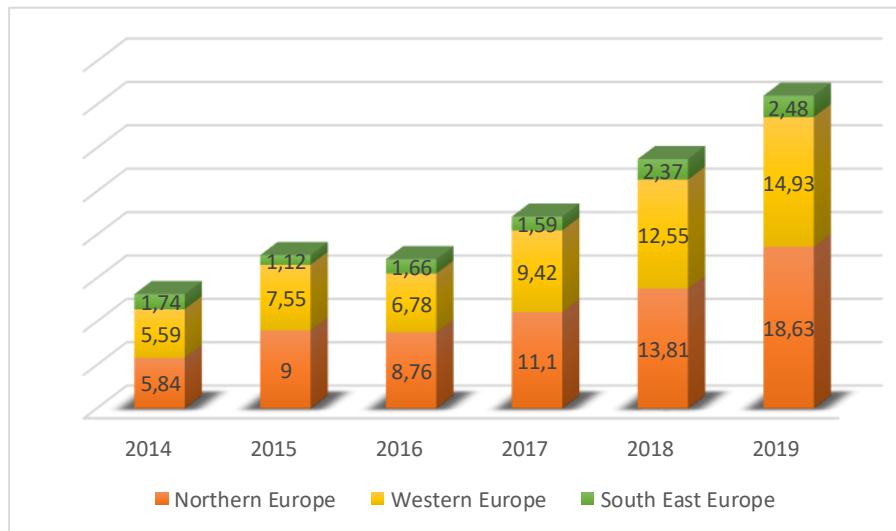


Fig. 2. Evolution of the volume of financing through venture capital in the European space in the period 2014-2019 (billion USD) [7]

Southeast Europe has the lowest share of 6.88% in the European area with a volume of USD 2.48 billion in 2019, which increased in the period 2014-2019 only 1.4 times.

The top 10 leading countries in the field of venture capital financing is represented in Figure 3. The United Kingdom ranks first in the top of the first European countries in the field of venture capital financing, registering thus 1425 transactions in a total volume of USD 14.31 billion, which constitutes 40% of the European market. The second place belongs to Germany with 444 transactions in the volume of USD 6.65 billion, which constitutes 18% of the European market. France ranked third with 425 transactions in the amount of USD 4.39 billion [7]. The next countries in the ranking are Sweden with 278 transactions, Spain with 270 and Switzerland with 246.

Today, there are successful companies, such as Shazam, Spotify, Monitise and Seatwave, with capitalisations of more than EUR 100 million [5, p.138]. There are also venture capitalists who have made very profitable exits from the companies in which they have invested, very significant examples in this regard being Autonomy and Skype, brands that have become important business entities for their buyers.

One of the most important players in the European venture capital market is the European Investment Fund (EIF). In 2018, the EIF signed agreements with venture capital funds committing to invest EUR 1.4 billion. The EIF supports financial intermediaries that provide financing for small and medium-sized enterprises (SMEs) across Europe. Its main shareholders are the European Investment Bank (EIB) (58.6% of the capital), the EU, represented by the European Commission (29.7%), and other stakeholders, including public and private banks and financial institutions 18. The EIF implements venture capital intervention instruments primarily on behalf of others, such as the EU, the EIB (under the Risk Capital Resources (RCR) mandate), national or regional authorities and private investors [4].

In the historical context and in order to move to a pan-European venture capital market, the European Union adopted in 2013 a Regulation on European venture capital funds (No 345/2013). It sets out a new label on the "European Venture Capital Fund" and includes new measures to allow risk investors to trade their funds across the EU, based on a unique set of rules. This setting includes unchangeable requirements and conditions for managers of collective investment undertakings wishing to use the name "EuVECA" regarding the distribution of eligible venture capital funds in the Union, thus contributing to the proper functioning of the internal market [5, p.138]. The Regulation provides permanent rules on the distribution of eligible venture capital funds to eligible investors in the Union; the structure of the portfolio of eligible venture capital funds; the eligible investment instruments and techniques to be used by eligible venture capital funds, as well as the organization, conduct and transparency of the managers of eligible venture capital funds. According to that Regulation, the administrators of the fund with eligible risk capital shall ensure that, when purchasing assets that are not eligible instruments, the part of the total capital contributions and unpaid working capital used for the acquisition of such assets does not exceed 30%. The 30% of limited value is calculated based on the amounts that can be invested after deducting all relevant costs. Holdings of

cash and cash equivalents are not taken into account in calculating this limit, as cash and cash equivalents should not be considered investments. The managers of the eligible venture capital fund shall not use any method at regarding to the eligible venture capital fund that would increase the fund's exposure above its committed capital, either by borrowing cash or securities, or by engaging in positions related to derivative financial instruments or by any other means. The purpose of this ordinance is to label the "EuVECA", to increase the growth and innovation of small and medium-sized enterprises in the EU. With aims as important as these, the label was designed to be an important tool for achieving the goals set for the Europe 2020 strategy, adopted in 2010.

Conclusions. Venture capital financing is still a new method borrowed from the US and successfully developed in recent years in European countries. For the Republic of Moldova, as for other Eastern European countries, this possibility of financing remains less known and developed. International practice highlights that the transition of a company from the initial stage to the extension can be achieved through direct investment. So, among the most common forms of financing in this regard can be achieved only through venture capital. The purpose of venture capital investors is common, and presumes investing in the form of share capital in start-ups, in order to make a profit from the development of the enterprise and its sale to other strategic investors after a certain period of time.

Many of the structural factors that can either boost or limit venture capital in Europe are still largely the prerogative of the Member States. For example, national tax laws may hinder the development of the venture capital market, those governing business and employment may restrict the recruitment of staff, and the regulatory framework can diminish investor's wish to risk and may limit fundraising.

Venture capital can be described as targeted capital in the form of long-term direct investment, in unsafe companies, which are in the transition stage. The given investments have the role of stimulating innovative projects, know-hows as well as new forms of business. Investments are made by venture capital funds considered professional participants in the capital market, which manages the money of people and large companies. The capacity of these investments can vary between 5 and 20 million dollars [8, p.52], and investments less than these amounts are not taken into account, due to the high administrative costs incurred by venture capital funds. Apparently, not all companies are prepared for this type of capital; one reason would be that not everyone has the experience of business angels. With regard to venture capital funds, we can mention their considerable support for entrepreneurs, helping them find development partners, suppliers and strategic customers, as well as professional managers and specialists. The basic investment of a venture capital fund is not made in equipment or products, but in the people who promote the project, in the management of the company.

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