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Possibilities of using of the venture capital as an innovative instrument in conditions of the Slovak republic in the competence of the National Agency for Development Small and Medium Enterprises

The contribution describes the venture capital as an innovative instrument used in the Slovak republic. Basic characteristic of venture capital presents its advantages and disadvantages, as well as describes the existing venture capital funds in the Slovak republic and the venture capital programmes are given in the first part. Hereby, the contribution describes monitoring of development of venture capital investments in the Slovak republic in the competence of the National Agency for Development Small and Medium Enterprises. Finally, the paper presents possibilities as we can improve availability of the venture capital in our conditions.

Introduction

The venture capital is a fund which invests own capital into unlisted companies by investor, as well as partnership of enterpriser and investor. It is a fund used to finance the start of the company. The venture capital is used for development of a company. Investor of the venture capital provides some amount of financial capital. Hereby, investor acquires an agreed proportion of own capital of a company. In the present time, venture capital is one of the new alternative forms of a company financing, but still not very often using form of financing in practice. The importance of using of the venture capital is increasing. Although it is always considered as very risky financial instrument and its using is minimal in conditions of the Slovak republic. The venture capital has big importance mainly within the development of small and medium enterprises.

Basic characteristics of the venture capital, its advantages and disadvantages

The venture capital is provided by professional companies investing into enterprise handling potential of significant growth for purposes to start operations, development or transformation ownership.

The venture capital is:

- Investors put money into the own capital of companies whose shares are not registered and traded on the stock exchange,

- Means to finance the start of companies operations, its development or expansion, when venture capital investor enters into an agreed share of the own capital of a company for its provide a certain amount of financial capital,

- The newly emerging companies - setting up a joined company with a cash contribution to basic capital of the venture capital company¹.

The venture capital is a type of private equity finance involving investments in unquoted companies with growth potential. It is generally medium to long term in nature made in exchange for a stake in a company. The term a venture capital is likely to be accepted as the generic term for business angels, mezzanine equity, institutional or any similar investments in early stages of business².

Primary investors of the venture capital are following:

Business angels,

Dependent, semidependent and independent investors,

Government supported organizations.

Possibilities of the venture capital financing:

1. Seed capital - the completion of a research, development and verification of initial concept and business plan before start-up position is achieved by enterprise,

2. Start-up capital - financing provided companies to develop and finalize production of a product or service and initial marketing. Enterprises may be in the establishment phase (this is a new business) or enterprises that have already been established, but do not sell their products or do not provide their services regularly on a commercial basis,

3. Other early stage – enterprise has completed a development phase of the product or service and requires further financing to start commercial production for the purposes to achieve early sales, a company has not had to make a profit yet,

4. Development, expansion - financing provided for the purpose of growth and development already production enterprise, irrespective of whether they have reached the breaking point or not, the investment goes to the expansion of production, development of market potential, further development of a product or service, possibly in extending working capital¹.

Using of the venture capital as an innovative finance instrument has some advantages and disadvantages.

Advantages of the venture capital:

One of the possibility strengthening of capital which is owned by an enterprise,

Means of ensuring growth of an enterprise,

¹ THE NATIONAL AGENCY FOR THE DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES: <http://www.nadsme.sk/content/rizikovy-kapital> [cited 2011-02-16]

² DAGOGO. D. W., OLLOR. W. G. The effect of venture capital financing on the economic value added profile of Nigerian SMEs. African Journal of Accounting, Economics, Finance and Banking Research Vol. 5. No. 5. 2009. p. 41. Available online < http://www.globip.com/pdf_pages/african-vol5-article2.pdf>

Enterprise does not pay interest or payments,

Expansion of a business cooperation,

Disadvantages of the venture capital:

Increase of number of owners,

High risk for investors, as well as owners of enterprise,

Main sources of venture capital are considered individuals, banks, governments, universities and pension funds³.

Programmes of the venture capital

The concept of the venture capital was designed in year 2005 (the venture capital focused on development of small and medium enterprises). The National Agency for Development of Small and Medium Enterprises approved Conditions of realization and focus of the Venture capital Programmes on 28 February 2006⁴.

The National Agency for Development of Small and Medium Enterprises established following venture capital funds till year 2006⁵:

a) Start-up Capital Fund

Start-up capital fund was established on the basis of the Seed capital programme in 1995. It was financed by the PHARE and then by the state budget. Fund was managed by the Seed Capital Company established by National Agency for Development of Small and Medium Enterprises. Fund is dedicated to support small and medium enterprises within the overcome deficiency of seed and development capital by providing the venture capital. Seed Capital Company was renamed as Fund of Funds in 2006. Minimum amount of investment in EUR is 6 639, maximum amount of investment in EUR is 663 878 and preferred amount of investment in EUR is in the range 199 166 - 265 551. Scope of financing is preferably in the range 10 – 40 %.

b) Regional Start-up Capital Funds

It was created in 2003. Fund is intended for the development of small and medium enterprises in Banská Bystrica, Zilina, Košice and Prešov regions. This fund differs from Start-up capital fund by the geographical acceptability of projects and size of investment. Minimum amount of investment in EUR is 6 639, maximum amount of investment in EUR is 165 970 and preferred amount of investment in EUR is in the range 66 388 – 99 582. Scope of financing is preferably in the range 10 – 40 %.

c) INTEG Fund

It was established for the purpose to support innovative projects in 2005. It is the venture capital for enterprise involved in the technological incubators in Bratislava and Inova Tech in Sladkovicovo. Minimum amount of investment is undefined, maximum amount

³ BALÁŽ, V.: Trendy vo financovaní inovácií v Európskej únii, In: Ekonomický časopis, 2000, č. 5, s. 559 – 582. Bratislava: SAV, ISSN 0013-3035

⁴ FOND FONDOV: FONDY RIZIKOVÉHO KAPITÁLU: <http://www.fondfondov.sk/> [cited 2011-03-07]

⁵ 3ON PRIVATE EQUITY: <http://www.3on.sk/fondy.html> [cited 2011-02-16]

of investment in EUR is 132 776 and preferred amount of investment in EUR is in the range 16 597 – 33 194. Scope of financing is preferably in the range 10 – 40 %.

d) SISME Fund

It is newly established fund opened at the end of 2005 together with the INTEG fund. Its resources are to be used for innovative projects from the area of industry production, production and trade services and new technologies from all over Slovakia. Minimum amount of investment is undefined, maximum amount of investment in EUR is 165 970 and preferred amount of investment in EUR is in the range 66 388 – 99 582. Scope of financing is preferably in the range 10 – 40 %.

e) Development Fund for Small and Medium Enterprises

National Agency for Development of Small and Medium Enterprises established following Funds of the venture capital through Fund of Funds within the implementation of the venture capital programme:

- Seed Capital Fund,
- Slovak Start-up Fund,
- Slovak Development Fund.

Minimum amount of investment within the Seed Capital Fund in EUR is 6 639, maximum amount of investment is unlimited and preferred amount of investment in EUR is in the range 99 582 – 165 970. Scope of financing is preferably in the range 10 – 40 %. Minimum amount of investment within the Start-up Fund is undefined, maximum amount of investment in EUR is 1 659 696 and preferred amount of investment is undefined. Scope of financing is preferably above 25 %. Minimum amount of investment within the Slovak Development Fund is undefined, maximum amount of investment in EUR is 3 319 392 and preferred amount of investment is undefined.

Table no. 1 Overview of the venture capital programmes

Venture capital funds	Minimum amount in €	Maximum amount in €	Preferred amount in €	Scope of financing
Start-up Capital Fund	6 639	663 878	199 166 - 265 551	10 – 40 %
Regional Start-up Capital funds	6 639	165 970	66 388 - 99 582	10 – 40 %
INTEG Fund	undefined	132 776	16 597 - 33 194	10 – 40 %
SISME Fund	undefined	165 970	66 388 - 99 582	10 – 40 %
Seed Capital Fund	6 639	unlimited*	99 582 - 165 970	10 – 40 %
Slovak Start-up Fund	undefined	1 659 696	undefined	preferably above 25 %
Slovak Development Fund	undefined	3 319 392	undefined	minority stakes (at min.25%), majority stakes

* maximum amount of investment was dissolve in year 2009 in keeping with average amount of investment 663 878 €

Source: “Fond fondov, s.r.o.”, own elaboration

Table no. 1 contains overview of the basic information within the venture capital programmes relating to the minimum, maximum and preferred amount of investments in EUR, as well as scope of financing.

Table no. 2 Overview of the acceptable and unacceptable financing area within the venture capital funds

Venture capital funds	Acceptable financing area	Unacceptable financing area
Start-up Capital Fund	Industry, production services, innovative enterprises, active tourism	Agriculture primary production, farming, production of weapons, alcoholic beverages, operations of gaming-houses, passive tourism, wholesale and retail sale
Regional Start-up Capital funds	Industry, production services, innovative enterprises, active tourism	Agriculture primary production, farming, production of weapons, alcoholic beverages, operations of gaming-houses, passive tourism, retail sale
INTEG Fund	Innovative projects within the industry, production and business services area and new technologies	Agriculture primary production, farming, production of weapons, alcoholic beverages, operations of gaming-houses
SISME Fund	Innovative projects within the industry, production and business services area and new technologies	Agriculture primary production, farming, production of weapons, alcoholic beverages, operations of gaming-houses
Seed Capital Fund	Unlimited	Agriculture primary production, farming, production of weapons, alcoholic beverages, operations of gaming-houses, passive tourism
Slovak Start-up Fund	Small and medium enterprises	Agriculture primary production, farming, production of weapons, alcoholic beverages, operations of gaming-houses, passive tourism, wholesale and retail sale
Slovak Development Fund	Small and medium enterprises	Speculative investments in selected asset classes, investment in operating gambling

Source: "Fond fondov, s.r.o." own elaboration

Table no. 2 is focused on acceptable and unacceptable financing area within the existing venture capital funds. The most acceptable financing areas are industry, production and business services, new technologies, innovative enterprises, active tourism and in the case of Slovak Start-up Fund and Slovak Development Fund it is small and medium enterprise. Seed Capital Fund is unlimited. Excluded are investments within the agriculture primary production, farming, production of weapons, alcoholic beverages, operations of gaming-houses, passive tourism, wholesale and retail sale, speculative investments in selected asset classes and investment in operating gambling, but it depend on type of venture capital fund.

Table no. 3 Overview of suitable financing stages, investment period and geographical eligibility within the Venture Capital Funds

	Venture capital funds						
	Start-up Capital Fund	Regional Start-up Capital funds	INTEG Fund	SISME Fund	Seed Capital Fund	Slovak Start-up Fund	Slovak Development Fund
Suitable financing stages	seed, start up, development	seed, start up, development	seed, start up	seed, start up	seed	start up, development	start up, development
Investment period in years	flexibile 1- 5	flexibile 1- 5	flexibile 1- 5	maximum 1 - 5	1 - 5	flexibile 1- 4	Mid-term horizon 2 - 5
Geographical eligibility	Slovak Republic	SR – Banska Bystrica, Zilina, Presov and Kosice regions	SR – Bratislava and Trnava regions	Slovak Republic	Slovak Republic	Slovak Republic	The seat and core business of the company must be in SR

Source: “Fond fondov, s.r.o.” own elaboration

Table no. 3 contains overview of suitable stages, investment period and geographical eligibility within the individual venture capital funds existing in the Slovak republic. The most suitable financing area is start up financing area and investment period is in the range 1 – 5 years. Geographical eligibility within the venture capital funds is all area of the Slovak republic with the exception of Regional Start-up Capital funds, INTEG Fund and Slovak Development Fund with geographical eligibility in selected regions of the Slovak Republic.

The venture capital can be formal, i.e. venture capital funds come from institutional investors or informal, i.e. venture capital funds come from companies and private persons⁶. Venture capital funds in the competence of the National Agency for Development of Small and Medium Enterprises are not the only venture capital funds in the Slovak republic. In addition to these funds, private funds as Slovak-American Enterprise Fund – SAEF, VenCorp Slovakia and Genesis Capital there exist. These funds also provide the venture capital investments for small and medium enterprises.

Slovak-American Enterprise Fund (SAEF) is successor of the Czech and Slovak American Enterprise Fund. These funds strengthen development of enterprises generally in three main areas:

⁶ SPIŠÁKOVÁ, E.: Rizikový kapitál - inovatívny finančný nástroj, Financial markets, journal for theory and practice of financial markets, 2010, Available online <http://www.derivat.sk/files/2010casopis/2010_Dec_Spisakova.doc>, [cited 2011-03-08]

Investments in start-up enterprises bring to market new technologies and processes (seed capital, early stage),

Investments in existing small enterprises, which this type of capital assisted in their organic growth, growth through acquisitions or within the restructure of the balance sheet (development, expansion),

Buy-in, buy-out, spin-off⁷.

VenCorp Slovakia started its activities in a Slovak market in order to carry out business activities of a private equity group of investors from the region of western and central Europe. The group is a member of SLOVCA (Slovak Venture Capital and Private Equity Investment). The goal of its activities is to valorize funds of its shareholders through investments into qualitative and perspective projects in different phases of development. Since the beginning, the group has been developing in two directions; i.e. in the property development field, currently prevailing, and venture capital. When investing, VenCorp group uses various equity instruments (share redemption, capital increase, convertible debt, management buy-in). Time spent in the project until it exits is from 3 to 7 years⁸.

Genesis Capital provides sources for financing acquisitions, management buy-out, management buy-in and leveraged buy-out. Company provides capital for development small and medium enterprise in the Slovak republic and the Czech republic and financing of buyouts of Slovak and Czech companies⁹.

Overview of the venture capital investments in the Slovak republic in competent of the NADSME

Venture capitals funds are complex system of development of the innovations and small and medium enterprises as a new innovative financial instrument.

The venture capital is not enlarged in forms of financing in the Slovak republic currently. Its use is in a great measure limited to the underdeveloped capital market. The reason for the insufficient use of the venture capital is the fact that in Slovakia there is a lack of fast growing innovative companies using this form of financing, as well as less-developed capital market.

The main purpose of using the venture capital is to support projects that are associated with high risk of failure. Currently, countries dependent on success in global markets, especially from innovative activities, but the innovative capacity of the Slovak republic is insufficient. In terms of those in the Central and Eastern European Statistics, EVCA,

⁷ THE NATIONAL AGENCY FOR THE DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES: <http://www.nadsme.sk/content/rizikovy-kapital> [cited 2011-02-16]

⁸ VERCORP, MEMBER OF THE SLOVAK VENTURE CAPITAL AND PRIVATE EQUITY ASSOCIATION: <http://www.vencorp.sk/o-spolocnosti/o-spolocnosti-vencorp/> [cited 2011-03-08]

⁹ GENESIS CAPITAL: <http://www.genesis.cz/> [cited 2011-03-08]

Slovakia lags behind not only the countries of the Central and Eastern Europe, as well as the actual European average. The venture capital is very important area of enterprise in developed countries of the European Union.

Table no. 4 Total amount of approved investments in venture capital funds in the Slovak republic in competent of the NADSME

Venture capital funds in EUR	Roky				
	2006	2007	2008	2009	2010
Start-up capital fund	956	0	1 845 582	3 396 100	5 350 330
Regional start-up capital funds	116	0	165 970	460 960	498 450
INTEG Fund	0	0	0	0	0
SISME Fund	332	0	0	329 940	828 450
Seed Capital Fund	249	664	6 881 099	3 542 476	0
Slovak start-up fund	3 983	6 838	3 452 168	5 620 646	0
Slovak development Fund	0	0	0	5 078 000	22 062 300
Total	5 636	7 502	12 344 818	18 428 122	28 739 530

Source: NADSME, „Position of small and medium enterprises from 2006 till 2010“

In the present time using all of venture capital funds have increased. In the time of economic crisis, the venture capital supports perspective firms, which are not able to realize their activities by reason of hard access to finance.

Although awareness of enterprises within the opportunities of the use of innovative financial instruments has increased gradually, the fact that a stranger should enter an enterprise discourages considerably. Despite the fact that entrepreneurs have an opportunity to drawdown, which would represent potential start-up and development of the company, their distrust of the possibility of funding is still in a significant negative factor.

The venture capital is not used in the same extent as in other European countries. Insufficient using of the venture capital is caused by defects of the venture capital supply, as well as on the side of venture capital demand. Deficiencies on the supply side are arising from the facts that demand for risk capital is low.

However, not every enterprise is suitable for the location of the venture capital mainly in terms of investment criteria, such as potential growth of branch and target company, quality of a management, realistic business plan, return on investment, creation/maintenance of position in work, impact on the environment is not negative and innovation of a project. The enterprise must have a suitable property and ownership structure and a promising prospect. Starting small and medium enterprises with a unique idea, which do not have enough financing sources, are interesting for the venture capital financing, as well as innovative enterprises which have significant potential for future growth.

Conclusion

The venture capital can be described as the capital provided by professional companies to start, development or transformation of the private firms that are able to demonstrate their growth potential and are not listed. High potential return on investment compensates investor's relatively high risks. Investment of the venture capital is a number of year's process of cohabitation subject of enterprises surrounded by venture capital investors.

Use of the venture capital has also some disadvantages. Investors require a high rate of return to cover the risk involved and there is an increase in the number of owners who have an impact on strategic decision-making of enterprise. Many entrepreneurs have an aversion to the entry of a new partner or shareholder in the firm, or against the future to sell their stake in a new company stronger investor.

Since the provision of venture capital in the SR has been still underdeveloped and does not cover companies' needs, availability of venture capital should be improved. It is necessary to propose a new regulatory framework to enhance the attractiveness of the use of the venture capital for small and medium enterprises. Bad financial structure of enterprises is a negative factor for the entry of the venture capital, but also a barrier to use foreign resources in the form of bank loans. A large part of Slovak companies are consistently undercapitalized. However, investors' interest has increased in recent years. Investors considered the Slovak market for an interesting site in terms of its use.

Increasing of awareness of the venture capital using is responsible the Slovak Venture Capital Association. This association cooperates with various Slovak and foreign institutions and organizations in solving problems of its members and the general issues relating to a private enterprise. Now, it offers the opportunity to represent the common interests of investors of the venture capital. The main purpose of this association is to inform not only businesses, but also the investment and banking institutions. It is necessary to increase the awareness of other economic, political and administrative institutions in the Slovak republic. Hereby, it is very important to inform the general public, too.

The main aim of paper focused on the possibility of using the venture capital as an innovative financial instrument in condition of the Slovak republic within the scope of the National Agency for Development of Small and Medium Enterprises was to highlight the fact that the venture capital represents currently for enterprises available external source of enterprises financing. The paper contains many information within the venture capital programmes, overview of acceptable and unacceptable financing area, suitable financing stages, investment period and geographical eligibility, as well as overview total amount of approved investments in venture capital funds in the Slovak republic in competent of the NADSME. The aim of the paper is to show of possibility of financing by the venture capital and to rise awareness on venture capital funds, therefore it is one of the effective methods of financing. Despite of the advantages, financing by the venture capital is not very often used method of financing in the present time. Given the fact that a small and medium enterprise is an essential part of the national economy, promotion of its financing is very important. There is potential, which could be the venture capital applied, but there is no functional system, especially as regards financing the early stages of innovative businesses.

The main sources of information in terms of this area were data relating to the venture capital obtained from the National Agency for Development of Small and Medium Enterprises in the Slovak republic. Data base is represented by the documents “Information on the state revolving programmes implemented to support small and medium enterprises through the National Agency for Development of Small and Medium Enterprises”.

Material for elaboration of this paper were research reports and statistical data, technical and scientific contributions published within the seminars, book publications of domestic and foreign authors, which represent a secondary source of information required for Report elaboration and European Private Equity & Venture Capital Association and Reports relating to the position of small and medium enterprises from 2006 till 2009 obtained from the National Agency for Development of Small and Medium Enterprises in the Slovak republic. In this area, some structured interviews with participant of the National Agency for Development of Small and Medium Enterprises for the purpose of ascertain of actual situation in the Slovak republic have been carried out. Basic methods used in the paper include the selection methods, methods of analysis, method of synthesis, evaluation of results, statistical testing methods and testing of hypothesis relating to the venture capital using by the free statistical software.

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Summary

Venture capital is an important assumption for the existence of small growth enterprises that have ideas, too bold for traditional banking products. The acquisition of funds by banks is a lengthy process for enterprises. This process is very complicated and approval of bank loans is strict. Financing by the venture capital is appropriate, especially for entrepreneurs who did not have enough funds to start business or unable to properly spend the funds effectively. Increasing the use of the venture capital is related to reviving the economy, improving the business environment, infrastructure, reviewing ownership, improving conditions for the business environment, capital market development and increases a rate of economic freedom. It is necessary to highlight the benefits that the use of the venture capital brings with it.

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