VENTURE CAPITAL FINANCING – AN ALTERNATIVE SOURCE OF FUNDING RESEARCH ACTIVITIES

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Abstract: During the past decades, different funding sources for research activities have been explored. Traditional sources of public and private funding can no longer provide the financing demand for this activity. Venture capital funding first appeared in the USA, but it became increasingly popular in Europe as well. Venture capital funds may provide financing for research activity, especially within research projects that require infrastructure investments or achieving desired results from research after a longer period of experiments and implementation of their results in the economy (e.g. artificial blood).

Keywords: financing, reasearch, venture capital, infrastructure, investments.

1. Introduction

In a world without borders, the external opening of national economies turned modern companies into real agents of globalization since activity extension towards new market areas corresponds to their inclusion in a regional/local business environment, lower production costs, if the company runs its business in less developed areas, and their access to financial and infrastructure facilities allowing de-localizing the activity. Apart from these advantages, globalization emphasized competition and it imposed decision makers to find innovative solutions for providing financing resources, with acceptable costs.

At the same time, the world financial crisis had a negative impact on company activities, increasing financing costs, based on a serious lack of trust and feelings of uncertainty regarding business development, in a world shaken by booming bankruptcies.[1]

2. Research methodology

Throughout our scientific undertaking, we used a quality approach crossing sometimes the quantity approach, as far as research methodology is concerned. Therefore, the observation and information collection processes played an important part considering that the specialized literature is less accessible, and this is the reason why we resorted to information on the internet. For informative purposes, we turned both to primary documents in this field, and to secondary ones throughout standard documentation.

Alternatively, internet research was positive, but it did not replace the above-mentioned papers. This research enabled our access to information (the website of the European Union, as well as specialty articles) helping our sceintific undertaking.

As a conclusion, we collected data that we examined according to our subject, and the result surfaced further to data processing. [2]

3. Venture capital

The venture capital represents investments in companies not listed on the stock market performed by venture capital companies that administer their own (internal) money, individual or institutional, acting as managers. The venture capital includes financing early stages of a business (initial and startup) and its extension. The venture capital is a professional capital co-invested together with its entrepreneur in order to finance a business during its first three development stages. [3]

The initial capital (seed capital) represents the financing provided for research, assessment and development of an initial concept for a product or a service, before launching the company.

The start-up capital represents the financing granted for product development, its release on the market and initial marketing. The company is under organization or in business for a short period of time (2-3 years), but has not yet sold its product or service. Therefore the new product has yet to show a profit.

The expansion capital stands for the financing granted for developing and expanding an operational company that may or may not have reached breakeven yet, that may or may not have shown profit. The capital is used for increasing production capacity, for developing a business market or a product and/or for providing an additional working capital. These investments show a lower risk level than the investments carried out for companies in the seeding or start-up stage considering that target companies have a certain business experience (3-5 years), they have an organizational structure, a portfolio of products and services that have already been successfully released on the market, as well as stable relationships with suppliers and customers.[4]

Venture capital financing has both advantages, and disadvantages. The main *advantages* are as follows:

1. The venture capitalist attracts other investment funds as well, and provides financing resources for subsequent stages of company development;
2. Besides financing, venture capitals contribute to company management, provide experience and information during key moments of company development, especially if the company founders have less experience in company management;
3. Given their specialization in certain industries, companies with venture capital can help the business by means of facilitating access to potentially important customers, suppliers and other contacts in the industry.[1]

The main *disadvantages* are the following:

4. The venture capital presents a higher cost due to the high risks the investors assume. Considering that the success rate of businesses financed with venture capital ranges within 20-30%, venture capital funds aim at achieving high efficiency;
5. The access to venture capital is really limited. The venture capitalists receive many unsolicited financing requests, where most of them are not true investement opportunities. Thus less than 1% of the companies presenting a business plan are granted financing.
6. Venture capital availability depends on the macroeconomic fluctuations. According to a study on cyclicity of financing small and medium-sized companies performed by the European Commission, the impact of the decreasing gross domestic product on the available financing sources for this kind of company is considerable. Hence, if the gross domestic product decreased by 2.5%, then bank loans for micro and small-sized companies would drop by 5%, bank loans for medium-sized companies would drop by 7.4%, while the venture capital would drop by 32.1%.[5]
7. The entrepreneur could lose control over company management. Usually venture capitalists acquire 40% or more from the company capital and they name some of the managing board members. Frequently, venture capitalists receive preferential stock, thus offering them a privileged position as opposed to the other shareholders in case of selling or liquidating the company. [1]

4. Venture capital financing of research activitiy

In the area of capitalizing results of research activity, the American pragmatical mentality noticed that one of the appropriate financing methods is by means of venture

capital. These resources were oriented mainly towards innovating companies and they allowed financing implementation of research results. Even if in the beginning of the 90s the dynamics of these financings slowed down, after 1992 they revigorated. During the same period of time, in the USA, GDP per capita increased from USD 26,426 in 1990 to USD 27,197 in 1997.

In Western Europe, venture capital financing became popular especially in the 90s, so this type of financing grew from 6.1 billion USD in 1992 to 8.5 billion USD in 1996. In 1995 the European venture capital financing percentage was 19.5% from the one in the USA. Among the Western European countries, England invested 47.5% from the total of European venture capital financing funds, France 15.3%, and Germany 12%. In England, GDP per capita grew from USD 18,364 in 1990 to USD 19,108 in 1995, while in France it grew from USD 20,051 to USD 20,675 per capita, and in Germany from USD 21,523 to USD 22,586 per capita.

Following the successful example of the USA, the venture capital increased its importance in Europe. The companies recording a very quick growth needed access to venture capital in order to find the financial resources for investments. These venture capitals consisted of funds collected from the capital market through specialized operators. The European investors buy stock or invest in convertible bonds within the company where they become shareholders. The capital operators invest not with the purpose of receiving dividends shortly, but they aim at allowing the company to expand and, eventually, to acquire a profit from the invested capital. [6]

During the years 1991-1995, an analysis of the economic impact of the venture capital on European small and medium-sized companies was performed, as opposed to the efficiency of the top 500 companies.

Further to venture capital financing, the small and medium-sized companies raised their employee number by 15%, compared to only 2%, representing the percentage of the top 500 companies. Also, they increased their turnover by 35%, more than what „TOP 500" companies achieved. Most of the managers of these small and medium-sized companies showed that without an infusion of venture capital they would have reported a smaller growth or even none. [7]

Given the critical financing need for the small and medium-sized companies, some countries initiated public support projects for venture capital. The support project may provide the following measures and/or tools:

- Creation of an investment fund where public authorities are partners, investors or participants;
- Guarantees for an investment fund (venture capital fund covering a part of its administration and management costs);
- Guarantees for the venture capitalists against a percentage of the investment losses, guarantees related to loans for investors or funds for venture capital investments;
- Other financial tools in favor of the venture capitalists or venture capital funds for providing additional investment capital;
- Financial incentives for investment funds and/or their managers or investors, with the purpose of assuming the performance of venture capital investments. [1]

5. Conclusions

The international efficiency and competitiveness of a country depend on its fast knowledge acquisition, as well as on the effective transfer of technology and positive experience. Hence, investments in research activity will provide benefits even if not immediate.

If the Romanian government created a venture capital fund, it could lead to a higher level of research financing, thus materialized either by providing an infrastructure similar to the ones in the large European research centers, or by providing the necessary funds for carrying out some researches with major impact on the national economy. And here I would like to offer two examples: the first example refers to the new building on the Măgurele platform of the National Physics Institute, an investment that could have been developed with different funds than the public ones assigned for research financing; the second example refers to the researches regarding artificial blood. Concluding these researches would lead Romania to patenting artificial blood and, if capitalized, the cashed amounts could finance other research projects.

Let us keep in mind that Romania cashes even today, after over 50 years since the Ana Aslan's discovery of Gerovital, enormous economic benefits in various ways, both as royalties, and as taxes from the manufacturer, Farmec in Cluj-Napoca.

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