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## **FEATURES OF VENTURE CAPITAL FUNDS IN UKRAINE**

Innovative development of economy is the only chance for Ukraine to ensure a breakthrough in creating competitive products and a high income. Most innovations are financed by the government, corporations, and venture capital funds. In conditions of poor government funding and the reluctance of corporations to invest in innovations, a special role in the development of innovations are beginning to play venture capital funds that are interested in financing high risk projects. But the venture business has a number of problems in Ukraine. This article shows the features of the concept and operation of the venture business, was the most important experience of the Western practice of venture funds, the analysis of the concept of a venture fund in the Ukrainian legislation, the negative factors affecting venture funds in Ukraine, revealed the possibilities and prospects of activities of these funds in the country.

**Keywords:** innovations, corporations, venture business, start-up, institutional investors, institute of general investment

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## **ОСОБЛИВОСТІ ФОРМУВАННЯ ВЕНЧУРНИХ ФОНДІВ В УКРАЇНІ**

Інноваційний розвиток економіки – це єдиний шанс для України створити прорив у створенні конкурентоспроможної

продукції та забезпечити високий дохід. Більшість інновацій фінансуються за рахунок держави, корпорацій та венчурних фондів. В умовах неефективного державного фінансування та небажання корпорацій інвестувати в інновації, особливу роль в розвитку інновацій починають грати венчурні фонди, зацікавлені у фінансуванні проектів високого ризику. Але у венчурного бізнесу в Україні існує ряд проблем. У зв'язку з цим у статті відображені особливості поняття та функціонування венчурного бізнесу, найбільш важливий досвід практики діяльності західних венчурних фондів, проаналізовано поняття венчурних фондів в українському законодавстві, визначені негативні фактори впливу венчурних фондів в Україні, показані можливості та перспективи діяльності цих фондів в країні.

**Ключові слова:** інновації, корпорації, венчурний бізнес, стартап, інституційні інвестори, інститут загального інвестування

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## **ОСОБЕННОСТИ ФОРМИРОВАНИЯ ВЕНЧУРНЫХ ФОНДОВ В УКРАИНЕ**

Инновационное развитие экономики – это единственный шанс Украины обеспечить прорыв в создании конкурентоспособных товаров и получении высоких доходов. Чаще всего инновации финансируются государством, корпорациями, а также венчурными фондами. В условиях неэффективного государственного финансирования и нежелания корпораций инвестировать в новшества, особую роль в развитии инноваций начинают играть венчурные фонды, которые заинтересованы в финансировании высоко рискованных проектов. Но и у венчурного бизнеса в Украине существует ряд проблем. В связи с этим в статье отображены особенности понятия и функционирования венчурного бизнеса, изложен наиболее важный опыт практики деятельности западных венчурных фондов, проведен анализ понятия венчурного фонда в украинском законодательстве, определены негативные факторы, влияющие на венчурные фонды в Украине, раскрыты возможности и перспективы деятельности данных фондов в стране.

**Ключевые слова:** инновации, корпорации, венчурный бизнес, стартап, институциональные инвесторы, институт общего инвестирования

**Problem definition.** Necessary condition of improving the competitiveness of the national economy is innovation development. World experience has shown that the main subjects financing innovation are the government, corporations, and venture capital funds. For many years the government having the budget deficit does not finance innovations, which even more aggravates the situation of the Ukrainian economy and makes it impossible to create the conditions under which it would be real to cover growing costs and give external debts. Innovative development of the economy is the only chance for Ukraine to make a breakthrough in production of competitive goods and obtaining high incomes.

Corporations in Ukraine prefer to invest in traditional branches (mining and processing of raw materials, construction, trade, agriculture), thereby reducing the risk of financial losses. But at the same time they obtain a relatively small profit. Innovation itself assumes high risk, as this refers to completely new products or services. Not more that 20% of 100% innovative projects survive, at the same time the financial result of sold projects totally covers all financial losses and gives profit to investors.

Today in Ukraine the most common way of getting money for business development is bank financing. But bank capital is not interested in financing risky innovation projects. This is due to the inability to obtain the necessary collateral base, which is the main condition for provision of new loans to market insiders, as well as the lack of guarantees of invested funds preservation and earning a certain rate of income.

Obviously, venture capital is one of the major and most effective sources of risky financing of innovation activity in such specific conditions.

**Analysis of studies and publications.** Analysis of scientific researches showed that problems of the development of venture capital in Ukraine were considered in works by V. Chaban, O. Zinchenko, V. Ilchuk, L. Rodzievskaia, V. Yevtushenko, M. Johne, V. Stadnik and others [1,4,7].

**Parts of common problem unresolved earlier.** Despite the fact that most of the scientists note unsatisfactory state of venture capital financing in Ukraine, explore the common causes of this condition and offer ways to overcome these problems, peculiarities of international and national organizational and legal, as well as financial support have not been studied in full.

**Purpose of the article.** Purpose of this article is to reveal the features of concept and functioning of venture business, describe the most

important activity experience of Western venture capital funds, analyze the concept of venture fund in the Ukrainian legislation, determine the negative factors affecting the venture capital funds in Ukraine and reveal the possibilities and prospects of their activities.

**Research main material presentation.** So, venture business is a kind of business, focused on practical use of innovations, technical and technological newly-designed products, and results of scientific advances that have not yet been tested in practice.

The essence of a venture business is partially reflected in its name, «venture» translated from English is «risky enterprise, risky plan or undertaking» [1].

To understand the essence of venture business deeper, the following peculiarities of its functioning must be noted, namely:

- The objects of investment are risky projects;
- Capital portfolio management is carried out;
- The main part of venture investments is made in the charter capital of venture capital companies, which are going to produce an innovative product;
- Venture investor shall actively participate in the management of an innovative project or, at least, provide himself reliable control;
- A flexible mechanism of harmonization of interests of investors and managers is carried out, and it depends on the stage of a venture project development;
- The way of exiting the venture business by the investor in the event of hazards is initially determined.

Venture capital is not "long-term" money, in the sense that the venture capital fund finances the enterprise up to the point until it acquires sufficient size and creditworthiness to be sold to a large corporation (strategic investor) or to be put on the stock market. The normal term of venture investments is 5-7 years.

Normal level of requirements of venture fund to the financed project is capital growth by 10 times within 5 years of the project realization. This means the return on investments just less than 60% per annum. This is a very large yield, but otherwise the fund will not be able to achieve an average return on invested funds of 20%-25% for investors and to ensure a sufficient level of income to managers because the certain part of the projects may be unprofitable, the other part may not produce the

expected revenue. Requirements for profitability may be lower if the later stage of business development is financed, in this case, risk of failure is lower [2].

The main purpose of the venture investor is an increase in profit of the company receiving investments, increase of its value in the market, and for this purpose he invests his money, without incurring any liability, except financial.

To determine the status of venture business in Ukraine it is necessary to study experience, trends and peculiarities of its development in developed countries.

World center of venture capital is the United States of America. Sand Hill Road in Menlo Park, Silicon Valley, Northern California, represent “Wall Street of Venture Capital”. Industry began to develop in the late 1960s - early 1970s, giving life to large corporations since then. Almost all main technological U.S. corporation or corporations related to technologies, such as Apple, Compaq, Dell, Genetech, Oracle, Cisco, Netscape, Amazon, eBay, Yahoo, are financed by venture capital [3]. In USA, for the period from 1996 to 2007 35531 innovative projects with a total volume of venture capital investment of USD 307.24 billion were carried out, and the average size of investment reached USD 8.65 million. At the same time venture capital plays a minor role in the primary financing of innovations. In USA more than USD 81 billion invested by venture capital industry in 2000, only about 23% are investments in the early stages of enterprise development, and less than 10% are investments in newly created companies (start-up) [4]. The main part of venture capital investments is directed to development of projects, initially financed out of the funds of state or large corporations. Venture capital plays a significant role in the subsequent stages of the innovation process, namely during the period when these innovations are commercialized. Most part of the venture capital investment is used to build infrastructure necessary for growing businesses, namely fixed assets, working capital, marketing and sales.

Another feature of venture capital in USA is that major investors investing money in venture capital funds in USA since 1980 have become pension funds, investment funds, insurance companies and other institutional investors.

The role played by institutional investors, and above all pension funds; venture capital financing has not always been as great as it is today.

If in 1987 in USA share of pension money in financing venture funds was 15%, in 1998 it is already 47%, though the absolute amount of investments in venture capital funds has increased over this period of more than three times. Certainly, the growth of investments by institutional investors is one of the main reasons for increasing the activity of the U.S. venture capital industry in the 80s - 90s. Also, a large part of funds in the U.S. venture capital funds comes from foreign investors (annually approximately from 15% to 25%) [2].

Venture capital funds invest in industries that are growing and competition in which up to a certain point is not high enough. According to statistics, in 80s a significant proportion of venture capital investments in USA were directed in energy and computer technology production, in the early 90s in the production of software, genetic engineering, and telecommunications, in the late 90s in internet companies. The pattern consists of only one thing, namely the venture capital is directed in quickly growing industries.

But in Europe venture business developed quite differently. Attempts to repeat the successes of the American venture industry in early 1980s failed and many investors moved into less risky, more predictable sphere of financing management buy-outs MBOs, or leveraged buy-outs - LBOs. Venture activity quickened markedly in the second half of the 1990s, when the stock markets of growing companies appeared, entrepreneurial activity increased, government support increased [3]. The volume of investments in 2002 amounted to about EUR 27 billion, although less than 10% of this volume is peculiarly investments that are ventured by their nature [2].

In Western Europe the list of participants of venture funds is complemented by government agencies, commercial and clearing banks, universities and other sources. A characteristic feature of Western European countries as compared to the USA is a higher proportion of banking structures in the formation of venture capital. For example, in Germany the share of banks is composed of for more than half of total risk capital turning in the country.

The notion of a venture fund in Ukraine is different from the usual one. According to the Law of Ukraine "On Joint Investment Institutions", adopted in March 2001, a venture fund falls under the definition of a specific institute of collective investment (ICI), the rules of formation,

existence and closure of which are built into the general operating rules of ICI and asset management companies. Venture Fund is considered non-diversified ICI of closed type, which performs exclusively private placement of securities of its own issue and the assets of which for more than 50 per cent consist of corporate rights and securities that are not admitted to trading on a stock exchange or trade information system. Participants of venture fund can be exclusively legal entities [5].

The matter of venture financing is also not solved by the Law of Ukraine «On Innovative Activity» which stipulates a procedure for financial support of innovative projects by the State Innovative Financial and Credit Institution through provision of loans or transfer of property, which is carried out upon condition of existence of a money back guarantee in the form of a pledge of property, insurance contract, bank guarantees, engagement contract, etc [6].

Thus, the assignment of a venture fund to ICI does not let to considerate a number of peculiarities of their activity and specificity of the relationship with the other members of venture activity. Moreover, the very name "venture" does not guarantee that the fund will focus its efforts on financing innovative activity, investing in high-tech risky enterprises and projects [6]. So in Ukraine the largest venture investments are made in retail trade, food industry enterprises; production of consumer goods. As there is a dynamic development just in these sectors, and short term of money circulation gives you the opportunity to reduce the risk of the project. Moreover, one of the basic principles of these funds functioning is investing primarily in enterprises that have successfully overcome the stage of organization and development of business, having a solid history of development. In order to ensure control over the process the investors buy at least a controlling interest in the investment object.

Most venture capital funds that operate in Ukraine were founded directly by international organizations such as the European Bank for Reconstruction and Development (EBRD), as well as within the intergovernmental agreements. In particular, company Euroventures Ukraine was created at the account of EBRD (capitalization is USD 30 million). There is an insignificant amount of private venture capital funds in Ukraine.

Such companies as private equity fund Western NIS Enterprise Fund (1995), AVentures (1994), Commercial Capital Enterprise (1995),

Foyil Assets Management, Ladenburg Thalmann Ukraine Ltd., Cambridge Life Sciences Fund, NCH Advisors, New Century Holdings, Euroventures Ukraine Fund (1998), Baring Vostok Capital Partners (1996) have their representatives in Ukraine and operate with the sums in the amount of USD 20-50 million each. According to data of venture capital companies, more than USD 400 million of venture capital have already been invested to Ukrainian companies [1, 7].

Also, State Agency of Ukraine for Investments and Innovations together with the project of the EU "Development of Financial Schemes and Infrastructure to Support Innovations in Ukraine" (which beneficiary it is) started realization of the 2nd component of the project "Promoting the Development of Venture Capital Funds in Ukraine" (grant is EUR 12 million).

During implementation of the planned activities a national venture capital fund of 100 million euros will be founded, it will finance innovative projects of Ukrainian residents. Moreover the order of money provision will be significantly different from the traditional procedure of bank financing. Venture Capital Fund will invest in additional capital of business entities. At the same time joint-stock companies will have to provide closed placement shares by an additional issue, and limited liability companies will have to increase the authorized capital. Part of a venture capital fund shall be 25 -50% of the authorized capital of the business association after its increase [8].

There are also problems faced by the venture business in Ukraine, among them there are important ones as follows:

- no clear definition of the legal status of the subjects of venture businesses;
- lack of venture capital funds financing due to restrictions for admission to participation of exclusively legal entities in them;
- the absence of government guarantees of funds repayment in case of unsuccessful innovation projects;
- lack of reflection of results of work of venture capital funds in official statistics;
- there is also a lack of venture capital professionals in the assessment and management of innovative projects, as the effectiveness of these funds activity depends on the evaluation of the project, its prospects and the possibility of determining the dynamics of the industry developing



depends largely on the;

- inadequate protection of intellectual property rights of researchers and entrepreneurs also inhibits the development and financing of innovation;
- problems of the stock market development: poor infrastructure, high risks, low liquidity directly affect the scale of the venture business in Ukraine.

**Conclusions and prospects for further research.** Today we can say that there is insufficient demand for innovation, low commercialization of innovative projects (1% of ongoing innovation) in Ukraine and, as a consequence, almost undeveloped market of innovative products and services, as well as its infrastructure, which component element are venture funds.

To create the prerequisites for the development of venture capital funds set of measures is proposed, implementation of which will contribute to the implementation and development of the venture capital industry in Ukraine.

First, it is to define a clear legal status of the subjects of venture businesses, and lack of financing venture capital funds can be corrected by admitting the institutional investors and natural persons for participation in them. It is also necessary to legally foresee investment of just innovative projects by the funds.

Second, to reduce the risk of loss of deposits in venture capital funds the state can provide a guaranteed minimum of deposits return to the participants.

Third, to increase the number of people willing to invest in venture capital funds it is necessary to present the results of their activity in official statistics, as well as promote development of a system of information exchange between developers and potential investors.

Fourth, the government should organize training of venture specialists, able to monitor promising industries, innovative projects, and be able to manage them effectively. In this case, it is necessary to form the structure on certification of such specialists that will only be possible in the study and use of international experience, in particular in cooperation with similar foreign companies.

Fifth, it is necessary to provide guarantees of state support of international and national patents, introduction of effective protection of

intellectual property from violations in this area.

Sixth, the absence of developed stock market in Ukraine can play a cruel joke with venture capital funds, because today the market cannot provide them with an effective exit from invested companies through the sale of shares on the stock exchange. The similar situation is characteristic not only for Ukraine but also for other developing venture capital markets. In this regard, the government should fix possible exit from business legislatively.

Also one of the most effective incentives for the development of venture capital funds in Ukraine is the use of more flexible tax incentive schemes (ICI today do not pay income tax) and the development of risk insurance projects.

Thus, analyzing the international experience and, taking into account the peculiarities of venture business development in Ukraine, we can say that venture capital is one of the most effective sources of financing innovation activities, and therefore the solution of financial security problems, the creation of a national innovation infrastructure, ensuring the effectiveness of cooperation between the state, science and business with a focus on global trends in innovation development is the most important component of scientific and technical as well as economic development of our country.

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### **BACKGROUND OF ESTIMATION OF THE ENTERPRISE COMPETITIVENESS**

The article describes the essence of the concept of "competitiveness" of the enterprise and is characterized by its dialectical relationship with the category of "competition", lit the fundamental principles of evaluation of enterprise competitiveness. Also justified the need for assessing the competitiveness of enterprises. Special attention is paid to existing approaches and methods of evaluation of enterprise competitiveness, their advantages and disadvantages have been identified. Presented to the most common methods for assessing the competitiveness of enterprises. And, at the end of the work, the emphasis is on the need to select the optimum factors for evaluating the competitiveness of enterprises with industry-specific.

**Keywords:** competition, competitiveness, evaluation and competitive factors.

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### **ПЕРЕДУМОВИ ОЦІНЮВАННЯ КОНКУРЕНТОСПРОМОЖНОСТІ ПІДПРИЄМСТВ**

В статті розглянуто сутність поняття «конкурентоспроможність» підприємства та охарактеризовано його