Piotr Wasniewski[1]

ANALYSIS OF POLISH VENTURE CAPITAL MARKET

Venture capital is invested in companies with solid prospects for dynamic growth, representing various industries and regions at different stages of development. The aim of this research is to assess the maturity of Polish VC market by exploring the success of venture capital-backed companies. The research will refer to number and types of submitting to VC funds firms, companies which received capital and the number and types of divestments.

Keywords: *venture capital; corporate finance; value of firms; startup; investment; divestment.*

Пьотр Васнєвскі

АНАЛІЗ ПОЛЬСЬКОГО РИНКУ ВЕНЧУРНОГО КАПІТАЛУ

У статті показано, що венчурний капітал інвестується тільки в ті компанії, які демонструють значні перспективи динамічного зростання, незалежно від галузі, регіону або стадії розвитку бізнесу. Досліджено ступінь зрілості польського венчурного ринку та продемонстровано успіхи фірм, які отримали венчурну підтримку від таких фондів. Представлено статистичний матеріал щодо кількості таких фірм, об'сягів фінансування та типів дивестування.

Ключові слова: *венчурний капітал; корпоративні фінанси; вартість фірми; стартап; інвестиції; дивестиції.*

Табл. 6. Рис. 2. Літ. 21.

Пётр Васневски

АНАЛИЗ ПОЛЬСКОГО РЫНКА ВЕНЧУРНОГО КАПИТАЛА

В статье показано, что венчурный капитал инвестируется только в те компании, которые демонстрируют значительные перспективы динамического роста, независимо от отрасли, региона или стадии развития бизнеса. Исследована степень зрелости польского венчурного рынка и продемонстрированы успехи фирм, которые заручились венчурной поддержкой таких фондов. Представлен статистический материал по количеству таких фирм, объёмам финансирования и типам дивестирования.

Ключевые слова: *венчурный капитал; корпоративные финансы; стоимость фирмы; стартап; инвестиции; дивестиции.*

Introduction

PE/VC funds have entered the Polish market since 1990. According to EVCA statistics the year 2011 was historically the best in the value of invested funds — 680 mln EUR invested into 57 Polish companies, in this dynamically growing firms and startups received 190 mln EUR. Also the value of divestments was the highest in history — 240 mln EUR and 24 firms exited. The article will present the research results on the size, directions and effectiveness of capital support given by venture capital funds to Polish firms. It is known, that on every 100 companies which send a proposal to VC funds, only several companies managed to reach more advanced stages of analysis than reading the business plans, yet only a few will successfully pass through the negotiations on contract conditions and eventually receive capital. It is likely that there is a symbiosis between business growth and venture capital, and VC-backed companies should outgrow their non-VC-backed peers.

To characterise European private equity here are some key metrics for 2011:

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– Fundraising in 2011 reached the level of 40 bln EUR (to compare 2010 – 20 bln EUR, 2009 – 18 bln EUR, 2008 – 80 bln EUR).

– 46 bln EUR were invested in more than 4800 companies (85% of them were SMEs) In 2010 41 bln EUR were given to 4816 European businesses. In 2009 – 23 bln EUR to 4696 businesses.

– 30 bln EUR divested from exited companies (in 2010 – 15 bln EUR, 2009 – 12 bln EUR).

– 1696 active private equity and venture capital firms operate at European market in which the second group is represented by 709 subjects. They were managing 523 bln EUR of capital from Europe.

Background

EVCA (European Venture Capital Association) in "Professional Standards for the Private Equity and Venture Capital Industry" is describing Venture Capital as "funding typically provided in equity form (minority stake) to the companies in early stages of their life cycles, i.e. seed, early stage, development or expansion".

Historically the term was used to refer generally to all private equity investments that is why many private equity associations refer only to venture capital in their name." Private equity provides equity capital to enterprises not listed at a stock market. Private equity includes the following investment stages: venture capital, growth capital, replacement capital, rescue/turnaround and buyouts. Private equity funds are pools of capital managed in general as closed-end, fixed-life funds doing primarily equity capital investments into enterprises (i.e. direct private equity funds as opposed to primary or secondary private equity funds) not listed at a stock market.

Venture capital is, strictly speaking, a subset of private equity and refers to equity investments made for the launch, early development, or expansion of business. Venture capital is an important source of funding for startups not only in innovative, high-tech industries, but also for developing enterprises from other, traditional industries, but using innovativeness as the competitive advantage. Venture capital is important in early periods of firm's life, when they are starting producing innovative products and commercializing innovations (Block, Sandner, 2009; Gompers, Lerner, 2001; Zider, 1998). Venture capital funds not only supply financing, but also provide screening, corporate governance, monitoring, operational assistance and strategic advice (Bengtsson, Wang, 2010).

The problem of small and medium-sized enterprises activity is a crucial point in European Union directions of development (Brzozowska, 2008). The lack of sufficient capital is pointed as one of the biggest barriers for setting up and developing SMEs. Banks do not accept the risk level of investing into startups, moreover, there is lack of knowledge about innovative ideas or products (Sniezka, Venckuviene, 2010). The results of correlation analysis between venture capital and labour market (Feldmann, 2010), shows that more readily available VC is likely to lowered unemployment rates and raised employment rates in industrial countries.

The situation at venture capital market is highly dependent on state VC policies, such as institutional change, support of business R&D and science and technology infrastructure (Rosiello et al., 2010). In 2000–2010 governments of many European and Asian countries have started programs, designed to encourage the development of venture capital market (del-Palacio, Zhang, Sole, 2010). Polish government established in 2005 the National Capital Fund (NCF), which is supporting venture capital/private equity funds by providing financing for their investments in innovative SMEs.

Furthermore, the situation at venture capital market is probably influenced by the effects of financial crisis. Block and Sandner (2009) have pointed to 3 reasons of the crisis impact:

1. Venture capital funds could have problems in finding investors not experienced too much by the crisis;
2. Low activity at IPO market and the fall of stock prices are causing problems to VC funds which exit their investments;
3. Turning the crisis into long-term recession would influence the generating of sufficient revenues at VC-backed firms.

Defining the fundamental problem

Venture capital is a provider of capital to risky and highly innovative firms at early stages of growth. They can boost the development potential by financing innovative ideas or products. The significant role in encouraging venture capital market belongs to government and its policies. They can use some direct and indirect initiatives to foster the market, improving the conditions for SMEs growth and development.

The life cycle of venture capital fund comprise 6 stages: fundraising, investing, investments management, investments disposal, distributions to investors and fund liquidation. The analysis of venture capital market is based on 3 characteristics: sum of funds raised, sum of investments, sum of divestments.

Fundraising is the process by which money is raised to create a fund. Fundraising is also the stage, when relations between managers and investors are established. Investors could choose the type of funds in which they want to participate (taking into consideration the risk of investment. Typical types of venture capital funds are (EVCA, 2012):

– Early-stage fund – focused on investing in companies at the early stages;
– Later-stage fund – focused on investing in later-stage companies in the need for capital expansion;
– Balanced fund – focused on both early-stage and development, with no particular concentration on either.

Investments means the amount of capital invested to acquire shares in enterprises. Financing could be provided at different stages of firms growth. Several financing stages can be identified in relation to the stages of VC-backed company development:

– Seed – financing provided to research, assess and develop an initial concept before a business has reached the startup phase;
– Startup – financing provided to companies for product development and initial marketing. Companies may be in the process of being set up or may have been in business for a short time, but not yet selling their product commercially.
– Other early-stage – financing to companies that have completed the product development stage and require further funds to initiate commercial manufacturing and sales. They will likely not yet be generating profit.
– Later-stage venture – financing for the expansion of operations which may or may not be breaking even or trading profitably. Later-stage venture tends to finance

companies already backed by VCs, and therefore involves third- or fourth- (or a subsequent) rounds of financing.

Investment disposal is a critical stage in the life of a fund. It determines the return to investors. There are many ways of exiting VC-backed firms. To most popular belong:

– trade sale (to industrial investors),
– sale to financial institution,
– public offering (IPO) – the sale or distribution of a company's shares to public for the first time by listing company at stock exchange,
– MBO (management buy-out).

Sometimes the process of divestment takes the form of "write-off", which means total or partial write down of a portfolio's company's value to zero or symbolic amount.

Firms that seek venture capital are affected by financial crisis. The results of Block and Sandner (2009) research shows the correlation between financial crisis and a decrease of funds raised amount, especially in later funding rounds. Also McKenzie and Janeway (2011) claim, that market conditions, both over the investment cycle and at the time of exit, are important determinants. Some authors (Gompers, Lerner, 2004) link the state of the IPO market to the amount and profitability of venture capital investing.

Presentation of research materials (including methodology and key results)

The research regarding the situation at Polish venture capital market with reference to its position in Europe and the region of Central and Eastern Europe (CEE). Some metrics of Polish market cannot be analysed in isolation from the CEE, for example, some funds are raised without division to specific countries, PE/VC funds in CEE region.

Fundraising of venture capital for the CEE region reached 645 mln EUR in 2010, 61% above the 2009 level. It means that the CEE fundraising represented 3% of the total funds raised in Europe in 2010. Investment in the CEE region slowed down in 2010, with 1.3 bln EUR invested, down from more than 2 bln EUR in each of the 3 previous years. Investments by value in the CEE region represented 3% of the total private equity investments in Europe, down from 11% in 2009. Poland alone accounted for just over half of the total amount invested in the region, attracting 657 mln EUR of investments. Only 36% of the companies financed in the CEE were venture-backed companies, as compared to Europe's total figure of 60%.

In 2011 the number of private equity firms headquartered in Poland reached 30, of which 15 were venture capital firms. Capital under management amounted 4286 mln EUR, of which: venture capital firms got 563 mln EUR. Private equity investments were responsible for 0,18% of GDP as investments under market statistics and for 0,19% as investments under industry statistics (EVCA Yearbook, 2012).

Polish member of EVCA is PPEA – Polish Private Equity Association, which gathers private equity and venture capital investors in Poland. The mission of PPEA is to promote and develop private equity and venture capital industry in Poland. PPEA comprises 41 full members, which are managing funds of over 14 bln EUR, have invested in Polish and CEE companies more than 8 billion Euro and have currently in their portfolios more than 700 Polish and CEE firms (www.ppea.org.pl).

Fundraising

Table 1. **Fundraising in Poland, 2010 and 2011**

Fund stage focus	2011		2010	
	Amount (in ths EUR)	%	Amount (in ths EUR)	%
Early stage	1 100	0,2	0	0
Later stage venture	2 460	0,6	7 660	6,7
Balanced	30 750	6,9	0	0
Total venture	34 310	7,8	7 660	6,7
Total funds raised	442 590	100	114 760	100

Source: Author's compilation based on the EVCA statistics.

In 2011, fundraising for Poland private equity recovered significantly from the 2010 level, being at 443 mln EUR, that is a 286% increase. The level of venture fund raising increased 348% year-to-year, to 34 mln EUR. This huge growth was the result of balanced funds increase (from 0 to nearly 31 mln EUR).

Investments

Table 2. **Investments of CEE and European VC funds in 2010 (bank leverage not included)**

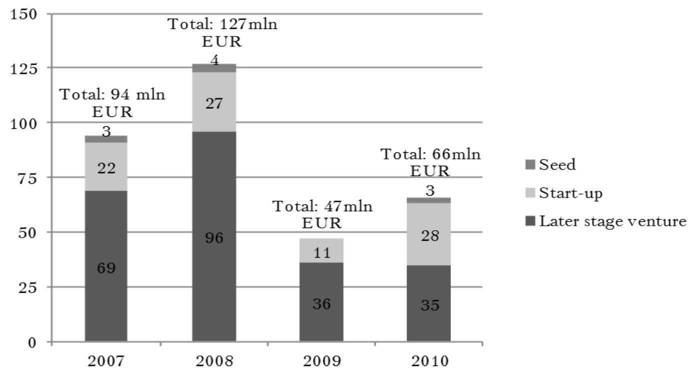
Stage focus	Poland	CEE			Europe	
	Amount (in ths EUR)	Amount (in ths EUR)	%	Number of companies	Amount (in ths EUR)	%
Seed	0	3 381	0,3	12	111 308	0,3
Start-up	1 293	27 411	2,1	33	1 730 420	4,2
Later stage venture	1 272	34 709	2,7	13	1 671 937	4,1
Total venture	2 565	65 501	5,1	58	3 513 664	8,5
Total investments	656 754	1 291 685	100	161	41 231 931	100

Source: Author's compilation based on the EVCA statistics.

Private equity investment in the CEE region in 2010 (1,3 bln EUR) decreased significantly in value in comparison to 3 previous years (nearly 2 bln EUR in each). Investment activity in the CEE region represented 1,87% of the total venture investment value in Europe in 2010. Poland was the largest CEE private equity investment market in 2010, accounting for more than half of the total amount invested in the region, but it represented only 3,9% of the total CEE venture investment in 2010.

The biggest decrease was noticed between 2008 and 2009. It was resulted by the financial crisis. In 2010 the sum of investment in seed (3 mln EUR) and startup (28 mln EUR) stage came back to the level before the crisis, unlike the later stage venture (only 36% of the 2008 level). Most popular venture-backed sectors by CEE Venture capital funds in 2010 were:

- financial services – 17,0 mln EUR,
- communications – 15,6 mln EUR,
- energy and environment – 13,2 mln EUR,
- computer and consumer electronics – 7,0 mln EUR,
- life science – 5,6 mln EUR,
- real estate – 3,2 mln EUR.



Source: Author's compilation based on EVCA, Central and Eastern Europe Statistics, 2010.

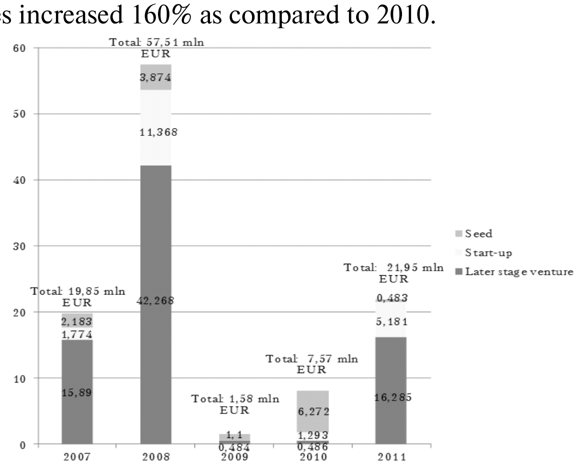
Figure 1. **CEE venture capital investments by stage, 2007–2010 (amount in mln EUR)**

Table 3. **Investments into Polish VC funds, 2010 and 2011**

Stage focus	2011				2010			
	Amount (in ths EUR)	%	Number of companies	%	Amount (in ths EUR)	%	Number of companies	%
Seed	483	0,07	3	4,6	0	0,0	0	0
Start-up	5 181	0,75	11	16,9	1 293	0,3	6	11,1
Later stage venture	16 285	2,36	12	18,5	6 272	1,2	4	7,4
Total venture	21 949	3,19	26	40,0	7 565	1,5	10	18,5
Total investments	688 657	100	63	100	504 243	100	52	100

Source: Author's compilation based on the EVCA Yearbook 2012.

Investment for venture companies increased over 190% year-over-year to 22 mln EUR, but much bigger percentage increase took place in the group of early-stage investment – 338% (to 5,7 mln EUR). Investment in later-stage opportunities reached 16,2 mln EUR in 2011, a 160% increase year-to-year. The total sum of private-equity investment increased in that period for only 37%. The number of venture-backed companies increased 160% as compared to 2010.



Source: Author's compilation based on the EVCA Yearbook 2012 and PPEA statistics (www.ppea.org.pl).

Figure 2. **Investments of Polish venture capital funds, 2007–2011**

Venture deals in Poland in 2010 were mostly in the following sectors:
- communications – 927 ths EUR;
- life sciences – 769 ths EUR;
- consumer services – 702 ths EUR.

Deals by venture capital funds in Poland in 2011 rapidly grew up and concerned mostly the sectors of:
- energy & environment – 7435 ths EUR;
- computer and consumer electronics – 6766 ths EUR;
- business & industrial products – 6157790 EUR;
- communications – 2536650 EUR.

Divestments

Investments realisation by funds are called exits or divestments. This normally take the form of a sale or flotation (IPO) of a portfolio company. There are 11 exit routes mentioned in European statistics.

Table 4. **CEE venture capital divestments by stage**

Exit route	2011		2010	
	Amount (in ths EUR)	Number of companies	Amount (in ths EUR)	Number of companies
Divestment by trade sale	3 805	4	19 007	2
Divestments by public offering	124	2	1 493	3
Sale of quoted equity	124	2	1 493	3
Divestment by write-off	4 261	3	4 138	4
Repayment of principal loans	4 000	1	42	1
Sale to another private equity house	585	2	18 023	6
Sale to a financial institution	4 363	2	150	1
Sale to management (MBO)	1 757	3	28 298	11
Divestments by other means	1 675	3	0	0
Total divestment	20 569	16	71 150	28

Source: Author's compilation based on the EVCA statistics.

In 2010, 28 venture-backed companies were exited (51% of all CEE companies exited), with the total amount divested at the cost of 71 mln EUR (24% of the total CEE divestment at cost). Venture divestments increased by 250% by amount at cost and by 75% in terms of the number of companies exited compared to 2009. More than a third of the exited companies were located in Poland. Close to 40% of venture divestment at cost in 2010 accounted for by sales to management, while trade sales accounted for 27% and sales to other private equity houses – 25%. Write-offs accounted for only 6% of the total value at cost, as compared to 14% Europe in general.

The most common ways of exits in the examined years were: sale to management in 2010 and divestment by IPO (70% of the total sum) and by trade sale (33% of the total number) in 2011. Interesting is the fact how different was the popularity of exit ways in both years. Other ways of exits, not mentioned in the table are: write-off, repayment of silent partnership and repayment of principal loans. Write-off is the total or partial write-down of a portfolio company's value to zero or a symbolic amount (sales for a nominal amount) with the consequent exit from a company or reduction of the share owned. The value of the investment is eliminated and the return to investors is equal or close to 100%.

Table 5. **Divestments – venture deals**

Exit route	2011			2010		
	Amount (in ths EUR)	%	Number of companies	Amount (in ths EUR)	%	Number of companies
Divestment by trade sale	3 162	22,1	5	7	0,0	1
Divestments by public offering:	10 752	65,7	3	586		2
a. Divestments on floatation (IPO)	10 706	65,4	2			0
b. Sale of quoted equity	46	0,3	1	586		2
Sale to another private equity house	259	1,6	2	7 548	25,7	2
Sale to financial institution	904	5,5	2	150	0.5	1
Sale to management	500	3,1	1	19 621	68,7	4
Divestments by other means	354	2,2	2	0	0	0
Total divestment	16 381	100	15	27 991	100	10

Source: Author's compilation based on the EVCA statistics.

The National Capital Fund

The National Capital Fund is the central fund of venture capital/private equity funds (VC/PE) in Poland. The NCF provides VC funds with financial support for their investments in SMEs of innovative character showing vast development potential in Poland. They put the 40–50% of the funds capital for the minority stake. The NCF is an investment vehicle that invests in VC funds. NCF's goal is to choose the best managers who will increase portfolio companies' value which will result in higher rate of return for funds' investors.

The NCF was established by Polish Government on July 1st, 2005 with the aim of filling in the equity gap at Polish SME market. The NCF manages more than 200 mln EUR coming from Polish Budget, European Union's Structural Funds (Operational Programme Innovative Economy) and the Swiss government (on Swiss-Polish Cooperation Programme). 100% shareholder of the Fund is Bank Gospodarstwa Krajowego. As of May, 2013 11 funds were supported by the NFC (see Table 6).

Table 6. **Funds under the support of the National Capital Fund**

NAME OF FUND	CAPITAL	INVESTMENTS
BBI Seed Fund	PLN 60 M	7
Helix Ventures Partners	PLN 40 M	6
Assets Management Black Lion	PLN 100 M	3
GPV I	PLN 84 M	2
Innovation Nest	PLN 40 M	2
Skyline Venture	PLN 100 M	2
Internet Ventures	PLN 100 M	1
Aquarium Venture Fund I	PLN 100 M	-
Nomad Fund	PLN 40 M	-
Opera Venture Capital	PLN 100 M	-
Venture Capital Satus	PLN 50 M	-
SUM:	PLN 714 M	23

Source: Author's compilation based on the www.kfk.org.pl data.

In 2009 the supported funds made only 6 transactions of buying stakes in firms at early stages (4 companies in the communications sector and 1 from computer and consumer electronics sector and computer services sector). In the following year the number of venture deals grew to the number of 9 transactions (4 companies from communications and 2 from life sciences, inter alia).

Here we present the examples of some venture capital transactions which took places in 2011, mentioned by the Deloitte in their reports about Central Europe private equity market:

1. MCI BioVentures, the fund investing in biotechnologies and healthcare, established in December 2011 its first investment exit, selling shares of MedCascoto, a Third Party Insurance Administrator to an industry investor – Dent-a-Medical S.A. The value of transaction is not available.

2. Enterprise Venture Fund I (EVF), the venture capital fund managed by Enterprise Investors investing 5.5 mln EUR in BLStream, a software company specializing in mobile technologies. It's formally based in Finland but almost all of the development work has been done by Polish IT specialists in Szczecin, Bydgoszcz and Wroclaw. After the transaction EVF holds 35% of the company.

3. MCI Management S.A using its Helix Ventures Partners venture capital fund (backed by the NCF), invested in Frisco.pl, the leading player at the e-grocery market in Poland. The transaction was not publicly announced.

4. MCI.TechVentures invested in Morele.net in November 2011, the second-largest Polish online retailer offering IT equipment.

Conclusions and outlook

The comparison of Polish, CEE and European venture capital market could create the impression, that limited scale of Polish funds capitals made difficulties for SMEs in access to capital. The author argues that this problem could have the second face – Polish SMEs are not innovative enough and the problem for venture capital funds is to find a group of ground-breaking firms with wide and clear prospects for future progress and profits.

The funds has broken the crisis-effect (especially in 2009) and all 3 market characteristics has visibly increased in the examined years 2010–2011. Investment levels in 2011 showed some improvement over the previous year and are expected to continue the increase now. Also the level of funds raised should be bigger, as the macroeconomic market situation is predicted to be more beneficial. It is also highly probable, that in the next few years the established NCF will very positively effect Polish venture capital market.

The ongoing part of the research is to analyse the VC-backed firms. The aim will be to measure the effectiveness of funds support. It is likely that there is a symbiosis between business growth and venture capital, and VC-backed companies should outgrown their non VC-backed peers. Also there is a need for empirical analysis to measure to what extent government policies have contributed to the development of venture capital market.

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