The Perfection of the Mechanism of Venture Capital Financing:
Organizational and Economic Model

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Abstract: The article deals with the problems and prospects of the realization of venture financing mechanism. The raise in efficiency of venture capital financing is a topical issue not only within the frameworks of the emerging innovative economy in Russia, but also for the developed countries which have long moved on the rails of innovative development. This research work is devoted to the quest of the most optimal model of the mechanism of venture funding. According to the author, one of the models which can be considered to be attractive to both investors and innovators is a “venture factory”, which is based on the networking cooperation of specialized infrastructural institutions.

Key words: Venture capital financing • Innovation process • Fabless-company

INTRODUCTION

Scientists of 20th century devoted a great attention to study of innovation process nature, influence of science and technologies development on economic growth. Theory of innovation process has found its reflection in work of J.A. Schumpeter [1], G. Mensch [2] and other scientists.

The acceleration of technological progress in the middle of the twentieth century led to the growth of investment proposals which promote innovative ideas. The most intensive process took place in the United States and then in European countries and South-East Asia. Due to investments in innovations, the process of wide implementation of new technologies into consumer market was carried out. The development of “consuming society” created the demand for innovations in the sectors of consumer goods, trade, service and entertainment. All these factors attracted considerable financial resources into business with increased risk level. The consequence of this became the emergence of a new mechanism in investment sphere - venture financing. Venture capital financing speeds the development of companies, enabling them to transform ideas quickly into marketable products and become industry leaders through first mover advantages [3]. Venture capital-backed companies aim at more radical innovations, are significantly faster in introducing their products to the market and pursue more aggressive market strategies than other start-ups [4].

In modern context the development of venture capital financing in Russia is one of the most topical problems of innovative economy formation. Despite the fact that in recent year’s venture capital business has been flourishing, the necessary supportive infrastructure has been created, the legislative base is constantly improving, the volume of venture capital investments is increasing, there is a number of stories of success of venture projects, still there are some problems. The prevailing institutional conditions have a great impact on the existing mechanism of venture capital financing, which cannot function as a single coherent mechanism contributing to the development of the innovation process. The existing supportive institutions of venture business are not always interconnected and effective. Experts explain that the situation is due to lack of a system of efficiency appraisal and control of business incubators and industrial parks activities by the state [5].

The aim of this research work is to develop a model of venture capital financing, aimed at the realization of innovative projects with in investment risk minimization.
MATERIALS AND METHODS

The research work is based on the principles of structural and functional approaches, as well as the methods of analysis and synthesis on theoretical and empirical levels. The methods mentioned are used within the frameworks of a systematic approach that contributes to the argumentation of the results made by the author.

The Main Part: Implementation of innovations is a risky process, providing at the same time success and contributing to rise in competitiveness of any business. With innovation mastering most companies face the lack of financial resources, experience in management of innovative process and in most cases venture capital helps solve these problems. Since the middle of the twentieth century first in the USA and then in Europe, South-East Asia and Russia a new financial mechanism got proliferation allowing innovations to be implemented. It turned out to be venture capital financing, which is a risky investment in start-ups promising in the future high incomes.

Venture capital financing is a financial element of innovative infrastructure that integrates capital and technologies’ holders and it is exactly it what solves the problem of financial insufficiency in the sector of starting innovative projects.

Besides financial needs the obstacle enterprises usually face while realizing innovations is the lack of experience in management of innovative activities, support of innovative product. The solution to this problem lies in the essence of venture financing mechanism. In the process of implementation of venture funding for realization of an innovative project not simply financial resources are provided, but what we call “smart money” which are accompanied by the expertise, the total understanding of how to do business. The venture investor brings to his portfolio companies not only financing but also methodological support.

The process from the generation of the idea to the emergence of an innovative product on the market can be characterized as transition of the stages, characterized by lowering of investment risk and increase in investor’s potential revenues. Each stage requires the development of a specific strategy aimed at reducing of the risk and search of the appropriate sources of funding. In particular, in early stages of the development of an innovation - in the period of the transition through “the valley of death” -active investment strategy and support are required, which imply not only specific sources of funding, but also investment of experience into future innovative product, knowledge in the field of management and business modeling. For the later stages of innovations’ realization passive investment strategies are suitable which provide an opportunity for innovative company-developers to capitalize. The success of innovative activity, besides the correct strategy chosen, depends largely on the effectiveness of supportive institutions. In today’s domestic and foreign practice there are various institutions of infrastructure aimed at the support of innovative activity. However, they do not constitute a single complex structure and often function inefficiently. The solution of this problem requires implementation of an optimal system of the so-called “innovative lift”, the core idea of which is appropriate support on each stage of innovative process. The existing in Russian practice developmental institutions, which are the elements of the “innovative lift”, doesn’t have a unified approach towards the process of determination of viability and quality of the innovative project. For today unified standards of innovative projects’ evaluation, which would allow increasing not only the effectiveness of their implementation, but also the activity of the investors, haven’t been developed.

In our opinion, a special mechanism is required which functions under the control of a single center and provides the needs of both investors and innovators. Taking into consideration domestic and foreign experience, we can formulate general principles of a single integrated mechanism aimed at the formation and realization of innovative projects in the form of a Smart-model of venture capital financing. It is based on interconnection between the elements of the “innovative lift” and differentiated approach to investment strategies and funding sources in dependence on the stage of the project. The purpose of the Smart-model of venture capital financing is to create a special “zero waste (waste-free)” mechanism of getting revenue, aimed at minimization of investment risk of innovative projects based on sales of innovative projects on the early stages or output of ready-made business. In its essence a Smart- model is a “venture factory” in the basis of which lies a hybrid of a fund, a business- accelerator and a managing company. The model is based on the networking interaction of specialized infrastructural institutions:
• A business-accelerator [6], which generates the flow of innovative projects and organizes their packaging;
• A venture capital fund, which finances the projects of later stages (early stage, expansion);
• A crowdinvesting-platform [7], which accumulates the funds for the projects of early stages (seed, start-up);
• A managing company-transmitter, which is a single control body of all institutions of the infrastructure.

The unity of standards’ assessment of an innovative project at each stage is provided by means of the control of a unified Managing company-transmitter, which accompanies all stages of an innovation process, starting with the analysis of the dynamics of possible development of innovative ideas up to the functioning of ready-made business-units.

The functioning of the Managing Company is based on the principles of the so-called fabless-company [8]; its activities are aimed at increasing the profits for the founders through its participation at every stage of the development and implementation of innovative projects. The Managing Company carries out the management of innovative projects at all stages of their life cycle, including participation in the activities of the specialized infrastructural institutions (the business-accelerator, the venture capital fund, the crowdinvesting-platform). To reduce innovative risk the Managing Company must form elaborate plan of action for each project and in accordance with it select the necessary financial resources and the team.

The Managing Company works on the principles of self-repayment, so the operating expenses will be covered by the revenues from the sales of the results of trendspotting even in the initial stages. The Managing Company’s revenues are formed from the sales at all stages of the development and implementation of the project; the management fee from the investors of the corporate venture capital fund; the management fee from the investors of the corporate crowdinvesting-platform.

The activities of the whole mechanism of “venture factory” should be based on the following principles:

• Fabless-principle allowing to use division of labor and integration and effective application of the resources required (intellectual, material, financial, etc.) in order to create and implement the projects. This principle is based on the attraction of the most suitable resources at minimum cost;
• Connect & Develop generating the search of innovative ideas and their subsequent elaboration [9];
• SbA (support-by-action) – support of the action aimed at the result - full immersion of the Managing Company into all stages of the implementation of innovative projects;
• Lean production - avoiding losses at each stage of the project’s realization, the provision of the continuity of the flow of incomes;
• Transmitter - the principle of the transmission, the gradual transition of innovative projects in the process of implementation from one stage to another in case of advisability;
• Network – a network principle based on the coordination of interconnected infrastructural institution [10];
• Copycat - principle, assuming business transfer of successful foreign technologies.

The mechanism of the Smart-model of venture capital financing implies also the principles of self-repayment, effectiveness, transparency and flexibility thus contributing to rise of investors’ confidence.

Profit-making is achieved by the investors mainly through the sale of the start-ups, the sales of the analysis’ results of trends and sales of ready-made business in the late stages.

**CONCLUSION**

The presented smart-model of venture capital financing has certain advantages in the sphere of financing of innovations and is such a mechanism that is considered to be beneficial to all. The innovators get the formation of an innovative idea into a ready-made complete project; they also have an opportunity to receive the necessary funding in the early stage of the business, during the transition from the “packaged idea” to its implementation. Apart from this the problem of managing an innovative project at all stages is solved. Due to the experience of the managing professionals the probability of bringing the project to its successful implementation increases. For the investors the argument of great importance in favor of investing is increase in profitability under risk reduction. The mechanism of this model allows to increase the investors’ profits at the expense of virtually “waste-free” implementation of innovative projects at various stages, including start-ups and also to reduce investment risk. In addition, the
investors get the opportunity of expanding the informational space about availability of innovative projects. On the whole, for the economy there appears a possibility of time ours implementation of new technologies, development of business initiative and animated development of innovative ideas.

Summary: The process of acceleration of scientific and technical progress requires such mechanisms and institutions which will be aimed at the formation of synergistic effect within the frameworks of building of innovative economy. One of such mechanisms is a Smart-model of venture capital financing, revealing the possibilities of mobilizing resources into innovative projects all the way from seeding up to mature company. The combination of various developmental institutions, which allow the project to move by the type of an “innovative lift”, the unified approach to the management of the project at all its stages on the basis of special principles form the further prospects of venture business.

REFERENCES