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Venture Capital Markets: A Cross Country Analysis

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Abstract

Venture capital (VC) may be defined as a support to entrepreneurial talents and appetite by turning ideas and basic science into products and services which are expected to envy the world. Venture capital funds are able to build companies from the simplest form to mature organizations. Venture capital investors generally actively engage with management of the company by typically taking place on the board. Through the due diligence process the venture capital firms concentrate on the founders, the management team, the concept, the marketplace, the revenue model, the value-added potential of the firm, the amount of capital needed to heal the business and whether all these fit to the fund's objectives. Over the next three to eight years, the venture firm works with the founding entrepreneur/s to grow the company. Once a company funded by venture capital matures and becomes successful, venture funds generally exit by taking it public through an initial public offering (IPO) or by selling it to big companies. This allows the venture funds to be free from the previous investment and invest in the next generation of companies. United States, Europe, Israel, Canada, China and India have the most developed markets for venture capital environment. The size of the venture capital market is nowadays about $50 billion and the United States has the most funds for venture capital of $33.1 billion in 2013. Venture capital firms may invest in promising firms in stages of seed, first round, second round or later. The median investment amounts in the United States in 2013 are $0.5 million for seed, $2.5 million for first round, $5.7 million for second round and $10 for later stage. The most attractive sector for venture capital is information technology for the United States, Israel and Canada, invested over $10 billion in 2013, while the most attractive sector is consumer products for Europe, China and India, invested over $4.8 billion in 2013.

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1. Introduction

Venture capital (VC) may be defined as a support to entrepreneurial talents and appetite by turning ideas and basic science into products and services which are expected to envy the world. Venture capital funds are able to build companies from the simplest form to mature organizations. The start-ups are generally composed of entrepreneurs and an idea expressed as a business plan. Venture capital firms are professional managers of risk capital that enables and supports the most innovative and promising companies. Venture capital funds new, promising and innovative ideas that may not be possibly financed by the ways of traditional banking. Venture capital is in fact a unique investment for institutional investors. When a venture capital investment is made in a company, it is an investment for a proportion of the equity in which the stocks are essentially illiquid and worthless until the company matures three to eight years and turns out to be a significant value. Later on the way the venture investors provide additional funding as the company needs cash injection to grow further. These are called rounds and typically occur every other year or two and also may involve additional equity investments by allocating shares among the investors and management team based on an agreed new valuation of the company. Nevertheless, venture capital is a long-term and risky investment which may have very little or no value unless the company is acquired or goes public.

In the period of 1991 and 2014, a total of 11,686 companies funded by venture capital in the United States over time in which 14% went public, 33% acquired, 35% still private and 18% failed. The most attractive sectors for US venture funds are software (41%), biotechnology (12%), media & entertainment (12%), IT services (7%), media devices (5%) and industrial energy (5%). New commitments to VC funds in the USA are $17.7 billion in 2013 and around $30 billion in 2014.

2. How a Venture Capital System Works

Entrepreneurship has been recognized as a major conduit for sustainable products and processes, and new ventures are viewed as an answer to many social and environmental problems (Hall et al., 2010 and Pacheco et al., 2010). Venture capital has a key role in nurturing entrepreneurship and new ventures. As such, venture capital may be viewed as an important catalyst to develop sustainable businesses (Bürer and Wüstenhagen, 2008) – those that contribute positively to the environment and society while generating a profit.

Venture capitalists are keys in the emergence of businesses. They can make start-ups grow faster, create more value and generate more employment and innovation (Keuschnigg, 2004). Venture capitalists may be viewed as the "gate keeper" to the emergence of new businesses, as their role is to select venture ideas presented to them by entrepreneurs (Marcus et al., 2013).

Actually, venture capitalists involve more than putting money into a risky business. Venture capital investors in general actively engage with management of the company by typically taking place on the board. Through the due diligence process the venture capital firms concentrate on the founders, the management team, the concept, the marketplace, the revenue model, the value-added potential of the firm, the amount of capital needed to heal the business and whether all these fit to the fund's objectives. Over the next three to eight years, the venture firm works with the founding entrepreneur/s to grow the company. The expected payoff comes only after the company is acquired or goes public. Although the venture capital investors have high hopes for all companies funded, statistically only one company in six ever goes public and one company in three is acquired. The most expensive asset for venture capital firms is time. Therefore, a business approaching venture capital firms should have a concept addressing world markets, superb scalability, expected to be successful in a reasonable timeframe, and be truly innovative filling a gap. A business concept promising a 10 or 20% improvement on returns is not likely to grab the attention of venture capital firms.

The success of venture capital is mostly embedded in the entrepreneurial spirit pervasive in the culture, financial recognition of success, access to advance science, and fair and open capital markets. Motivated entrepreneurs, protection of intellectual property, availability of a skilled workforce and existence of an environment for a good flow of science are the requirements of venture capitalists. A country's cultural look over entrepreneurships,