

V2C IMPLICATIONS TO RUSSIAN START-UP COMPANIES

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Abstract

Many entities exist to assist companies in the V2C operating space, i.e. in the matching of ventures and capital. The taxonomy of the V2C players includes incubators, advisors, business angels and classic (early stage) venture capitalists. All of them have different business models, varying motives, forms of value adding contribution, incentive schemes and profit generation models. In the post-soviet era, emergence of entrepreneurship has raised the issue of sufficient support to start-up and growth company also in Russia. In the traditional sense, the support consists of financial support, such as capital from venture capital operatives. V2C operatives support growing ventures relatively more with human and social capital than with financial capital. In this exploratory study, the field of venture capital in Russia is examined. Also the sphere of growth companies is outlined. The aim of the paper is to discuss the common and distinct features of VC players in Russia and ponder upon the utilisation of V2C models. Moreover, the aim is also to initially examine the existing gaps and how the operation models can be better suited for start-up companies in Russia.

Keywords

Russia, Venture Capital, Venture to Capital

INTRODUCTION

Prior research on venture capital (VC) and venture-to-capital (V2C) operatives has underscored their importance when new businesses are created (e.g. Seppä 2000, Rasila et al

2002). Importance of capital as main asset for ventures is however secondary issue as growing new firms often lack business wisdom, including knowledge on practical and social aspects of being on the market. General notion of different operatives is that their revenue logic is based on the success of new the underlying ventures, thus their interest is partially selfish, yet it serves the best of the ventures too.

Many entities exist to assist companies in the V2C operating space, i.e. in the matching of ventures and capital. The taxonomy of the V2C players includes incubators, advisors, business angels and classic (early stage) venture capitalists. All of them have different business models, varying motives, forms of value adding contribution, incentive schemes and profit generation models. Moreover, in the post-soviet era, emergence of entrepreneurship has raised the issue of sufficient support to start-up and growth company also in Russia. In the traditional sense, the support consists of financial support, such as capital raised from a venture capital operative. V2C operatives support growing ventures relatively more with human and social capital than with financial capital.

In this study, the field of venture capital in Russia is examined. Also the sphere of growth companies is outlined. The aim of the paper is to point out the common and distinct features of Russian VC operatives and discuss utilisation of V2C-models. Moreover, the aim is also to examine existing gaps, i.e. how the operation models can suit better for Russian start-up companies. This study is delineated to general description in Russia, as there is sufficient amount of information available. However, secondary delineation for this study is to discuss the existing gaps between prospective ventures and lucrative companies. In order to gain normative results a model of V2C-operative is employed. Findings in Russian context are reflected to normative V2C operative and the suggestions for applying such model in Russia are made.

THE HISTORY OF VENTURE INVESTING IN RUSSIA

The Role of European Bank of Reconstruction and Development (EBRD)

July 2003 marked the 10-year anniversary of the VC industry in Russia. In 1993, in a Tokyo summit, the agreement to support recently privatised Russian enterprises according to the State program of mass privatization in Russian Federation was accepted (According to that program about 15000 small and medium enterprises were transferred to private property). It was the agreement between the EU and G7 governments. EBRD conducted the process of the summit decision's fulfilment. It began the program of regional venture funds. The creation of venture funds in Russia began in January 1994. According to the Program of Venture Capital Regional Funds Creation 11 funds were founded. EBRD allotted \$312 million for that purposes. (Gulkin 2003)

On 7th of July 1994, EBRD declared the creation of the first regional venture fund, the Smolensk Regional Venture Fund (RVF) managed by Siparex Gestion et Finance (SIGEFI). The aim of the first RVF was determined as "rendering the assistance in the strengthening of privatized companies by the direct investments into the shared capital." (Gulkin 2003.)

During July 1994 - August 1995, six more RVFs were established. On 15 of August 1995 was declared about the creation of Northwest RVF. It was managed by the consortium of

Scandinavian companies - Euroventures Management AB (Swedish venture firm), Den Norske Bank (Norway), FINNFUND (Finnish Financial Corporation), SITRA (one of the largest Finnish VC operatives), Sitrans (Finnish-Russian joint consulting company, specialized in consulting and indirect facts the share of capital used for financing of technological transfer of technologies) and SND (Norwegian industrial and regional development fund). In 1995 also West-Russia RVF was formed. The fund was managed by a consortium of Italian firms (Sofipa Spa and Iritech Spa). The last of the 11 funds was Rabo Black Earth RVF, oriented to the Black Earth territory, is managed by the consortium of Dutch Companies headed by Rabobank International. It was created in 1996. (Gulkin 2003.)

Every RVF (excluding the first one) disposed of \$30 million in capital for private equity investments. In addition to EBRD investment capital, every fund had \$20 million provided by donor-country governments for covering both fund management expenses and operating and consulting expenses of the RVF investee enterprises. Ten of the eleven RVFs had non-Russian presidents (Shtipling 2002).

There are no reliable public sources of information about the RVF operation and performance, but according to some experts their relative level of innovativeness has been marginal. The share of EBRD backed RVFs in the total Russian VC market is more than 50% (see table 1). In 2001 EBRD restructured the system of RVFs management. Several funds were united under the separate management of several groups, which had agreements with Russia and important contacts in business society. Seven of the eleven funds nowadays managed by 3 groups of managers: Eagle Venture Partners, Nordic Russian Management Ltd. and Quadriga Capital. The last reconstruction stage was finished in 2001, when 2 more funds were united under the one managing company. (Gulkin 2003, Shtipling 2002)

Table 1. Regional venture funds EBRD. December 2001 (www.cnews.ru)

Name	Main territories	Share of EBRD	Investment of fund manager	Donor	Donor's facilities
«Eagle» the Black Earth fund	Belgorod, Kursk, Lipetsk, Tambov, Voronezh	24 million Euro	2,4 million Euro	EU	11 million Euro
«Eagle» Smolensk fund	Smolensk	\$12 million	N/A	EU	6 million Euro
«Eagle» Ural fund	Cheliabinsk, Perm, Sverdlovsk	\$30 million	\$3 million	EU	15 million Euro
«Eagle» Russian fund	Belgorod, Cheliabinsk, Kursk, Lipetsk, Perm, Smolensk, Ekaterinburg, Tambov, Voronezh	\$13,5 million	\$1,35 million	EU	Included into capital allotted for other «Eagl» funds
Regional Venture Fund (RVF) of Far East and Eastern Siberia. (Daiwa)	Irkutsk and regions which are situated to the east of it, including Primorsky and Habarovsky district	\$12,5 million	\$1,25 million	Japan	\$20 million

Lower Volga RVF	Samara, Saratov, Volgograd	\$30 million	\$3 million	USA	\$20 million
North-West And Western RVF (Norum)	Arhangelsk, Karelia, Murmansk, Novgorod, Pskov, Tver, Vologda	\$60 million	\$3 million	Finland, Norway, Sweden, Italy	\$27 million
Russian fund «Norum»	Arhangelsk, Karelia, Murmansk, Yaroslavl, Pskov, Tver, Vologda	\$13,5 million	N/A	Finland, Norway, Sweden, Italy	Included into capital allotted for North-Western and Western RVFs
RVF «Quadriga» central part of Russia	Ivanovo, Nizhnii Novgorod, Kostroma, Yaroslavl, Vladimir	\$30 million	\$0,3 million	Germany	32 million DM
RVF «Quadriga» for Saint-Petersburg and Leningrad District	Saint-Petersburg, Leningradskaya district	\$30 million	\$1 million	Germany	34 million DM
«Quadriga» Russian fund	Saint-Petersburg, Ivanovo, Nizhnii Novgorod, Kostroma, Leningradskaya district, Yaroslavl, Vladimir	\$13,5 million	N/A	Germany	Included into capital allotted to other fund under the management of “Quadriga”
South regions of Russia	Krasnodar, Rostov, Stavropol	\$7 million	\$0,7 million	France	48 million Fr
Western Siberia	Altai, Novosibirsk, Kemerovo	\$30 million	N/A	EU	13 million Euro

According to Nikkonen and Vlasov (2001), at the present, EBRD plays key role in the development of Russian venture capital industry. Thanks to the RVF scheme, management companies will have a chance to figure out how venture capital can function effectively in Russia. EBRD provides the individual investors leverage for entering the Russian market and, hence, contributes to the emergence of Russian venture industry professionals.

The role of IFC

Another important player on the Russian market of foreign direct investments and venture capital investments is International Financial Corporation (IFC). IFC is the investment arm of the World Bank Group, which specializes in new markets of developing countries. In April 1993, IFC decided to allocate \$8 million to Framlington Russian Investment Fund. The total capital of the fund was targeted at \$50 million Besides IFC, also EBRD and several European private investors invested in the fund. The fund was to be managed by a Framlington Group PLC (London) subsidiary. Since the beginning of the 1990s until 2001 IFC participated as investor in several venture capital funds in Russia (see table 2) (www.cnews.ru)

Table 2. Participation of International Financial Corporation (IFC) (www.cnews.ru)

Approved by the Board of Directors	The name of the project	The cost of project (\$, million)	The share of IFC (\$, million)	The description of the project
June 2002	Agro Industrial Finance Company	16.5	15.5	The creation of the new financial intermediary for agriculture financing
December 2000	Baring Vostok Fund	175.0	15.0	The creation of the direct private investment's fund for growing industrial sectors financing in Russia and other Post-Soviet Countries
June 1996	Pioneer First Russia, Inc.	15.1	4.0	Investments into the diversified financial group specialized in the management of funds, the financial services provision, shareholder's support, voucher investment funds and commercial banking
June 1995	Sector Capital Management	3.5	0.5	The creation of the financial consulting company which is directed to manage Sector Capital Fund and provide other financial services to Russian investing and companies
June 1995	Sector Capital Fund	36.5	4.5	The creation of a closed fund for investments into the share capital of the companies for the financing of small and medium businesses
January 1995	Russian Technology Fund	10.0	2.0	Investments into the share capital of technological firms
September 1994	First NIS Find	180.0	15.0	The creation of a closed fund for investments into the share capital of the companies in their starting point
December 1993	Framlington Fund	50.0	8.0	The creation of 10-years fund for investing into Russian enterprises, primary joint ventures

US Government

American government as well decided not to stay aside. During the meeting of Mr. Gore and Mr. Chernomyrdin the political decision was taken to create new instruments for venture capital investments into Russian enterprises. In 1994, the United States Agency of International Development formed two funds: Russian American Enterprise Fund (RAEF) and Fund for Large Enterprises in Russia (FLER). In April 1995, both of them merged into U.S. Russian Investment Fund ("TUSRIF"). The declared capital of that fund was \$440 million It was to create venture investments in Russia to "stimulate investing activity". (RVCA 2001)

During the period of 1993-1996, it was considered to be relatively easy to find unique technologies to generate profits to the first investors. The first investments were made in 1995. However, the investment process was troublesome thanks to several factors. Market economy development was still as at a very early stage. Direct investing mechanisms were not developed, and the understanding of that process was narrow. Companies' managers were afraid of outside investors. Fund managers were not adapted to Russian business environment and hence the creation of the managing teams was slowed down. The managers lacked direct contacts on the ground. Special attention was drawn to the companies oriented on the local markets of consumer products, especially to food and connected goods and services (RVCA 2001).

The first positive results of fund management were seen during 1997-1998, when the growth of investing volume was considerable. But the progress stopped in August 1998 due to economical crisis. After August 17, the possibility of new capital flows had decreased dramatically. Bank system crisis materialised into blocking and holding of payments and had a very negative influence on the Russian business life. Indeterminacy and instability followed. At the same time, however, new favourable features in Russian economy appeared. The competitive advantage of Western industrial companies had fallen in Russia. At the same time, venture capital funds gained market advantage due to the crisis of banking system and the absence of any long-term credits. The valuations of venture deals came down to the benefit of the venture capital investors. (RVCA 2001)

Difficulties of the Russian government and the necessity to boost business sector development led to decreased bureaucratic pressures on venture capitalists. In 1999, all management effort was directed solving post-crisis problems and, in 2000, growth of investment activity began again. This period can be characterized by quality improvement and growth of average investment amount, as well increase in syndication between venture capital funds. In the end of 2001, altogether 40 venture capital funds were in operation in the Russian Federation with a total capitalisation of \$500 million of which ca. \$350 million was invested (Nikkonen, Vlasov 2001).

During the latest years, technological innovative centres, law, licensing and consulting firms have been created in Russia. Legislative Acts have been accepted to form a market economy based research sector. New instruments and mechanisms appeared as well. During the last 10 years ca. 250 companies have received investments, but according to experts, investments in the high-tech sector have been no more that 5 %. In the beginning of 2003, the first private venture fund was created where 10% of the fund capital came from the State venture Innovations Fund.

Russian Government Support

Except private investors, also the government is coming into the market. Governmental structures are the second important investor. Most funds financed by government have special aims dictated by the agreements of Russian and foreign governments, such as Defence Fund, oriented into the conversion of Russian defence industry, TUSRIF, AGRIBUSINESS and etc. In the summer of 2000, the Industry Ministry created Venture Investment Fund (VIF) intended to develop the infrastructure of Venture Financing in Russia. The State invested

RUR 100 million in the project. Other founders were Rossija Bank and the Support Fund of High-tech Entrepreneurship (Bortnick Fund).(Gorskiy 2002.)

The VIF is intended to create RVFs, which contain in their statutory capital a VIF share. The maximum VIF share should be not more that 10%. The VIF is considered to become a “fund of funds” and play a considerable role in the Russian venture capital industry. It is supposed to create a network of regional venture investment institutions, which are aimed to pool Russian and foreign capital to be invested into Russian high-tech enterprises.

Russian Venture Capital Association (RVCA)

Most venture funds operating in Russia are members of Russian Venture Capital Association (RVCA). RVCA was created by EBRD and IFC in 1997. The head office of RVCA is located in Saint Petersburg and it has emerged as the main Russian venture support organization. In June 1997, RVCA became member of the European Private Equity and Venture Capital Association (EVCA) and the National Venture Capital Association’s (NVCA’s) Council of European countries. Also a number of American venture funds (Delta Capital, Agribusiness) and direct investment funds (SEAF, SEEF) are members in the RVCA. Their total committed capital is ca. \$570 million of which ca. 210 million is invested into 71 companies. In total, RVCA members have more that \$1 billion in committed capital, of which ca. one third is invested into 133 companies. (RVCA 2003).

Special characteristics of the venture capital process in Russia

In Russia, the share of high-tech based industries is estimated, at maximum, at 3 % of GDP. The venture capital industry was imported to Russia from the outside; its creation was the result of political administrative decisions according to which Russian economy should have been transformed into market economy. The main sources of venture capital in Russia are institutional investors and foreign budget sources.

Russian venture capitalists prefer to back companies that operate on low demand elasticity markets. Also, the product should represent high export potential. This is why the portfolios chiefly comprise investments in pharmaceutical, food industry, building, packing materials production and transport and trade companies.

Since the beginning of 2000, investors started to pay more attention to machine and equipment construction in Russia. Investments into the high-tech space remain rather scarce. A case example of a high-tech investment involves “Alcor Bio” Ltd. In 1998, the company exchanged 40% of equity to a venture capital investment by Russian Technological Fund.

According to RVCA data, the annual compounded rates of return from in venture capital investments in Russia are ca. 25 %, while the figure is ca. 20% in Europe. The main sources of information about high-growth-oriented companies in Russia include industry associations and guilds, brochures published by business development agencies and companies, publicity, and exhibitions, topped with direct contacts by venture fund managers. The average investment amount in Russia is ca \$2,7 million. The fund market is by no means fully developed. In general, the financial activity of business firms is not equally transparent when compared to Europe and hence there is even less security for the risk investor. Consequently, there is a decrease in the number of small companies. This makes the future outlook for venture capital investments dimmer.

According to Alexei Tupitsin, director of “North-West” Ltd., the problems in the venture capital space gear around the domination of the oil sector in Russia. According to Nikkonen and Vlasov (2001), the main problems for development of venture capital investing include the taxation system, the legislation, requirements for investment registration and coordination, financial infrastructure development, and creation of favourable conditions for entrepreneurship.

Tax system should stimulate companies to transparently accumulate profit. The Russian system is far too bureaucratic and oriented on fiscal targets (not to help company management). Also, the possibility to deduct real financial expenses is limited.

Russian legislation does not contain any special laws regulating venture capital funds and venture capital companies. Residents of the Russian Federation manage only a fraction of the venture capital funds operating on Russian territory. Consequently, the funds often confront different problems in their everyday dealings, both on the federal as well as the local level. The organizational structure of a typical venture capital organisation comprises of a limited liability management company and a separate fund vehicle, often an unregistered structure taking the basic form of a limited partnership, such as a simple partnership according to the civil code of Russian Federation. In such a dual structure, according to Civil Code of Russian Federation and in analogy to Acts concerning pension and mutual funds, the managing company serves as a “financial accumulator”.

The legislation concerning repatriation of investors’ profits is more liberal than, for example, in many developing countries. The Russian legislation about intellectual property rights (patent and copyright law) can be considered relatively advanced. Russia is member of International Organization of Intellectual Property and the main international conventions: Bern Convention of literature and arts protection, Copyright World Convention, and Paris convention on the industrial property protection, including special international agreements, such as the agreement of patent cooperation. (www.venture-nvf.ru)

In 2002, the National Venture Fund pushed forward the “Law About Venture Activity”, but it is criticised by many venture capital market participants. Alexei Vlasov, Director of Regional Technological Fund, considers venture investing not to require any special legislative base. The main target is the creation of comfortable (enabling) investment conditions, the possibilities for business development via growth company process.

Also the legislative and governmental structures should create favourable conditions for entrepreneurship. There are problems in the protection of minority shareholder rights (for those holding less than 25% of equity). This limits growth of the smaller investment amounts. Liabilities of shareholders according to agreements, there should be more reliable legislative protection. There are long and expensive procedures of registrations. Also the exit-phase to the market lacks support. Sooner or later venture funds must sell their shares. To serve this end, stock exchange development should be supported by the government. Russian pension funds, insurance companies and banks are not ready to hold venture operations. Pension funds and insurance companies are limited by the legislation, and banks are the only players, but they act very conservatively. Regional and local government should concentrate on the support of small business to boost economic development.

Northwestern Russia is in many ways the closest to Europe and hence a logical choice as a financial centre. NW Russia is also one of Russia’s most developed regions. Saint Petersburg

initiated the decision of the delegation of a part of Moscow's plenary powers to the City Government to fasten the investment registration procedure. Due to this development, the region is expected to develop ever faster in the foreseeable future.

Today the NW market contains ca. 10% of the total Russian market volume. In the years to come, the full private equity market potential of NW Russia is estimated to \$3-5 billion (in entry valuations). NW Russia remains number one region in attracting venture capital within the Russian Federation. At present, the total Russian venture capital industry capitalisation is evaluated at \$580 million, of which the share of NW Russia is 33-34%. NW Russian funds have the total capital volume of about \$150 million. The head offices of the leading Russian venture organisations are located in Saint Petersburg – including that of the RVCA. At present, ca. 2/3 of all venture capital funds operating in Russia are represented in the city (RVCA 2003).

In NW Russia, the main venture capital investor in the high-tech space is Norum (Nordic Russian Management Company) Ltd, the management company of the Northwest RVF of EBRD. To mark Saint Petersburg's role as Russia's capital of venture capital, the first important exit was completed there in the end of 2000: One of funds sold its shares in the "The new Era" Ltd and received its original investments back 2,1 times (RVCA 2001).

THE PRESENT SITUATION AND PERSPECTIVES FOR THE FUTURE

A future concept for Russian venture capital industry

In the end of 2002, the Ministry of Industry and Science launched a project of Concept of venture industry development until 2010 (venture funds creation for financing of venture high-tech companies). The project is intended to change the GDP structure and dynamics, increase the share of products with higher value added cost. That will help to decrease the country dependence from natural resources and raw materials export. The Ministry of Industry and Science considers venture investing as the main source to attract money into the high-tech space. Venture funds are supposed to play the main role and finance small and middle businesses. (Interfax 2002.)

The first stage according to the concept will last for 5 years and builds on strong government support, the forming of venture infrastructure, economical and legislative conditions, the provision of venture investment's liquidity, the creation of reliable venture industry image. Special incubators are planned to support the creation of small enterprises. In 4-5 years, such agencies should be created in all leading state scientific organisations. An interdepartmental council is supposed to be created to realise those purposes. The program acts will be financed by the Interested Ministries' and local authorities' budget. (Interfax 2002.)

In 2003 began the program of venture specialist's preparation, for those purposes incubators are organised. The second stage supposes the development of venture industry itself, the government plans to leave the market. According to the concept the effects will be considerable: Starting from 2004 ca. \$1 billion of private capital per year is expected to be attracted into new venture funds. That should stimulate the competitiveness of Russian enterprises. Also the decrease in the number of small high-tech enterprises will be terminated and, instead, increase to 5-7 thousand per year until 2007. In addition, concept realisation will

help slow down the capital flows abroad, to form the environment for flows back and investments into the Russian economy.

Venture Fairs are one of the instruments of venture financing institutions' forming in Russia. The aim is to raise investors' (national and foreign) interest to innovative projects of high-tech prospective Russian firms. The Fair is held once a year and plays an important role in venture businesses life. The main organisers of Venture Fairs are Russian Venture Capital Association (RVCA) and The Centre of Strategic Elaboration "Northwest". The first Fair was held in Moscow, the following in Saint Petersburg. The 4th was held in October 2003 in Perm. The first Venture Fair comprised 28 participants, the second – already 46 companies from 14 regions, the third – more that 60 innovative companies from 22 Russian regions. The venture Fair has become the exhibition of technological achievements, which are demonstrated to the investors who are looking for profitable projects. (RVCA)

"Expert" has compiled data on all the declared high-tech venture deals in 1999-2003 (Ammosov 2003). The data includes company and investor name, date and deal size (see figure 1).

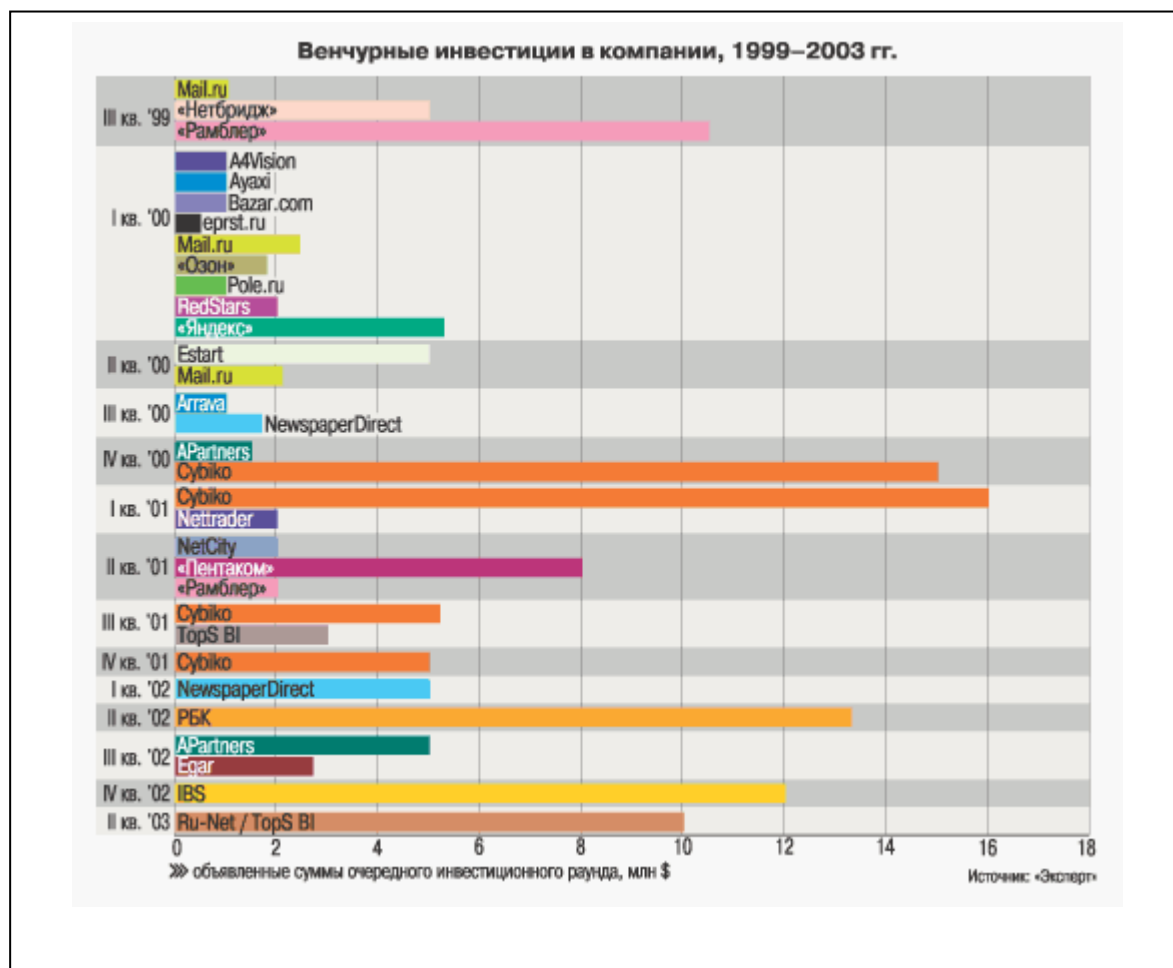


Figure 1. Declared sums of next investment round (million \$)

Our analysis of the data suggests the following synthesis on the dynamics of the venture capital investment process in Russia. During 1999-2003, a total of ca. \$150 million was invested in the declared deals. Lion share of the volume was invested in a handful of

companies: Cybiko (received by far the largest amounts), Russian Business Consulting (RBC), "Rambler"¹, IBS and Ru-Net. Taking into account that considerable amount spared for Ru-Net was addressed to its portfolio company TopS BI, which already got investments in the sum of \$3 million, RBC and TopS share the 2nd place in the recipient's list.

The increase of technological investments provoked by the Internet-Boom began in the middle of 1999 and reached maximum in the middle of 2001. From the 2nd part of 2002 the investments volume into technology companies rose, but the structure of demand for investments changed. All the deals of that period were large-scale, late stage investments. There were no investments (reportedly) into early stages. During 2002-2003, only 5 large investments were made: \$13,3 million into RBC, \$12 million in IBS, \$10 million into Ru-Net Holdings, \$5 million into A4Vision, \$2,7 million into Egar Technologies. Only the investment into A4Vision can be considered as early stage investment as at that moment the company didn't have any sales, although it had already existed for 2 years. (Ammosov 2003.)

Three out of five companies (IBS, Ru-Net/TopS BI and RBK) are service companies and oriented into the inner IT Russian market. Egar produces the financial software for derivative operations. That's why the motive of investors in that period was not the aspiration to the technical leadership or fellowship after the fashion of the world innovative process, but the orientation into the capitalisation of economic growth results in Russia. Almost all companies are established and well functioning already; they are 5-10 years old. There are two major outcomes from this case. Investing activity is still not high, though the deals' scale compensates partly its' rarity. And, investing activity does not reach start-up companies (Ammosov 2002).

Effectively, the pool of venture capital in Russia is about \$60 million. That is not much – twice less than under the management of direct investment funds. That amount is invested in USA every 1,5 days. In 2002, there was only one clearly early stage venture fund - Mint Capital. Mint, created in the end of Internet-Boom, accumulated \$20 million. It invested mainly in 6 companies, 4 of which (Parallel Graphics, jNetx, Abbyy, "RBC/pentacom") could be related to technological, and 1 (telecompany "Studio 2B") is media asset. The money collected in 2001 is already invested and nowadays Mint is exploring the possibility to create one more fund (Ammosov 2002).

From other funds, launched in 1999-2000, most were not able to hold their ground in the end of 2001. Sun Capital, after some unsuccessful investments, closed its subsidiary fund Vesta. Ru-Net Holdings, which had begun as a specialised integrator fund created by Barings Vostok Capital Partners (BVCP), UFG and Rex Capital, re-oriented into system integration.

At that period the small Saint-Petersburg Russian Technology Fund (RTF), which invests into trade and service firms was not very active. It is functioning, but it still has not acquired enough experience to work with venture technologies. Financial results of EBRD funds are not impressive. Nowadays the largest venture investor is the IFC. In 2002-2003 it invested \$19,5 million into 3 deals. IFC interest to technological market stimulates other investors, which can raise additional profits as IFC places a shoulder for their financial risks.

The present situation can be characterised by the active creation of new private venture funds. In 2003 two new funds have been created: local department of Intel Capital and the fund

¹ Russian search engine www.rambler.ru (cf. www.altavista.com etc.)

“Russian Technologies” belonging to Alpha-Group. Also, there is information that Draper Fisher Jurvetson functions through a local partner-coinvestor in Moscow (Ammosov 2003).

There are several critical obstacles to overcome, and yet the most important reasons for failure of VC funding relate to difficulties of matching ventures and capital and the lack of such culture. In Russia, entrepreneurship only has a history of a good ten years. There are still unclear ownership conditions. At the same time, the structure of economy is changing from capital intensive to service sector or knowledge intensive. The legal conditions do not support entrepreneurship. Legislation in Russia does not fully go along with the legislation in more developed business environments; therefore there is a lack of foreign investments. Russian stock market is underdeveloped and therefore the prospective for VC’s are not as favourable as the successful exit is hard to gain.

CONCLUSIONS

Since the venture business in Russia has obvious shortcomings, there seems to be need for support for the growth company process. Along the official changes, such as development in legislation and creation of feasible conditions, there is also need for venture level support. Observations about V2C business models and how they have functioned in, for example, Finland and the United States, suggest that there is a special niche for venture-to-capital operatives also in Russia.

In Russia, there are clear signs of a classic capital gap as both number of venture capital funds is rather limited and the sizes of average venture capital investments are far larger than needs in the early stage of high-tech company process (Rasila et al 2002; cf. Figure 1). The financial contribution provided by an institutional venture capital fund is not sufficient as growth resource. Intellectual capital is addressed as a key requisite for growth, to know how to act in different situations. Because accumulation of human capital is slow, due the fact that it is transferred in learning and socializing processes, funded companies need sweat capital provided by V2C operatives. Figure 2 describes the ideal V2C process.

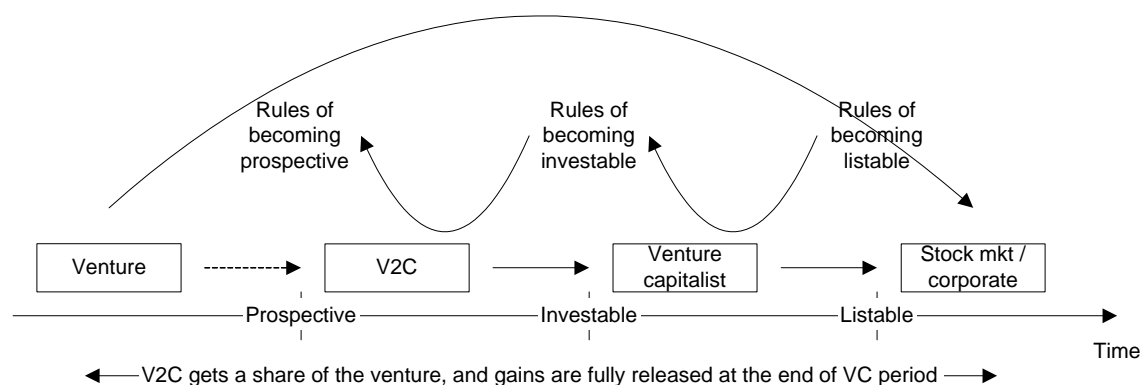


Figure 2. Ideal V2C process (Jungman et al 2004)

The task of a V2C player is to select and guide ventures that are willing to accept conditions to be set by a venture capitalist. Moreover, a V2C player also prepares those prospective ventures to survive in dynamic business environments by providing inputs such as businessman wisdom, growth management skills, managerial advice and entries to networks. In a nutshell, V2C deals with investing human and social capital into ventures.

As discussed above, there are problems related to matching ventures and capital and, moreover, to building business from venture to capital. There is an obvious need for new type of matchmakers. There seems to be a call for both public sector and private sector V2C-operatives.

The value chain of the growth company process is not complete in Russia; none of the different type V2C operatives are strongly represented (Rasila and Okkonen 2003). However, the different types of V2C are needed – some more than others – as the scope of enterprises is vast in Russia. Russia can be seen as a promising environment, yet there are several risks that are recognised. Utilising formal processes, such as ideas of public and private V2C mechanisms, the environment could be made more transparent, and thereby more desirable to investors. Moreover, by constructing and applying tailored models one could build a balance between strictly controlled system and a totally liberal one.

This exploratory research took the form of a pre-study and a general discussion on the status of venture capital in Russia. Due to insufficient background material and general level of data, the reliability of the findings is limited. Venture capital research is still taking its first stages in Russia, thus the need for more rigorous literature analysis, and especially fieldwork, remains. As this paper presented general and scattered descriptions of the operating environment, future research is easier to delineate. Further research should concentrate on more detailed analysis and description of the Russian venture capital industry and growth company process, especially to facilitate for the construction of enabling V2C models tailored for the rapidly evolving and growing Russian market.

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