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## THE MODEL OF FINANCING INNOVATIVE FIRMS THROUGH VENTURE CAPITAL

### Abstract

Entrepreneurs of companies keep asking themselves what sources to use in order to finance their own entrepreneurial ideas that enable growth, existence and income because they do not have sources of financing. One of these sources is risk capital, normally used by capital owners to finance innovative companies with a suitable business idea or challenge, a persuasive business plan and a vision of doing business with income that would be achieved in a certain period of time with the help of the business idea. Venture capital is a part of equity and venture capital funds, which enter a company, become its co-owners for a certain period of time. The research, provided among Slovenian entrepreneurs and investors of venture capital, shows that knowledge about the purpose and role of venture capital at financing high potential and development companies is rather poor. This is the reason why the development of venture capital can be expected in a couple of years.

**Keywords:** entrepreneurship, entrepreneurial knowledge, venture capital, income, venture capital funds

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## 1 IMPORTANCE OF RISK CAPITAL FOR ENTREPRENEURSHIP

Aspect of each entrepreneurship is finance – money plays an important part in economy. The familiar wisdom says that if there is enough capital, new companies will be established and vice versa (Hisrich and Peters 2004, 385). Success of small companies is based on friendly and personal networks because an individual cannot gain all sources necessary from suppliers, banks, public agencies, relatives, friends and non-refundable funds (Premaratne 2001, 368). O'Rourke (2000, 2) says that in the European Union the share of borrowing is 70 per cent, whereas it is about 30 per cent in the USA. Size and long-term relationships between foreign capital and bank financing are essential for startup companies because capital structures depend on property structure (Cassar 2004, 275).

The main factor of information economy of the 21st century is risk capital which allows, encourages and supports development and growth of business ideas, innovations from the beginning till the final market realization. Venture capital is permanent property employed in the company and presents sources of financing for companies in the early or development stage as well as for new risk businesses (Ribnikar 1991, 195). Venture capital appears when there are no other sources of financing or they are inaccessible on the goods or money market (Pratt in Khoylian 1988, 613). Investments of venture capital fund providers demand certain experience, knowledge and risk abilities – their rewards are high capital gains. Venture capital is collected in investment funds whose interest is to invest risk capital in new and growing companies where they want to have ownership according to the size of capital invested (Griffin in Ebert 1993, 570-571; Keeley in Kapp 1994, 99-100).

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The examples that can be found in foreign theory and practice show that investors of venture capital choose startup fast-growing companies dealing with high technology. It is important to know that venture capital fund admittance does not mean loss of management freedom, but it is about a common goal because each fund tends to grow and be profitable.

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Development and progress of industry will be allowed by venture capital financing only. It is the only way of financing that can bring new business cycles in industry. There are important years ahead for venture capital investors because it is predicted that around 60 per cent of capital will be invested in industrial projects (Heesen 2005, 3). It is vital that venture capital fund providers use all knowledge necessary to find out where and what areas to invest in (De Clercq 2003, 39) because most of them want additional income (Henderson in Leleux 2003, 38-39).

## 2 FORMATION OF INNOVATIVE FINANCING WITH RISK CAPITAL MODEL

In the modern world, according to Steyn (2004), there are successful companies that produce and forward in new products and services. Business creativity and innovativeness are not just a pillar of competitiveness of individual companies but of the whole economy (Marrana et al., 2009).

The model includes guidelines and contents of the European model whose position is that of Zurich model, which is based on the assumption that the one who leads others in helping to solve a common problem has all legitimacy and authority needed. The model also includes certain opinions of Sankt gallen model, according to Bleicher (1994), where vision, culture and company participants are very important because company's mission, goals and basic operational aims depend on them.

The model presents operation intersection structure and process with schematic chart structure where the following elements are included:

- survival and existence of innovative companies,
- creation of pleasant business environment,
- access to financial sources for innovative companies,
- promotion of enterprise culture and mutual cooperation,
- cooperation among capital investors, owners of companies and business partners.

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The model shows that a company is a dynamic and problematic system, partially open, autonomous, directed towards goals, searching for a system of cooperation and connection in business and financial sense. Planning and decision-making are oriented towards the future of the company, direct implementation leadership and realization of business aims and interest control.

In the forefront of solving management problems and duties are people so attention is given to:

- personal characteristics and goals of individuals,
- relations between owners and investors,
- interactions that appear between owners and risk capital investors with business and financial environment.

The model is based on the analysis results of our own qualitative and quantitative research. Owners of companies, risk capital investors and their interests, expectations and cooperation risk are included in the model.

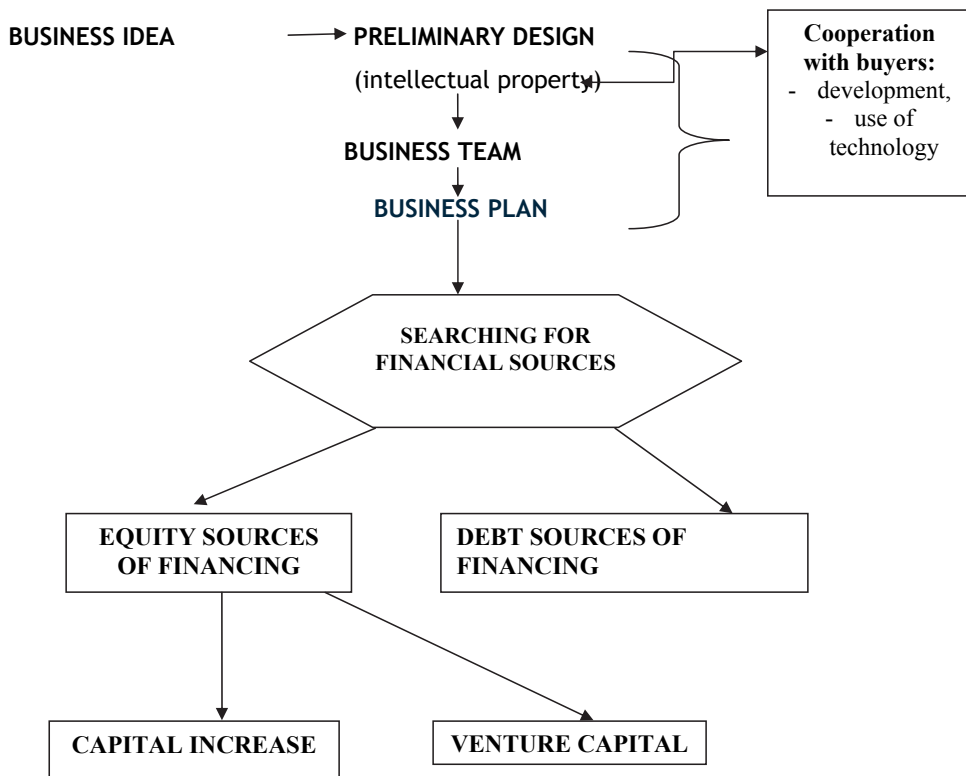
The purpose of the model is to form and introduce key factors that have an influence on business as well as financial cooperation between risk capital investors and owners of companies.

### 3 VENTURE CAPITAL FINANCIAL MODEL STRUCTURE

Establishing the model of innovative financing with venture capital includes definitions of problems and decision-taking concerning venture capital by owners of companies. Two expert groups in the model are presented by members of risk capital (funds) investors and owners of companies. When establishing the model theoretical knowledges as well as experience (foreign and local) were taken into account and based on them deficiencies and problems of venture capital investments were introduced.

Owners of companies look for financial sources to accomplish their business ideas, whereas venture capital investors search for challenges and readiness to invest capital in companies and business teams with good innovative business ideas. We agree that connections and cooperation with potential buyers should be implemented at the beginning of the product development and use of technology processes (picture 1).

**Picture 1:** *Searching for financial sources to accomplish business ideas*



The results of the research show that entrepreneurs lack knowledge in the fields of marketing, marketing researches, financing, fiscal charges, needed to offer business programmes, products and services. Furthermore, entrepreneurs who are not familiar with risk capital will not include it in their business financing.

The purpose of the research is to study, analyse, compare and compile findings, theoretical discussions and researches in the field of entrepreneurship development in the light of financial sources. Potential risks, on the company owners' as well as capital investors' sides, are exposed.

The research also shows that there is no proper venture capital supply and demand in Slovenian economy. Based on literature study, foreign researches and our own research we found the answer to the question why Slovenian companies cannot accede to venture capital funds and introduce their business ideas and ambitions. The finding is that domestic venture capital funds wait to be found by companies instead of having the ambition to find companies themselves and work out business, financial and profitable cooperation strategy with them.

When financing and reaching yields a certain financial source structure is needed, part of which are:

- knowledge,
- plans, goals and
- branch, a company is part of as a seeker for business ideas with venture capital.

The model follows the logics of yield obtained invested in innovative ideas and branches, not in branches without yields desired.

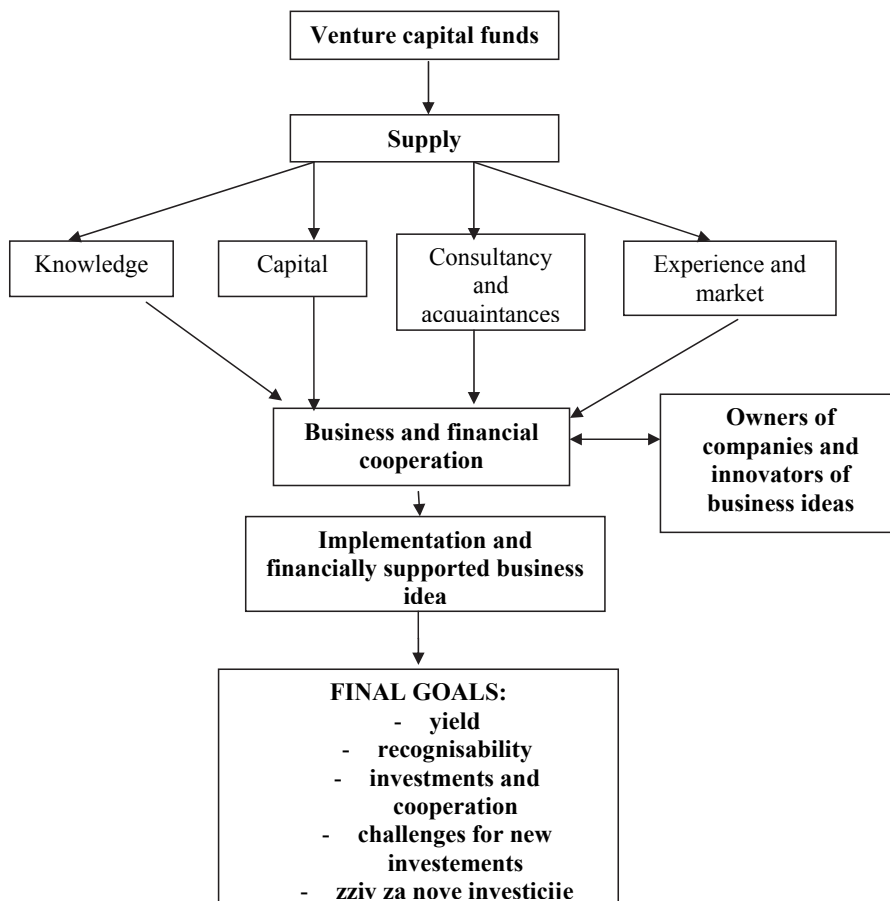
The results of questionnaires among owners of companies show that many of them are not familiar with venture capital and the role of venture capital representatives. The Slovenian entrepreneurs are more fond of equity (inner) financing. It is also obvious that education and entrepreneurs' awareness about alternative sources of financing are too small.

It is vital that venture capital funds know how to present their operations, mission, strengths and opportunities, interesting branches and cooperation goals (picture 2).

Their offer should consist of the following:

- knowledge,
- capital,
- acquaintance and advisory experience,
- knowledge of the market and buyers,
- knowledge of individual activities.

Picture 2: Cooperation factors of venture capital funds and owners of companies



An important factor of business and financial cooperation is owners of companies with their innovative business ideas venture capital funds are ready to support financially.

In case of successful cooperation goals will be achieved and expressed in:

- yield,
- new investments and
- recognition of companies and risk capital funds.

There is a possibility that conditions of acquisition and cooperation are unsuccessful. This is the reason why the role of an entrepreneur and his team or company owner is to look for business and financial cooperation possibilities with other providers of funds venture capital funds are part of.

The model introduces challenges in business cooperation, search for venture capital investors, ability and achievement of interests of all participants. Their common cooperation is seen in:

- participants' authority
- common goals and
- different forms of formal and informal education

The model (picture 3) introduces the purpose of cooperation in realization of business culture and vision of company operations. It includes:

- transfer of knowledge and experience of all participants,
- implementation of competitiveness,
- access to markets and buyers,
- growth and development in business challenges and their realization.

Goals of cooperation (in the model) are presented in forms of:

- business idea realization,
- desired level of yield desired,
- division of business and financial risks of all participants and in
- recognition and further independent operation of entrepreneurs with a team or owners of companies.

In case that business idea is not realized due to lack of financial sources, this presents a negative factor of entrepreneurship and national economy development. It is presumed in the model that venture capital plays an important part in development and innovative entrepreneurship financing.

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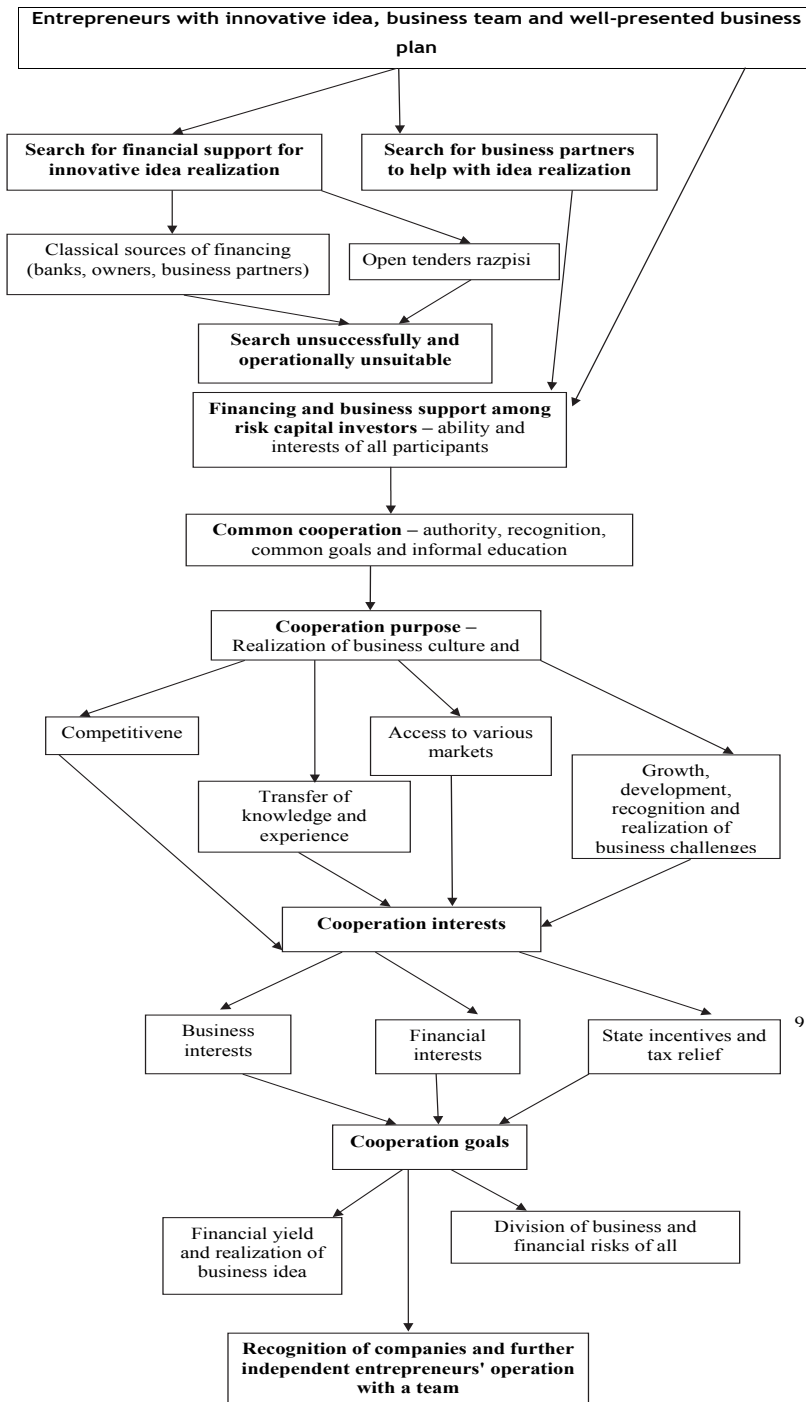
For entrepreneurs with innovative business idea that wants to be realized venture capital investors are essential for they possess financial as well as business interests and experience.

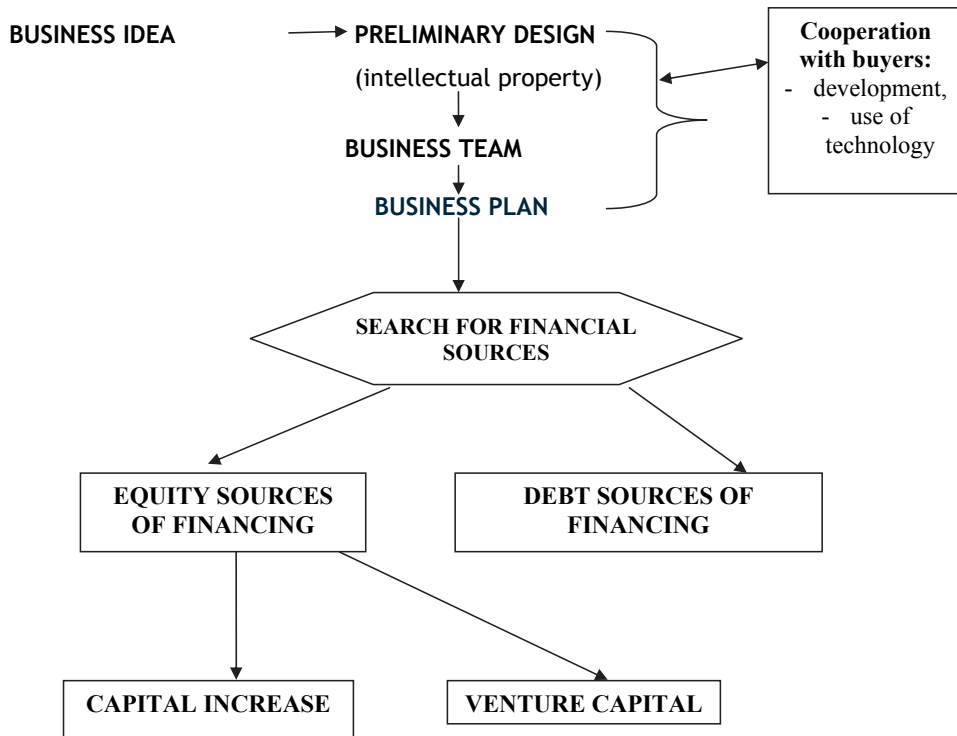
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We think that connections and cooperations with potential buyers should be implemented in the very beginning of the development process and use of technologies (picture 4). For innovators on the part of buyers feedback serves as a base for success or failure, taking into account stimuli, and at the same time causes higher success value on the market.



**Picture 3:** *Model of innovative financing with venture capital*

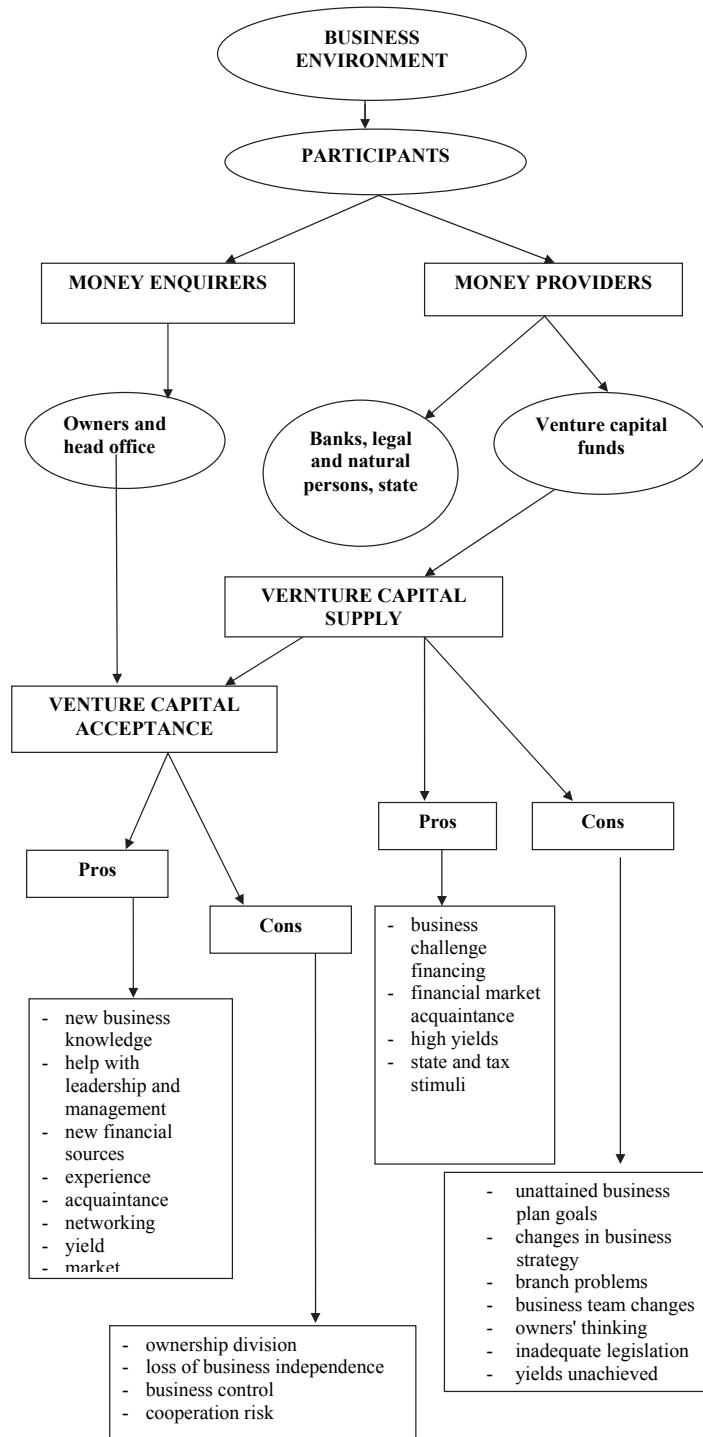


**Picture 4:** *Search of financial sources for business idea realization*

The empirical analysis emphasizes knowledge and misunderstanding of risk capital by owners of companies. The results of the research show that entrepreneurs lack knowledge in the fields of marketing, marketing researches, financing, fiscal charges, needed for the supply of business programmes, products and services.

Findings of our own researches show that in Slovenia business environment is more oriented towards individuality (picture 5). Entrepreneurs do not want or find it difficult to accept the fact that others interfere in their ownership, business and financial decisions. This is the reason why venture capital is not important to them. Such business attitude and business culture have no future and do not contribute to bigger growth, innovative entrepreneurship development and increase of gross domestic product. Owners of companies and venture capital funds must mutually accept pros and cons of financing and cooperation caused by venture capital.

**Picture 5:** Role of venture capital for participants in business environment



## 5 CONCLUSION

In modern world of entrepreneurship business and capital cooperation are essential both from local and from foreign sources of financing point of view, because they stimulate development of companies if they have proper vision, innovative ideas and business goals.

Business innovations are necessary because they allow growth and development of entrepreneurship. They should not be just a one-time activity but a continuous process. It is vital to support business ideas and individuals' knowledge that need financial support. The main factor of success in entrepreneurship is a team and its innovativeness, persistence and propulsive business ideas that can be carried out in practice. Support is desired both from owners of companies and from risk capital investors.

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