RUSSIAN VENTURE CAPITAL INVESTMENTS: SPECIFICS AND POSSIBILITIES

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Abstract: The article investigates the venture capital investment in Russian. The author explains specifics and possibilities of Russian venture capital investment.

Keywords: Russian venture capital investment, analysis of venture capital market, prediction at the future.

Venture capital is a type of equity financing that addresses the funding needs of entrepreneurial companies that for reasons of size, assets, and stage of development cannot seek capital from more traditional sources, such as public markets and banks. Venture capital investments are generally made as cash in exchange for shares and an active role in the invested company. Venture capital differs from traditional financing sources in that venture capital typically:

- Focuses on young, high-growth companies;
- Invests equity capital, rather than debt;
- Takes higher risks in exchange for potential higher returns;
- Has a longer investment horizon than traditional financing;
- Actively monitors portfolio companies via board participation, strategic marketing, governance, and capital structure;

A startup or high growth technology companies looking for venture capital typically can expect the following process:

- Submit Business Plan. The venture fund reviews an entrepreneur's business plan, and talks to the business if it meets the fund's investment criteria. Most funds concentrate on an industry, geographic area, and/or stage of development.
- Due Diligence. If the venture fund is interested in the prospective investment, it performs due diligence on the small business, including looking in great detail at the company's management team, market, products and services, operating history, corporate governance documents, and financial statements. This step can include developing a term sheet describing the terms and conditions under which the fund would make an investment (National venture capital association [сайт]. URL www.nvca.org/).
- Investment. If at the completion of due diligence the venture fund remains interested, an investment is made in the company in exchange for some of its equity and/or debt. The terms of an investment are usually based on company performance, which help provide benefits to the small business while minimizing risks for the venture fund.
- Execution with VC Support .Once a venture fund has invested, it becomes actively involved in the company. Venture funds normally do not make their entire investment in a company at once, but in "rounds." As the company meets previously-agreed milestones, further rounds of financing are made available, with adjustments in price as the company executes its plan.
- Exit. While venture funds have longer investment horizons than traditional financing sources, they clearly expect to "exit" the company (on average, four to six years after an initial investment), which is generally how they make money. Exits are normally performed via mergers, acquisitions, and IPOs (Initial Public Offerings). In many cases, venture funds will help the company exit through their business networks and experience (Russian venture capital association [сайт]. URL http://www.rvca.ru/rus/resource/library/rvca-yearbook/).

VCs focus exclusively on companies developing significant innovations - be it a new piece of software, a life-saving cancer drug, or a new model for consumer sales. Unless the company is poised for significant growth, a VC won't invest. Making investments at the earliest stages of a company's development - often before a product or service is more than just an idea - involves significant entrepreneurial risk, which severely limits capital sources for such companies. Yet, venture capitalists assume this risk alongside the company founders by providing capital in exchange for an equity stake in the company.

The VC's goal is to grow the company to a point where it can go public or be acquired by a larger corporation (called an "exit") at a price that far exceeds the amount of capital invested. Approximately one-third of portfolio companies fail, so those that do succeed must do so in a big way. Typically, when a venture-backed company exits the portfolio, the VC distributes the profits to the fund's investors and eventually leaves the portfolio company's board of directors. Once all the investments of a particular fund have been exited and the proceeds have been distributed, the fund ends. In many cases, however, the institutional investors reinvest these earnings in a new crop of funds and the process begins anew.

The year 2012 has become a challenge for venture capital on the world market. Global economical uncertainty greatly affected the market, with some market parameters having fallen down to the lowest level since 2009. The Russian venture capital landscape looks more optimistic. According to the results of RVCA (Russian venture capital association) annual investigation of Russian private equity and venture capital (PE&VC) market, volume of accumulated capital in Russia is continually showing positive dynamics during several last years; in 2012, this parameter surmounted $ 26.4 bln - 28% growth (Russian venture capital association [сайт]. URL http://www.rvca.ru/rus/resource/library/rvca-yearbook/).

Moreover, the last years validly evidenced the fact that investors are ready to run risks and to back up early stage companies: more than 70% of documented deals corresponded to the early stage companies in 2012.

In 2012, investment activity was registered in all types of industries. The total documented investment volume directed by investors in the companies acting in the Russian market made the biggest amount for more than ten-year history of observations in the context of the investigation being conducted - near $4.15 bln.

Almost 2/3 of total documented investment volume was provided by investments in 12 companies to the amount of $ 100-250 mln and one large investment equal to more than $600 mln. To a great extent it was supported by a number of large investments realized with RPEF participation with attraction of foreign investors' capital: according to available information on the investments with known volume - a third or more of the total 2012 documented investment volume.

Average investment size by the 2012 totals came to $21.4 mln (approx. by 6% less as against 2011), that was determined first by considerable growth of seed, start-up, and early-stage investments. A trend to continual increase of average investment volume is traced with the exception of critical for the industry year 2009, when mean value of investments decreased considerably: $10 mln in 2006, $12 mln in 2007, $12.3 mln in 2008, $7.4 mln in 2009, $19.6 mln in 2010, and $23 mln in 2011.

In 2012, the biggest volume of invested capital was accumulated in ICT sector. The total investment volume in the companies of this sector made up a considerable value – $1.11bln or near a quarter of total documented investment volume. For comparison: in 2011 the investment volume attracted in ICT companies was 2 times smaller (approx. $0.56 bln or 18% of total investment volume, 66 deals).

The ICT sector leaded also among number of financed companies (near a half of their total number - 103). This number doesn't include 46 investments with unknown volume from the sector under review, although their branch identity is mirrored at the graph of distribution of the number of financed ICT sector companies (Russian venture capital association [сайт]. URL http://www.rvca.ru/rus/resource/library/rvca-yearbook/).

In the 2nd place by aggregate investment volume after ICT sector the Financial services sector was situated with $871 mln result or near 21% of total volume of the investments documented in 2012 (9 documented investments or near 4.5% of total financed companies' number). According to estimations available, no less than a half of total investment volume documented in this sector fell at the investments made by RPEF with attraction of foreign investors' capital. At the same time, the deals with RPEF participation accounted for only 22% of total deals' number in the Financial services branch. This contributed to returning the branch to leading positions after temporary retreat in 2011 (to the 4th place), with almost fourfold increase of investment volumes in comparison with preceding reporting period when aggregate investment volume totaled $233 mln, and more than twofold increase of the documented investments' number (4 in 2011). Average investment volume in Financial services branch amounted to $96 mln. The targets of investments in this branch were rather manifold in 2012: from banks and collector agency to electronic trading system and major Russian stock exchange.

The 3rd place was occupied by the Energy industry branch ($665 mln), but its ascent was caused first by one large infrastructure investment in one of the branch companies which was made with RPEF participation also (the share of the investment in the total documented investment volume in the branch – more than 90%).Taking into account these peculiarities, it may be stated that total investment volume has grown almost 5 times in comparison with 2011 (near $140 mln) with the total deals' number in the branch keeping the same - 8 deals in 2012.

During recent years, the Russian private equity and venture capital market maintained stable positive dynamics both in respect to the processes of new funds rising, and volumes and number of the realized investments. In spite of certain decrease of activity which was registered in 2009, the Russian PE&VC market manifested a satisfactory margin of safety and ability to speedy recovery. It's confirmed by the growth of main market indices registered by the 2012 totals.

In spite of influence of the continuing world economy crisis, according to the RVCA data, total number of the funds acting on the Russian market has grown by more than 50% since 2008 and now is equal to 247. Average investment volume has increased in recent years, too (from $12.3 mln in 2008 to $21 mln in 2012).

Important role in this onward motion has been played by the government's activity on development of the infrastructure for investment processes support. For example, one may note creation of the Russian Private Equity Fund (RPEF) in 2011 with the record for Russian market size of committed capital to the amount of $10 bln. One of the main tasks of the Fund is to attract foreign investments in the leading companies of the most high-growth sectors of the Russian economy that mirrors the positive estimations of the Russian PE market. In 2012, RPEF made a number of major deals with sufficient inclusion of the foreign investors' capital (share of aggregate investment volumes with RPEF participation in the total documented investment volume accounted for no less than 35% in 2012).

In the whole it may be stated that a considerable potential has been accumulated in the Russian PE&VC industry. The next issue of the Russian private equity and venture capital market Review 2013 will be devoted to analysis of the process of this potential realization in the nearest future.

References

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