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## **VENTURE CAPITAL IN RUSSIA AND UKRAINE: CURRENT TRENDS AND WAYS OF STEPPING UP THE INVESTOR ACTIVITIES**



*Venture industry in Russia and Ukraine has been analyzed from the point of view of its ability to be a source of financial support of innovation projects. Unlike the Russian venture funds the Ukrainian ones have been showed to prefer the traditional economic sectors rather than the high-techs industries. Comparative analysis of the legislative framework in Ukraine and Russia has been made.*

*Key words: venture capital, private equity, fundraising, and venture fund.*

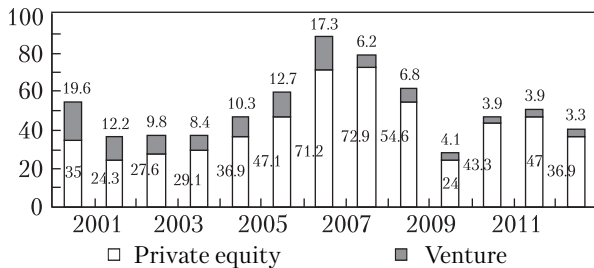
The need in venture capital as a means of financial support of innovation is caused by two main trends of economic development in most countries. On the one hand, the innovative development has no alternative; on the other hand, the financial resources to achieve it are limited. In this situation, it is just the venture capital that should be an alternative source of financing the creation and development of high-tech innovations which could become a driving force of vivid economic development. Therefore, this article dealing with comparative analysis of the current state and development trends in the venture capital in Russia and in Ukraine in the light of European tendencies is relevant.

In 2013, in the Global VC/PE country attractiveness index Ukraine was ranked 69<sup>th</sup> among 118 countries for which the index was calculated; Russia was rated slightly higher on the 40<sup>th</sup> place. Analyzing the dynamics of their ratings since 2009, when this index started to be calculated, one can conclude that, despite relative stability of positions of Russia and Ukraine in 2009–2013 (Rus-

sia holds its position around 40<sup>th</sup> place, while Ukraine ranges within 60–70 positions), there is a certain improvement in performance due to an increase in the number of countries for which the index is calculated (in 2009–2010, the ranking list numbered 66 countries, whereas, in 2013, there were 118 countries) [1].

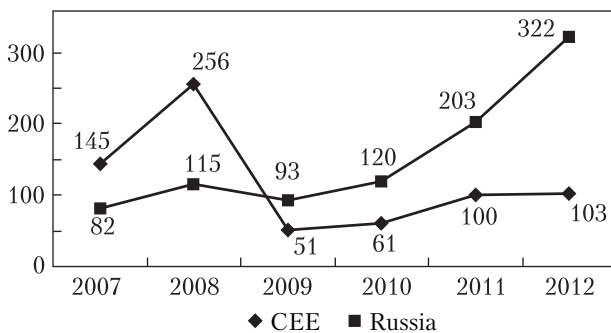
It should be noted that the growth of the main indicators of private equity industry in 2010–2011 in the whole Europe in general, and in Central and Eastern Europe (CEE), in particular, has given way to a quite significant drop, in 2012. For example, as compared with the previous year the level of European fundraising fell by 43% reaching the bottom for the last decade, EUR 23.6 billion [2]. Also, this concerns a decrease in the volume of private equity and venture capital, in particular, in European countries (see Fig. 1).

The situation in Russia favorably differs from European trends. The Russian fundraising started to show positive dynamics in 2009 and continued to do this in 2012 at a higher pace. Thus, in 2012, an increase in fundraising in Russia made up 75%, from USD 3.8 billion to USD 6.7 billion [3]. Russia not only exceeds all the countries of the CEE region (see Fig. 2) by the total venture



Source: compiled by the author according to [2].

Fig. 1. Dynamics of the total amount of private equity and venture capital in Europe, in 2000–2012, EUR billions



Source: compiled by the author according to [3, 4].

Fig. 2. Dynamics of the total private equity investments in the CEE region and in Russia, in 2007–2012, EUR millions

capital investments, but also is characterized by a relatively stable tendency towards increase in the volume of this type of investments. In Russia, the number of companies which have attracted venture capital investment also exceeds the cumulative index for CEE region: in 2012, in Russia, 136 companies got venture capital investments versus 123 in the CEE region [3, 4]. However, given the recent changes in political and economic spheres in Russian Federation, the rate of venture segment development can be assumed to significantly decline, although the final conclusion will be made in 2015 at the earliest.

While making a comparative analysis of the venture segment in Russia and Ukraine, let us start with describing the legislative framework of venture capital industry. Both in Russia and in

Ukraine there have been no special regulatory documents governing venture capital operation and venture capital activities. The specified market segment is considered to be a subsystem of collective investment institutions (CII) and is appropriately governed by regulatory documents related to the CII activities [5, 6, and 7].

The implementation of special legal documents for both private equity (direct investment) and venture segment is rather ambiguous. Experts of the Russian Venture Capital Association (RVCA) note in [8] that direct investments are regulated by existing legal rules and do not require a separate law insofar as the law can neither stop nor activate the human initiative, unless he/she does not want or conversely is going to become an entrepreneur. The government policy should be aimed at ensuring the private equity industry with equal opportunities and conditions for fair competition with other institutional investors engaged in the same field of economic activity. In the venture capital industry, there are no specific issues that might require the adoption of a special law. The first part of the statement is doubtless, whereas the second one can be argued if it is considered in the context of Ukrainian realities.

In accordance with the Regulations on composition and structure of assets of joint-stock investment funds and mutual funds [6] the CEOs of closed venture mutual funds focus the requirements for the composition and structure of the fund assets on the investment of shareholders' funds primarily in commercial non-public companies whose shares are not traded by any organizer of the auction. The Ukrainian legislation does not take into consideration this aspect. According to [7], venture fund is non-diversified closed CII which performs exclusively private placement of CII securities among corporations and individuals. This means that for the venture capital funds operating in Ukraine it is unnecessary to invest in unlisted companies. Practically, this led to a completely uncontrolled and unjustified increase in the number of so-called venture funds that have made up the lion's share of Ukrai-

nian collective investment institutions. In 2003, in Ukraine, there were registered only 6 CIIs, 3 of which were venture capital funds, while in 2008, 888 CIIs were reported, with 636 of them (71.6%) being venture capital funds. After the global crisis of 2008–2009, the total number of Ukrainian CII continues to grow with a more moderate pace, and so does the share of venture capital funds. According to the Ukrainian Association of Investment Business (UAIB), as of 31.12.2012, in Ukraine, the number of CII accounted for 1222, with 973 being venture funds [9]. Paradoxically, by their quantity Ukraine keeps up with the whole of Europe rolled into one and significantly dominates over Russia. So, according to RVCA experts, in 2012, the number of private equity funds in Russia amounted to 247, 155 of which were venture capital funds [3].

There is a logical question: «Are all the Ukrainian funds really the venture ones?» i.e. «Do they finance high-risk projects at the initial stages of their creation and implementation?» It is quite difficult to answer this question, because the UAIB aggregates data for those CII which meet standards established by the National Commission on Securities and Stock Market with respect to the minimum amount of assets by the following parameters:

- ✦ Dynamics of the main types of CII and their regional distribution;
- ✦ Cost and structure of both general and net assets of the CII;
- ✦ CII yield;
- ✦ Structure of CII investors, with the investors being classified only by two parameters: *residency* (residents, nonresidents) and *subjectivity* (individuals and corporate entities). This means that no official statistical data on sectoral structure of investments of Ukrainian CII, in general, and venture capital funds, in particular, have been kept. It is possible to make indirect conclusions on the CII investment directions proceeding from the structure of their assets.

The largest share in the structure of CII assets for all types of funds (except for venture funds)

belongs to securities that allow their holders to take part in the management of companies (see Table), whereas the venture funds have about 60% «other assets» in the structure of their total assets, which complicates comprehensive analysis of their activities.

In addition, venture funds are involved in real estate investments, which should not happen in a perfect world.

Another way to indirectly characterize the structure of Ukrainian CII investment portfolio is to analyze the list of the most common securities. As of 31.12.2011, the following companies have the largest shares in the portfolio of CII by the aggregate value of securities:

1. *WIZARD INVEST*, LLC (information on the scope of activities is unavailable);
2. *Vesta NMPK*, JSC (production of electricity distribution and control apparatus; galvanic elements (electric batteries and primary cells);
3. *Stanisław Trading Company*, LLC (Distillery);
4. *Lebedyn Specialized Enterprise no.11*, OJSC (gas pipelines, installation of technical equipment, plumbing, and electrical work);
5. *Urban Investments*, PJSC (construction, financial brokerage);
6. *Ofal OBK*, PJSC (construction);
7. *Ukrainian Innovative Financial Company*, OJSC;
8. *Fozzy-Food*, LLC (production of bread, bakery products, and confectionery, wholesale trade in beverages, retail trade in food, beverages, and tobacco goods in non-specialized stores);
9. *Kyiv TZhK*, LLC (shopping and residential complex);
10. *NEO VITA*, PJSC (construction) [10].

It is an interesting fact that there is no publicly available information on scope of activities of *WIZARD INVEST* whose securities take lead by aggregate value in the portfolios of mutual funds. Therefore, the involvement of Ukrainian collective investment institutions, in general, and venture capital funds, in particular, in the financial support of innovation is questionable, despite the fact that Ukrainian CII have raised a consider-

able amount of financial resources (according to UAIB expert data, in Ukraine, the pool of CII assets has reached 10% of the nominal GDP).

More specific data on sectoral structure of private equity investments in Ukraine can be obtained from the official data of the European Private Equity and Venture Capital Association (EVCA). Thus, according to statistical data, in 2012, the total private equity investments in Ukraine amounted to EUR 67 million which was slightly more than in the previous year (EUR 60 million), but much fewer than in 2010 (EUR 94.3 million).

The whole bulk of funds was invested into limited number of companies. In 2012, only 5 companies received investments (versus 9, in 2011). These data may indicate a certain consolidation of investments. The funds were mainly invested in the field of communications, computers, and consumer electronics, consumer goods and retail trade, agriculture, financial services, and life sciences. However, it should be noted that no transactions on the very venture stages were reported to the industrial statistics.

Due to the fact that, in 2012, the computer industry got 17.5% of all private equity investments, the total share of investment in high-tech increased to 14.7% of the total investments, whereas in 2009–2011, it did not exceed 4% [2]. It should be noted that the information and communication industry shows a pretty vigorous development: the country is among the leaders in the dissemination and transfer of information technology [11].

According to market statistics, in contrast to the industrial one, in 2009–2012, in Ukraine, there were reported investments made at the very venture stages. For example, in 2011, two companies received investments worth UAH 3 266 thousand totally at the late venture stage (of which UAH 2,552 thousand was invested in the *computers and consumer electronics* industry, and UAH 714 thousand was assigned to a company representing the *energy and environment* sector). In 2012, EUR 1,557 thousand was invested to a company at late venture stage from the *computers and consumer electronics* sector. The above mentioned difference in the market data and the industrial statistics can be partly explained by the fact that venture capital investments in the period under review were made by foreign investors [2].

Thus, according to the European statistics, in Ukraine, there are examples of occasional, case-to-case venture capital investments, which, in our opinion, is consistent with the real situation.

As for Russia, it is possible to make a quite reliable analysis of venture capital funds, as RVCA aggregates data that are comparable to the European indicators of investment activity of venture capital funds. According to RVCA official information the total volume of private equity investments in Russia, in 2012, amounted to USD 4.151 billion of which venture capital investments accounted for less than 10% (USD 397 million). In this case, the majority of funded companies (136 out of 194) received investments at the «venture

Structure of Assets of Ukrainian CII by Types of Funds, in 2011–2012, %

CII type	Cash and deposits		Securities		Including, shares		Including corporate bonds		Other assets		Real estate	
	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012
Open	28.6	30.5	62.5	55.7	29.6	21.2	10.4	10.7	8.2	12.7	0.0	0.0
Interval	23.3	14.8	68.0	74.8	55.8	61.1	9.0	9.8	7.7	9.8	0.0	0.0
Closed (non-venture)	6.7	6.3	60.1	58.2	47.8	43.1	5.9	6.4	32.4	34.2	0.3	0.2
Venture	3.5	2.2	31.2	31.2	10.1	11.5	8.0	7.1	62.7	64.1	2.6	2.5

Source: author's data [9].

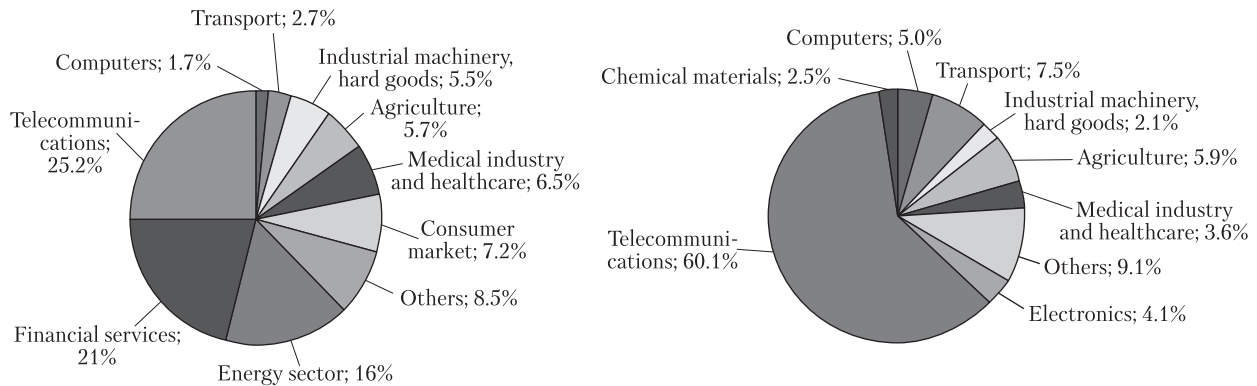


Fig. 3. Sectoral distribution of private equity and venture capital in Russia, in 2012

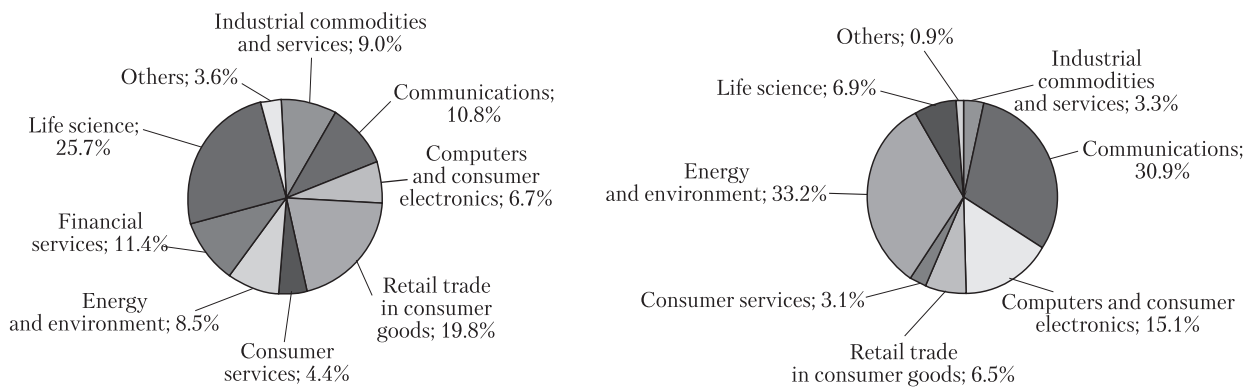


Fig. 4. Sectoral distribution of private equity and venture capital in the CEE region, 2012

stages». It accounted for more than two-thirds of the recorded investments in the reporting period.

As one can see from Fig. 3, in 2012, about a quarter of all private equity investments in Russia was directed to the communications sector. The financial services industry showed the 2<sup>nd</sup> result. The share of these sectors accounted for about 50% of total investments. It is logical that venture capital investments are more focused on the financing of high-tech industries: the share of the telecommunications sector accounted for about 60% of all venture capital investments. In addition, it should be pointed out that the share of companies which have received venture capital investments in this sector made up 55% (75 out of 136 companies).

Having compared the investment sectoral structure in Russia and in the CEE region, one can

conclude that in Russian Federation, the investments are more focused on the support of high-tech industries (see Fig. 4) that favorably characterizes the venture segment of Russia.

Hence, the following conclusions can be made proceeding from the analysis:

1. The Russian private equity and venture capital market is developing quite rapidly unlike that of European countries, which recently have showed a slumping trend.

2. In Ukraine, the lack of data that could be comparable to the European statistics on indicators of activities of CII, in general, and venture capital funds, in particular, greatly complicates the analysis of effectiveness of the venture capital industry. In addition to non-innovative directions of VC investments, in Ukraine, the following factors adversely affect the development and

use of venture capital as a source of innovation funding:

- ✦ Identification of «*venture capital*» with «*private equity*» (venture capital is only an integral part of private equity).
- ✦ Imperfect legislative framework (the absence of law on venture activities). The venture activities are governed solely by the Law of Ukraine on Collective Investment Institutions, which, in author's opinion, is inadmissible. Despite the fact that in the United States and in the EU the venture capital perfectly operates without proper legislative framework, the author believes that in Ukraine the clarity of terms and definitions in this area is of paramount importance, inasmuch as often funds doing investments in real estate and financial services are referred to the «venture funds». In addition, the clearly defined basic concepts of venture activities will facilitate the adequate statistical description of VC operation. It should be noted that Ukraine made attempts to introduce special regulations governing the operation of venture capital industry into the legal framework, but failed to implement them in practice);
- ✦ The lack of «fund of funds». (A good example in this regard is the experience of the Russian Venture Company. In Ukraine, the national venture company has not yet been established, despite the fact that in 2011, the State Agency for Science, Innovation, and IT Development made the preparatory work on its creation, including the development of draft statute).

Currently, the collective investment market in Ukraine is developing quite rapidly, with the larger part of this market belonging to venture capital funds and, consequently, to venture investments. Unfortunately, today, the investments of venture capital funds are not of absolutely

«venture» character, inasmuch as money is invested mainly in the traditional industries instead of the high-tech innovative sectors. However, the very existence of venture funds and their dynamic development should be considered a favorable factor.

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ВЕНЧУРНИЙ КАПІТАЛ В РОСІЇ  
ТА УКРАЇНІ: ПОТОЧНИЙ СТАН  
ТА ШЛЯХИ АКТИВІЗАЦІЇ  
ДІЯЛЬНОСТІ

Здійснено порівняльний аналіз сучасного стану індустрії венчурного капіталу в Росії та Україні з точки зору його участі у фінансуванні інноваційних проєктів. Показано, що українські венчурні фонди, на відміну від російських, надають перевагу фінансуванню традиційних, а не високотехнологічних секторів економіки. Проведено аналіз законодавчого забезпечення функціонування венчурної сфери в Росії і Україні.

*Ключові слова:* венчурний капітал, фандрайзинг, приватний акціонерний капітал, венчурний фонд.

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ВЕНЧУРНЫЙ КАПИТАЛ В РОССИИ  
И УКРАИНЕ: ТЕКУЩЕЕ СОСТОЯНИЕ И ПУТИ  
АКТИВИЗАЦИИ ДЕЯТЕЛЬНОСТИ

Проведен сравнительный анализ современного состояния индустрии венчурного капитала в России и Украине с точки зрения его участия в финансировании инновационных проектов. Показано, что украинские венчурные фонды, в отличие от российских, предпочитают финансировать традиционные, а не высокотехнологические секторы экономики. Проведен анализ законодательного обеспечения функционирования венчурной сферы в России и Украине.

*Ключевые слова:* венчурный капитал, фандрайзинг, частный акционерный капитал, венчурный фонд.

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