



# PRINCIPLES OF VENTURE AND BUSINESS-ANGEL INVESTMENTS

## Summary

Positive state policies in the developed countries of the world are directed towards fundamental transformation and development of innovative economical sector.

One of the most principle ways for solving tasks of priorities set for economical development is correct guideline of innovative activities; particularly, processing and implementation of the programs of public and private partnership in the financial, investment and infrastructural sectors; creation of wide network of state-private venture funds, technopolis and business incubator center and etc.

Herewith, extended nature of the terms of repurchasing of innovative and especially – venture investments shall be emphasized.

To our mind, in the development of innovative and venture entrepreneurial sector, as united complex, we shall distinguish two “narrow places”; the first – “Primary” is non-development of the initial investment; the second one – is the lack of qualified specialists.

Business-angel, primary, seed and start-up investment sectors are not developed in Georgia and it includes narrow circle of projects; herewith. Neither venture capital, not – institutions related with it own serious financial resources.

As for qualified specialists, there are many high-qualified specialists, and managers of serious investment projects in Georgia, but there is the lack of people, who are aware of difficult mechanisms of venture and business-angel investments.

It is often very difficult to find common language between participants of innovative projection and investment processes; sometimes the parties do not understand each other; in the process of searching for investments, sometimes difficulties of preparing business-offers take place and etc. Due to this fact, many of potential interesting transactions are cancelled at the stage of negotiations.

In the United States of America, and in fewer cases in the EU states, venture and business-angel fields are allocated for separate specialization. Their representatives are different in professionalism, and the best features of practitioners knowing standards and criteria. This lowers the above risks to the minimum.

To our mind, solving said problems may be provided in two ways:

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In practical field governmental – private partnership, programs shall accelerate development of the sectors of venture and business-angel investments.

Together with the existed ones, it is necessary to develop programs of joint co-financing of initial, seed and startup investment funds, together with business-angels.

## Problems of financing high-technology business.

Distinctive features of technological business are high share of expenditures on Research and Advanced Development in cumulative volume of investments and increasing rates of renovation of markets. Volume and expediency of financing of high-technology projects become principle competitive advantage. This leads to the fact that the place of leading players in multiple segments of high-technology business is occupied by large corporations, dominating at their own markets, by virtue of the effect of scale and opportunities of switching financial resources on development of the most recent designs. Effect of the scale is in the fact that large industry receives opportunity for decrease significantly manufacturing costs per unit of products in terms of increasing its quality. Besides this, competitive priority of large corporations is the opportunity for providing large scale of Research and Advanced Development and establishing industry-specific standards. Benefit from the scaled corporate researches and processing is confirmed with practice: for IBM profitability of investment into the Research and Advanced Development is more than 40%, and for Intel it reaches almost 100%.

Giant-corporations, such as Hewlett-Packard, Intel, Toshiba, Canon, Matsushita, Samsung, make basis to the innovation potential of their countries. In the Table 1.1 there are data on amount of patents issued in the USA to the leading corporations of the world in 2004 and 2005.

Though, paradox of innovation economy exists in the fact that large technological corporations can not be absolute guarantors of permanent innovative develop-



Table 1.1

Leading companies by patent arrangement in the USA

Company	2004		2005	
	Position	Number of patents	Position	Number patents
IBM	1	3248	1	2941
Canon	3	1805	2	1828
Hewlett-Packard	4	1775	3	1797
Matsushita	2	1934	4	1688
Samsung	6	1604	5	1641
Micron Technology	5	1760	6	1561
Intel	7	1601	7	1549
Hitachi	8	1513	8	1271
Toshiba	9	1311	9	1258
Fujitsu	11	1296	10	1154

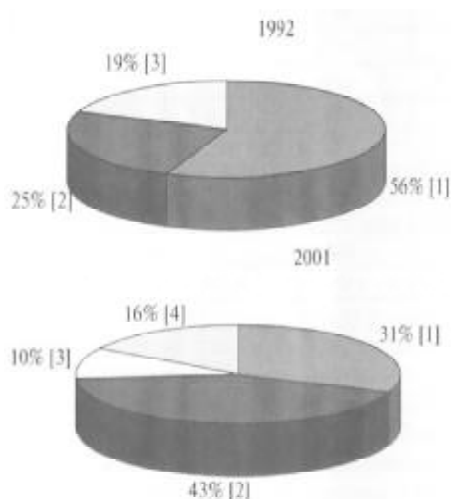
Source: United States Patent and Trademark Office (USPTO). <http://ko-online.com.ua/node/23274>

ment of their countries, as their position at the market may be strictly worsened in the process of technological revolution in particular sectors. As a consequence, new technologies and companies start giving tone to the market. For example, transfer to the personal computers in 1980s destructed dominating condition of IBM, manufacturing all components of large ECM, and forwarded new giants – Intel (in new quality of leading providers of the systems). Manager of IBM under the management of L. Gerstner in the years 1993-2002 could save the company, reorienting it to the service (Fig. 1.1).

In 2005-2006 manufacturers of photo devises, such as Kodak suffered difficulties, as traditional photography was being precipitously displaced with digital one.

Professor of Harvard Business School K. Christensen in the book “Investor’s Dilemma” [9] showed consistency of such state of things at the example of manufacturing hard disks. Reason for changing leaders of the market and vulnerability of giant companies in front of unexpected competition, may be target figures of the latest (Table 1.2).

It is noteworthy that these principles of ownership



Source: materials IBM.

- [1] Completion
- [2] Service
- [3] Software

- [1] Completion without technologies
- [2] Service
- [3] Technologies
- [4] Software

Fig. 1.1. Distribution of the sources of income of the Company IBM and subsidiary companies in 1992 and 2001



Table 1.2

Target figures of working of large corporations and risks of negative influence upon innovation activities

Target figures	Outcomes	Risk of negative influence upon innovation activities
Orientation upon current profitableness and existed market demand	Improvement of short term financial index	Underfunding of Research and Advanced Development and introduction of innovative products, which at the moment attract interest of the largest groups of consumers in virtue of unformed market
Rising capitalization and increasing rates of growth	Satisfaction of shareholders	Orientation towards largest markets, which are often conservative and insufficiently receptive to innovative products/services
Planning of investment projects and detailed analyze of risks	Predictability of operational and financial results	Focus at already tapped market inasmuch as the work at the new markets is subject to predictability much more difficultly.

of state or combined enterprises are also applied, as evaluation of activities of management by governmental bodies are also based on the share of the market (including volume of implemented state order) and current short term indexes.

Consequently, large corporations are not always sensitive to the “explosive” technologies, with following peculiarities:

- 1) They are simpler, cheaper, but in the first place they provide lower quality of production;
- 2) During first several years they provide lower rewards, than conservative projects;
- 3) At the initial stage of introduction they are not in focus of interest of the largest groups of consumers and they are in great demand only at new markets and those insignificant with volume;
- 4) They have latent potential, promoting rapid and often explosive growth of target market, at which they offer products and services worked out by means of new technologies.

By virtue of the first three peculiarities, development of “explosive” innovations is not often included into the short-term commercial interests of large corporations. As a result, commercialization of radically innovative ideas is mostly provided by small companies, oriented towards rapid growth. Today multiple examples

of small companies are known, counting on “explosive” technologies, undergoing strict market selection and as a consequence to occupying serious share of the increased market (peculiarity 4). Many of such companies are created by scientists and inventors – by immediate authors of the idea. The most famous companies area – the companies Silicon Graphics, Netscape Communications, Yahoo, Google, Skype, Facebook, be become the leaders in their domains.

Such rapid changes of leaders are distinguished not only in the field of high technologies. They are characterized to all fields, in which there is the effect of scale and innovations support amendment of structure of the market. This is confirmed with multiple examples in the industry of consumption and field of service (Starbucks, Body Shop), in the fields of extraction and processing of natural resources. Thus, analysts connect large perspectives with small oil producing companies, with approved technologies of economic oil extraction on small amount of wellsites.

Practice shows that serious hindrance to the development of small innovative enterprises with “explosive” technologies and new, unstructured markets is insufficiency of financial resources and adequate financial mechanisms at the initial stage. Founders often have no sufficient sources, and on the way of getting commer-



cial credit, they face three obstructions:

1) too high risks by virtue of unformed and unpredictable markets;

2) relatively slow return to project at profitability (often more than two-three years);

3) absence of collateral, as main kind of ownership of innovative enterprise are illiquid assets – intellectual property, know how, specialized devices or resources, and experimental sample.

Above situation may be briefly characterized in the following form.

*Notwithstanding concentration of resources and effect of scale, in terms of technological revolution dom-*

*inating corporations often concede markets to new companies, increasing from small innovation enterprises. However, small innovative enterprises with “explosive” technologies have colossal potential; at the initial stage of development, they lack financial resources from traditional sources 0 banks, equity market and etc. This situation is called equity gap.*

“Gap” between demand and offer of financial resources for starting companies and those aiming to the rapid growth of companies fill new forms of financing – venture and business-angel investments, in which deriving profit exists in rapid growth of industrial business, and high risks together with dividends and liquid

Table 1.3

Stages of development of non-public company

Name	Volume of necessary investments	Brief description
Seed	Up to 1 million US Dollars	Formation of the company, existence of the project or business-ideas, process of formation of management companies, providing Research and Advanced Development and creation of experimental samples, marketing researches. <i>Processing concept of business.</i>
Start-up	1-5 million US Dollars	The company is formed. There are experimental samples, organization of serial products of organization is provided on taking products to the market. <i>Starting production and marketing.</i>
Early stage, early growth	5-10 million US Dollars	Manufacturing and commercial realization of ready products. Gradual transfer to the “break even point”. <i>Growth of the volume of necessary floating assets.</i>
Expansion	Over 10 million US Dollars	Occupying by the company particular positions at the market, transfer to the sustainable profitability from basic business, extension of production and sales, conducting additional marketing studies, increasing basic funds and volume of floating assets. <i>Necessity of large investments in further development.</i>
Later stage	Depending from demands of the company	Strong footing at the target market. Sustainable profitability. Share of the company may be converted at the stock exchange. Rates of annual growth – not large. <i>Dividend payout.</i>



assets during first years after distribution of sources are norm. In these kinds of financing, investor proceeds from the fact that rapid growth of company attracts rising of its capitalization, allowing it sell its share in the business, for higher price than that it was purchased in terms of investments.

**basic definitions and term of industry of direct and venture investemtns.** Professionals, providing active investment of capital for the purpose of making high profit, always aim at investment of sources into the promising companies starting business. Purpose was the rising price of the invested company, and the method of fixing profit – “exit”, or selling the share owned by the investor in several years after starting financing. In case of success, volume of the sources, gained at the “exit”, was several times higher than investments of the investor.

History shows that such type of investments was of great importance for economical development in total, as the category of long-term projects with high risk included radical innovations, providing breakthrough at their focus markets. High-stakes projects with vogue commercial perspective in due time where telephone, car, plane, personal computer and many other technological innovations. Classic examples are following transactions:

- In 1874 T. Sanders and G. Hubbard financed company of A. Bell, specialized in processing of the first telephones. In several years, investors were able to make get extremely successful “exit”.

- In 1878 American businesspersons J.P. Morgan and S. Trask financed designs of T. Edison in the field of electricity.

- In 1930 the Vice President of Stanford University and one of the founders of Silicon valley F. Terman invested 538 US Dollars in the project of high-precision oscillator of the students W. Hewlett and D. Packard becoming first product of the Company Hewlett-Packard established by them in 1939.

However, in the middle of 20<sup>th</sup> century such investments were of irregular nature – there were no standards and terminologies of speculative investments; there were no specially trained managers, nor common methods of searching, analyzing and evaluation of projects, no standard mechanisms of risk diversification. In fact, every investor or investment group was to reinvent everything and rely on their intuition.

Situation was cardinally changed in 1940-1950, when technical progress and rapid growth of consumer demand in the USA resulted in sharp increase of the amount of investments into the speculative innovative projects: due to the growth of demand on innovations of different kind, the share of incomes of the projects were increased, and the incomes themselves were increased. Gradually insti-

tutional investors became dominated groups of investment; they were banks, insurance companies, pension funds, financial-industrial groups, being able to offer “long money”. Innovative business was developed not only in the field of high technologies: in 1950-1980, multiple innovative projects were implemented in the field of production of consumer goods, trading and fields of service.

In consequence, strong flow of financial resources with increased risk level was directed to the entrepreneurial domain, resulted in occurrence of qualified managers, specialized funds, consulting infrastructure, and soon wide sector of investments into non-public companies announced itself – private equity and venture financing. From the USA, it was distributed towards development of the countries of West Europe, and for the 90s it came to the developed markets, including Russia, countries of East Europe and South-West Asia. Niche for venture capital exists by virtue of ineffectiveness of the high-stakes business of early stage, by means of main principles of market activities. Technology, idea, and business-model – these are intangible fixed assets, which are difficult to evaluate in money equivalent. Moreover, the Banks refuse in issuance credit if there are no guaranties in the form of material assets. At the same time, risk level, characteristic to the startups required crediting at the rate higher than maximally acceptable to the company.

Direct and venture financing – these are investment of capital in exchange for important (more than 10%) share in increasing companies aimed at making high profit by means of selling the said share (“exit”), becoming more expensive by means of development of the company. Venture financing is characterized with orientation towards enterprises of earlier phase of development, than private equities [2,3].

Principal distinguishing feature of direct and venture investments in relation with other investment sectors exist in the fact that profit is formed by means of the growth of capitalization of the company during “relationship” with investor, offering not only necessary cash resources, but also assistance in the process of creating, developing and managing business, promotion of production. Evidently, the earlier investments were made, the more is the profit, but higher the risks.

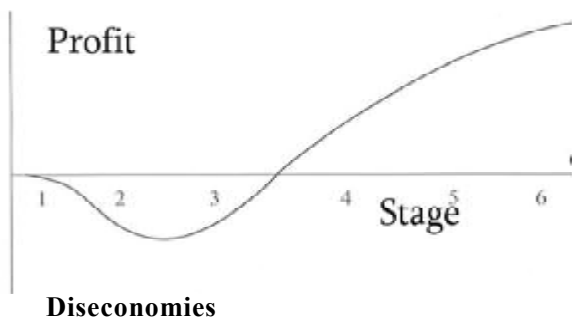
Currently, in theoretical scientific works and official documents there are variant readings in determinations of direct and venture investments. In the USA and West Europe for designation of “direct investments”, they use the term “private equity”. In West Europe, the terms “private equity” and “venture capital” are in the most cases synonyms; therewith they include LBO (leveraged buyout – redemption with involvement of borrowed funds). In the USA private equity, venture capital and LBO are clearly delineated.



They consider investments to be successful, if investor's share at the "exit" is sold for the prices, which are much higher than investments, allowing fixation of important volumes of profit (over annual 50-70%). Total duration of the cycle from "seed" to "exit" takes 3-10 years, depending on the specificities of company and stages, at which "exit" takes place.

During last several decades in the direct and venture investment occurred standards, rules and traditions – terminology, management methods, methods of evaluation of projects, criteria of success of investments and comparing projects, procedures of risk diversification. In many countries, there are legal and consulting companies specialized in this field, association of direct and venture investment, uniting most of large investors in this or that country. Venture infrastructure is also formed in Russia (see Chapter 2).

In the industry of direct and venture investments, separation of the process of growth and development of the companies not participating at the stock exchange into stages became universally recognized (Table 1.3).



1 – "Seed"; 2 – start-up; 3 – Early growth; 4, 5 – Extension; 6 – Sustainable development

**Fig. 1.2. Financial condition of the company depending on the stage of development**

Scheme of changing financial condition depending at the stage of development of the company is represented in the Fig. 1.2. Financial failing, given in the Figure is called by investors "Poison Valley". Its peak gets at the transfer from the stage of Start-up to the Early Growth. This is related with the beginning of sustainable manufacturing of products and increasing demand not only in capital investment, but also in floating assets, also retardation of the growth of the number of personal and amount of available devises from the size of orders.

Seed stage is also hard, when the projects are only ideas or package of intellectual ownership and the company is only "getting on its feet". At this stage, as a rule, there is lack of clear financial flows and expenditures. However, different from the "Poison Valley", at the Seed stage there is no requirement in large volume of cash

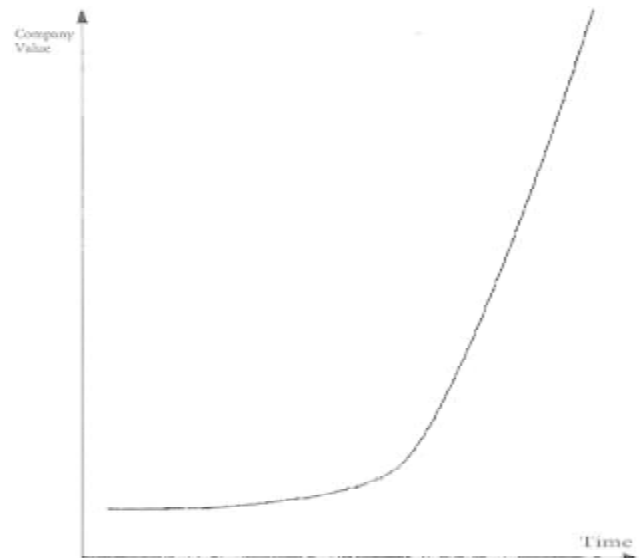
resources, as necessity in capital expenditures and floating assets in total, will appear later, at the stage of organization of serious production or rendering service.

Peculiarities of the projects of seed and start-up stages are also very important, which get investments of business-angels and venture funds.

Following are principle of them:

- Acute need for internal investments at the early stages of growth;
- Correlation "high profit – high risks";
- Orientation not towards rapid dividends, but selling the share in the company after several years and fixation of profit through growth of capitalization;
- Role of the company and intangible assets as fixed assets;
- Orientation of the project towards high-growth market.

As for the growth of the price of the company depending on the stage, its trajectory is considered to be non-linear. In case of success, explosive growth is provided before "exit" during last several years (Fig. 1.3). According to the slang of the investors, the schedule is called "hockey bandy" and "J-curve".



**Fig. 1.3. Non-linear growth of the price of venture project in time (Schedule "hockey bandy")**

Profit of investors is fixed by means of selling shares in the companies at the "exit", by using one of the following methods:

- 1) Selling share to the strategic investor (*trade sale*) or investment fund;
- 2) Initial placement at equity market (IPO - Initial public offering) with selling share of the investor at the stock exchange;
- 3) Management buyout (MBO);



Table 1.4

**Investment type depending on the stage of development of the company**

Investment type	Stage at the moment of starting investment	Investor
Seed investment	Seed	Business-angel, 3F, Public and other non-commercial seed funds
Venture investments	Start-up	Venture funds
Private equity	Early growth, extension	Funds of private equity

4) Leveraged buyout (LBO).

Usually “exit” of investors takes place before the stage of “extension” or “sustainable development”, though it also may take place earlier (reselling to another venture investor of fund of direct investments). The fund intends implementation of “exit” at the peak of value of the company, when venture means per share in It may be much higher than initial investments. “Exit” from the company more often takes place in three-seven years from starting of investment.

IPO procedures with selling of share of the investor often consider venture investments to be final purpose. Herewith, great majority of investors implement “exits” without using equity market. According to the averaged data National Venture Capital Associations (NVCA) in the USA in relation with IPO and “private exits” in terms of implementation of venture investments make at average 1:10 in favor of the latest. Besides this, appearance of shares of the company at the stock exchange may not be accompanied with the “exit” of investor.

Each stage of development of a company is characterized with its type of investment (Table 1.4). Niche of venture investment is the phase of “start-up”.

Private and venture investments are characterized with investment chains: at early stages to the financing of the company much larger investors (different rounds of investment) are being included. Usually, rounds are lettered with A, B, C. For the most of venture projects, this chain is quite difficult to be traced due to the closeness and non-publicity of early stages. In addition, investors of previous round have opportunity for making complete or partial “exit” with fixation of profit.

Each round allows measurement of changing value of the company *through method of last investment*. Let us make illustration of the example. Let us assume that business-angel invested 1 million US Dollars and took the share of 50%. After two years investment attractiveness of the company increased and venture fund invested 4 million US Dollars into the Company, taking the

share of 50%. In such case, initial investors of the company, the business-angel, has  $50\% \times 50\% = 25\%$ . Due to the final transaction, for venture investors 50% share of the Company cost 4 million US Dollars, i.e. share of the business-angel (25%) costs 2 million US Dollars.

Let us consider another example, in which after five rounds, value of the company is increased from 1 million to 50 million US Dollars (Table 1.5).

Profitableness of venture investments depends on the used mechanisms of decreasing risks, listed below.

In the first place, this qualification of the investor and his/her participation in the management of the company, transfer to the establishers of the company the experience of doing business, useful relations and skills. Venture – special economical relations, where the entrepreneur, in the form of investor, gets not only donor of financial resources, but also the manager of the consultant and the team member.

In the second place, for distribution of risks between different groups of investors venture funds are formed. In the West, average venture fund makes more than 10 million US Dollars, and larger ones – 1 billion US Dollars. The most famous are located under the management of Kliener Perkins Caufield & Byers, Sequoia Capital, and Draper Fisher Jurvetson. The Fund is managed by professional managing company, and investors in the most cases are institutional: pension funds, insurance companies, banks, large corporations, being able to offer large volume of sources.

In the third place, key role is played by diversification of risks through investments simultaneously into multiple companies. Typical is correlation “3–3–3–1”, when out of 10 companies invested by venture funds 3 are not successful, three of them are of medium profitableness, three – high profitable, and one – super-profitable making hundreds of percents of profit, covering expenditures related with unsuccessful investment multiple times. However, in the beginning of the investment cycle, dynamics of portfolio companies are not known to the managers.



Table 1.5

Value of the company depending on the stage of its development

Stage	Investor	Investment, Million USD	Share in the Company, %	Corporate appraisal, million USD
Seed	Business-Angel	0.5	50	$0.5/0.5\% = 1$
Start-up	Venture A	2	40	$2/0.4 = 5$
Start-up	Venture B	4	40	$4/0.4 = 10$
Early growth	Venture C	7	50	$7/0.5 = 14$
Extension	Private equity	20	40	$20/0.4 = 50$

In the fourth place, interests of both parties (investor and recipient) are protected by agreement, setting the rules of the “game”. Following complex financial instruments are directed towards and used for conflict resolution and minimization of risks: privileged shares of different classes, options, convertible debt securities. There are the mechanisms allowing protection of the investor from anti-dilution, when the companies are to issue additional volume of shares for covering expenses.

*Convertible venture funds* represent basic form of venture business. Their body is made of the capital of large corporations and business of numbers of companies-recipients, which are in close relation with the mother company. Such funds are often pursuing the goal of technological refreshment of the corporation by means of purchasing start-ups or promoting its production through integration of the latest into the new technologies, creating start-ups. Intel, IBM, Google, Chevron and etc. have corporate venture strategies.

Main criteria of difference between seeds and start-ups is in the fact that the latest – it already existed company, having developed its production, while the “seed” company is the business, being at the initial stage of formation. Principle distinctions between these stages are given in the Table 1.6 below.

It shall be understood that risks at the stages of “seeds” and “start-up” there also are of different natures. If for “seed” financing, basic market is related with uncertainty of the perspectives of the project, than for “start-up” – with the lack of floating assets and large expenses on launching of production. Due to this fact, volume of investments in start-up is essentially more than investment into the “seed” enterprise (see the Table 1.6).

Depending of the goals set to the companies, style of management with them is essentially different. In start-up, grounds to implementation of strategic and current tasks are made by detailed business plan, reviewed only for important changes of market situation. Many business procedures are efficient. At the “seeding” stage,

strategy and management procedures are just formed, business is run at the base of purposes, formed in general features and permanently specified and operative management – on the base of short-termed documents: technical assignment, estimates, calculations of expenditures. Planning and creation of detailed strategy – one of the basic tasks of “seed” stage, and work on it is time-consuming, to every participants of the project, including investors.

Together with it, the enterprises of both stages have much common, distinguishing them from the enterprises of later stages of development. They are characterized with quite simple management structure, informal relation in the staff, and absence of sustainable profitability, high mobility, absence of stock-exchange quotations, work on the new and incomplete markets, and absence of large and liquid ownership. For this purpose, they often speak about enterprises of early stages, uniting stages of “seed” and “start-up”.

**Profile of Business-Angel and “Seed” Financing.** *Business-Angels* [2,5] – these are private investors, making investment into the high-stakes (in the first place, innovative) projects of early stages; at the same time, volume of investments into one project, as a rule, is not more than 1 million Euros. More frequently, business-angels are acted by individuals, but they may also be legal entities. Generally, these latest are small investment companies, invested into the capital of founders.

The term “business-angel” comes from the field of American show business, where they called “angel” the sponsor, financing project on non-repayable terms and claiming for profit only in case of success. However, modern business-angel is not a philanthropist, but particularly investor, offering resources into the project for making commercial profit. In exchange for funding, the investor gets important share in the capital of the company.

As in classic venture investments, the purpose of the business-angel is growth of capitalization of the invested companies and fixation of profit through “exit” – by selling its share for significantly higher price, than





Table 1.6.

Comparing stages of “seed” and “start-up”

Characteristics	Seed	Start-up
Future cash flow	Being not subject to prognosis. Having only initial appraisals	Predicted with essential level of reliability
Formation of company (legal entity)	Being formed	Work on formation of the company is completed
Business plan	There are its separate elements: calculations of expenditures, budgets, technical assignments, and general running of business.	There is clear business plan, including economical grounds of the project. However, it may be subject to periodical review.
Team	It is being formed; part of supposed members is known.	Formed.
Entrepreneurial qualification of the founders of the company	May be low; the investor actively transfers knowledge to the field of business management.	The Team is able to solve basic tasks of business development independently. Participation of the investor is required only in “narrow places”.
Market	It is learnt. There are general vision and separate best practices on promotion of the created product.	Initial works on market surveillance are implemented; consumers are determined; marketing strategy is being developed.
Intellectual property (IP)	Incompleteness of pilot projects and absence of registration of intellectual property are allowed.	Initial package of intellectual property formed and protected.
Production/rendering services	Trial production/rendering services is developed.	Trial production is developed; works are implemented in organization of massive production/rendering services.
Required investments	0.1—1 million US Dollars	1—5 million US Dollars
Dominant mode of expenses of the investor	Company registration; salary to the team members; renting small premises; working on registration of information system; purchasing raw materials and parts for trial samples; completing development of the product, working on market analyzing and starting promotion of products.	Increase in staff, implementing the most expensive works on registration of information system, work on creation of massive production/rendering services (leasing more spacious premises, purchasing equipments); marketing surveillances; advertisement, creating reputation of the enterprise; expenses on promotion of products; floating assets.
Meetings of the investor and the team	Frequent informal “open collar” meetings.	Frequent meetings within the framework of formal procedure within determined terms.



Table 1.7

**Principle distinctions between business-angels and venture funds**

Characteristics	Business-Angel	Venture Funds
Sources of resources	Own sources	Attracted capital
Volume of investments into one project	Up to 1 million US Dollars	1-5 million US Dollars
Management style	Informal	Quite high level of formalization

volume of investment. Business-angel shall have important sources, loss of the part of which from unsuccessful investment into the project will not influence upon its life level and future commercial activities. Besides this, business-angels diversify their investments, investing in several projects simultaneously.

Principal distinction between business-angels from venture funds exists in the fact that business-angels invest into the projects own resources, while venture funds attract capital from several investors, including institutions – banks, small corporations, pensions and insurance funds. Distinction is also identified in the methodology of making investment decisions. For venture fund, they developed formal requirements on profitability and risk projects, which are followed by the managers of the company for attraction of the capitals of the private and institutional investors. Business-angels, on the contrary, staking only “their” capital or united together, absolutely free in their actions, and relation in the management of the invested company carries informal character (Table 1.7).

Generally, business-angel joins the project at the

earliest and the most staked “seed” stage of development, when there is only idea and it is not always possible to give reliable financial prognosis. Attractiveness of the projects of initial stages exists in their potential surplus profitability, as growth of capitalization is simply provided from zero and is more than the hundreds of annual percents (Table 1.8). Examples of effective business-angel investment – companies Google and Skype (See 1.4 Chapter 1).

Practice of USA and Europe shows that the role of business-angels in the economy is very important, as they acting for the principle donors of start-up capital and give innovation projects “free pass”, alongside with 3F (friends, family, founders<sup>1</sup>).

It is not competition for projects that takes place between venture funds and business-angels, but “separable labor”: business-angels participate in formation of the company at the “seed” stage, when the project is only at the level of structuring idea and business-model, requiring relatively small expenditures.

Venture funds are mostly making investments into the start-ups – the companies with already existed busi-

Table 1.8

**Examples of surplus profitability of business-angel investment**

Company	Field of activity	Business-angel	Investment volume	Price of share at “exit”	Size Meas.
Apple Computer	Manufacture of PC	Name is confidential	91 thousand US Dollars	154 million US Dollars	1 692
Amazon.com	E-shop	T. Albert	100 thousand US Dollars	26 million US Dollars	260
Body Shop	Cosmetics	I. McGlinn	4 thousand Pounds	42 million Pounds	10 500
Aport	Internet search	J. Avchuk	1 million US Dollars	25 million US Dollars	25
MI Laboratories	Treatment of kidneys	K. Lich	50 thousand Pounds	71 million Pounds	1 420

<sup>1</sup> Another rendering of the term 3F: friends, family, fools.



ness and products. Profitableness of successful business-angel investments makes 40-70% a year, as for the venture – 30-40% a year.

However, there are multiple exemptions. There are business-angels, investing into the start-ups and venture funds, providing investments into the “seed” projects, though, during last years there is a sustainable trend regarding separation of labor.

Reason for explosive development of the sector of business-angels, at the beginning in the USA, and later in the Western Europe – combination of the strategies of venture funds into the direction of projects of later stage with investments of 1-5 million US Dollars. This took place through inflow of cash resources into the venture funds and participation of large institutional investors with rough norms towards risks. Equity gap was formed at the market – the situation, when demand on the seed investments with the volume up to 1 million dollars is much more than the offer. Leaving of the venture funds from the field of “seed” financing, was resulted in the growth of the number and qualification of personal investors of initial phase – business angels.

Outcome of “growing” of the sector of business-angels, was rising professionalism in the said field, development of infrastructure, and mechanisms of collective investment (networks of business-angels, syndicates).

Currently, the role of mechanism of collective investment in business-angel sector keeps growing; national and international organizations of business-angels are being developed. One of the most famous organizations is European Business-Angels Network (EBAN). In the Europe, fiscal stimulation of business-angel investments gained momentum through fiscal relieves.

Modern condition of the sector may be considered based on the latest statistic data, brought by EBAN for Table 1.9.

**Basic figures of business-angel investments in EU and USA**

Parameter	European Union	USA
Number of networks	297	245
Evaluation of the number of business-angels, thousand	75	250
Volume of investments per single round, thousand EUR	165	210.5
Annual volume of investments, billion EUR	3-5	20

**Source:** Appraisals of EBAN 2009 on the base of own statistics, statistics of Angel Capital Association, ACA and the Center for Venture Research USA.

European Union and USA (Table 1.9).

According to the Centre of venture studies of New-Hampshire University (USA), market of business-angel investments in 2008 due to the beginning financial crisis showed respective decreasing of investments in US Dollars, though amount of investments was changed much less. Their summarizing volume in 2008 made 19.2 billion US Dollars, which means deduction for 26.2% in relation with the year 2007. Although, in the total complexity of 55 480 of entrepreneurial enterprises in 2008 made business-angel investment, which made only 2.9% of deduction compared to 2007. Number of active investors in 2008 was not in fact changed – 260 500. In 2008, total volume of the investment cash resources, in comparison with the small deduction of the number of transactions in 2008 (deduction of average volume of transactions for 24% compared to 2007). Different from the venture capital, in which money shall be invested during the term of validity of the fund, and particularly on the basis of the size of the fund, English investments are individual financing and business-angels invest from their own resources. Represented data show that business-angels give inessential deduction of activity, though, they invest less resources and treat investment with more care.

**Syndicates of business-angels.** Due to the aspiration for diversification of risks peculiar to business-angels, they practice creation of syndicates through accumulation of resources into the uniform, mutually managed financial pool with the following investment of its resources into the different projects. Syndicates notify venture funds, though they maintain most of advantages of the sector of business-angels – flexibility, rapidness of making decision, absence of awkward and formalized managing procedures. In the venture funds, there is separate legal entity – managing company, when the



syndicate is mostly managed by the participants themselves. Often in the syndicate there is leading investor (Lead-Investor), owning the biggest share of capital and dominating in terms of making decision.

Basic object of investments of syndicates are the companies of “seed” stages. Advantages of syndications – large volume of available investments compared to the angels-singles, corporation and mutual-assistance of participants in terms of selecting projects, concluding transactions, management with invested projects.

**BUSINESS-ANGEL NETWORKS AND ASSOCIATIONS.** Their basic function – investment mediation, i.e. offering investors opportunity for finding qualified project for investments; as for the potential recipients of investments – “sufficient” business-angel. The networks help the entrepreneurs offer their projects at the same time to several angels, and investors – to see quite great number of projects, maintaining anonymity until they are ready for negotiations for particular entrepreneurs. Therefore, the networks implement following functions:

- selection of entrepreneurial projects for representation of investors-members;
- bringing selected projects into readiness for the investment (completing project development, preparing business-offers or presentation);
- preparing and conducting presentation sessions, where projects are represented to the business-angels, who are the members of the network;
- consulting in the field of implementing projects;
- Formation of the teams for realization of the projects, attraction specialists according to the principle “seat equity”
- Development of educational programs, conducting trainings and seminars for business-angels and seekers of investments;
- Supporting syndication investors;
- Cooperation of business-angels at “exit” from the project, including representation of the company to the venture funds.

Many networks function in online regime, accepting requests for investments and information about projects in internet.

Several specialists work in the network on sustainable basis. Their functions include analyzing projects for investment, completion of projects to the investment readiness, consulting, transactions, running events and forums. Managers of networks “transmit” multiple projects, on the basis of which procedures of their analyzing are being processed, as well as typical forms of documents, formation of the knowledge of rapid determination of unqualified projects. All these allow saving of mass of time, and by means of accumulated experience of the quality of analyzes and accompanying of

projects is winning. Qualification of the senior manager of business-angel network or association today turns into the separate specialization, which took place with the managers of venture funds several decades ago.

Networks and associations usually function at the expense of membership fees. In case of finding investor for the project, business-angel network gets commission fee from the transaction of the share in the invested project.

Networks and associations of business-angels is widely distributed in the USA and in the most countries of Europe, where the number of “passive” business-angels was significantly increased, in the most cases, for the representatives of the middle class: doctors, lawyers, professors and even pensioners. Thus, according to the data of the experts, in Silicon Valley essential volume of “seed” investments are flown from the pensioners of California.

**INCUBATORS OF “SEED” INVESTMENTS (EXAMPLE Y COMBINATOR).** Currently, there are organizations, being engaged in “seed” investments with offering to the projects not only financial, but also infrastructure assistance. The most famous model is – Y Combinator. Tasks of Y Combinator include offering to the companies of initial “seed” investments and their assistance their assistance in attracting of investments of following round – in the list of investors, preparation of presentation of the project, structuring of transaction. Reputation of Y Combinator is additional factor in favor of attractiveness of investments in the company-resident.

Y combinatory offers small investments (seldom more than 20 thousand US Dollars) in exchange for the minority share in the projects (2-10%), assisting projects (basic focus of its activity – internet project) in the development of the ideas and concepts of product, preparing the company for “exit”, participating in the work on the strategy and business-plans, offering assistance in the field of jurisprudence and financial accounting, searching for the personnel, and patenting. In the process of development of the company, meetings with the experts and entrepreneurs from Silicon Valley, venture capitalists are organized, who made success by the “graduates” of Y Combinator. Being minorities, Y Combinator does not interfere in the management of start-ups; he/she is not the member of the Board of Directors, having no right for Veto. His/her offers are of recommendation nature. Taking into account “seed” nature of projects, business-plan is not required – it is necessary to fill the application and than are interviewed. At the moment, Y Combinator has more than 100 start-ups. Some of the “graduates” showed profitability in 200-300 times (for example, Zenter, sold for 6 million US Dollars. Google



or Reddit, sold for 3 million US Dollars. Conde Nast).

**SEED-FUNDS.** These are investment funds, object of investment of which are shares in the companies in “seed” stage. These funds may be governmental, public-personal and entirely personal. Private seed-funds may be formed as by business-angels, so with large institutional investors – investment and financial-industrial groups, corporations, and banks. Seed-funds are managed by professional managing companies. Famous example of seed-fund is Mangrove Capital Partners, investor Skype. Special place is occupied by the funds of co-investment, investing in the project only in case of existing private investor. Their principle function – decreasing risk of business-angels.

**STATE PROGRAMS OF SUPPORTING “SEED” INVESTMENTS.** State fund of seed investment becomes more and more distributed form of supporting projects of initial stage. Along with this in different countries,

there are numbers of programs, where resources are flown to the company directly from the authorized state body (as on non-returnable, so returnable basis). Many programs offer co-investment from the side of business-angels.

Basic programs of assistance of innovative business in the USA are the program of Small Business Innovation Research (SBIR) and the program of Small Business Technology Transfer (STTR). These initiatives are intended for provision of the “seed” innovative enterprise with initial capital and support US federal agencies in scientific and experimental and construction works. In 2007, small investment (“seed”) companies of the USA with the program SBIR were offered about 1.14 billion US Dollars; and 131 million US Dollars with the program STTR. Great amount of programs of supporting small business exists in the Europe, for example – Finish Fund of “seed” investments SITRA.

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## ვენერული და ბიზნეს-ანგელური ინვესტირების პრინციპები

**ლამარა ქოძიაშვილი**  
**ეკონომიკურ მეცნიერებათა დოქტორი, პროფესორი**  
**ნიმე ქოძიაშვილი**  
**სოხუმის სახელმწიფო-უნივერსიტეტის მაგისტრანტი**

### რეზიუმე

დღეს მსოფლიოს განვითარებულ ქვეყნებში პოზიტიური სახელმწიფო პოლიტიკა მიმართულია ინოვაციური ეკონომიკის სექტორის ძირეულ გარდაქმნასა და განვითარებაზე. ეკონომიკის განვითარების დასახული პრიორიტეტული ამოცანების გადაჭრის ერთ-ერთი მთავარი გზა არის ინოვაციური საქმიანობის სწორი წარმართვა, კერძოდ, ფინანსურ, ინვესტიციურ და ინფრასტრუქტურის სფეროებში სახელმწიფო და კერძო პარტნიორობის პროგრამების შემუშავება და განხორციელება, სახელმწიფო-კერძო ვენერული ფონდების, ტექნოპარკების და ბიზნეს ინკუბატორების ფართო ქსელის და ა.შ. შექმნა. ამასთან, ხაზი უნდა გაესვას ინოვაციური, განსაკუთრებით ვენერული ინვესტირების გამოსყიდვის ვადების ხანგრძლივ ხასიათს.

ჩვენი აზრით, ინოვაციური და ვენერული მეწარმეობის სექტორის, როგორც ერთიანი კომპლექსის, განვითარებაში უნდა გამოიყოს ორი „ვიწრო ადგილი“. პირველი, „საწყისი“, თავდაპირველი ინვესტირების განუვითარებლობა; მეორე, კვალიფიციური სპეციალისტების უკმარისობა.

ბიზნეს-ანგელური, საწყისი, თავდაპირველი (სეედ) და „სტარტაპი“ (სტარტ-უპ) ინვესტიციების სექტორები საქართველოში ფართოდ არ არის განვითარებული და პროექტების ვიწრო წრეს მოიცავს, ამასთან, არც ვენერული კაპიტალი და მასთან დაკავშირებული ინსტიტუტები ფლობენ სერიოზულ ფინანსურ რესურსებს. რაც შეეხება კვალიფიციურ სპეციალისტებს, საქართველოში ბევრი მაღალკვალიფიციური სპეციალისტი, სერიოზული საინვესტიციო პროექტის ხელმძღვანელი გვეყავს, მაგრამ ქვეყანაში ძალზე ცოტაა ადამიანები, რომლებიც ერკვევიან ვენერულ და ბიზნეს-ანგელურ ინვესტირების რთულ მექანიზმებში.

ინოვაციური დაპროექტებისა და საინვესტიციო პროცესების მონაწილეთა შორის ხშირად ძნელდება საერთო ენის გამოხატვა, ზოგჯერ მხარეებს ერთმანეთის არ ესმით, ინვესტიციების მოძიების პროცესში ზოგჯერ წარმოიშობა ბიზნეს-წინადადებების მომზადების სირთულეები და ა.შ. ამიტომ ბევრი პოტენციურად საინტერესო გარიგება მოლაპარაკებების ეტაპებზევე იშლება ხოლმე.

ამერიკის შეერთებულ შტატებში, შედარებით ნაკლებად-ევროკავშირის ქვეყნებში, ვენერული და ბიზნეს-ანგელური სფეროები ცალკე სპეციალიზაციადაა გამოყოფილი. მათი მუშაკები გამოირჩევიან პროფესიონალიზმის, სტანდარტების და კრიტერიუმების მცოდნე პრაქტიკოსების საუკეთესო თვისებებით. ეს კი ზემოთაღნიშნულ რისკებს მინიმუმამდე დაბლა სწევს.

ჩვენი აზრით, აღნიშნული პრობლემების გადაჭრა ორი კუთხითაა შესაძლებელი: პრაქტიკულ სიბრტყეში სახელმწიფო-კერძო პარტნიორობის პროგრამებმა უნდა დააჩქაროს ვენერული და ბიზნეს-ანგელური ინვესტიციების სექტორის განვითარება. არსებულთან ერთად საჭიროა საწყისი, თავდაპირველი და „სტარტაპ“-საინვესტიციო ფონდების, აგრეთვე ბიზნეს-ანგელებთან ერთობლივი თანადაფინანსების პროგრამების განვითარება.