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The Role of Venture Investments in the World Economy

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Abstract:

Invention and innovation drive today's global economy. However, traditional sources of funds have a rather limited ability to provide financing for high-tech business projects. Therefore, the founders of innovative projects are looking for funding from a relatively new type of investors - venture capital investors. The article explores the theoretical basis for the functioning of venture capital investments. The functions of venture investments are revealed. Three main groups of venture investment subjects are identified, their roles in the investment process and the benefits they receive from their interaction are considered. The most active countries in the field of venture investments are noted. The trends in the development of venture investments over 10 years and the current trends observed in the field of venture investments in the context of the development of the coronavirus pandemic are analyzed.

Keywords: venture investments; venture investor; venture fund, startup; limited partners; general partners.

Stimulating innovation and introducing new technologies to support businesses has always been at the heart of economic progress. For centuries this work has been carried out by wealthy families, monarchs and governments. But since the mid-twentieth century, venture capital firms (or venture capital firms) have emerged in the United States of America, representing a completely new type of investment management enterprise. They sought and used capital from a variety of investors, from national company owners and foreign investors, to fund and develop new ventures.

Venture investment is an investment in a promising innovative business that does not yet have access to the stock market. In other words, venture capital investments are investments, usually in the form of equity capital, in high-growth high- tech enterprises. Venture investment is typical mainly for the commercialization of the results of scientific research in areas that are science-intensive and high-tech, since most often the prospects of a high-tech enterprise are not guaranteed and there is a significant level of risk for the investor [7].

The functions of venture investment are:

- ✓ encouraging innovation by stimulating competition; –identification of promising technological industries;
- ✓ transfer of capital to the most promising sectors of the economy, as venture capital serves as a kind of "beacon" of the possibility of obtaining high returns on investments for large corporations, state enterprises, banking institutions and other investors;
- ✓ facilitating the acceleration of the technology transfer process;
- ✓ formation of initiative and self-motivation of entrepreneurs;
- ✓ development of a flexible investment mechanism adapted to the innovative development of the economy. [7]

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The main subject of venture investments is venture investors. Venture investors can be any individuals or legal entities. Their role is to invest their own or borrowed funds in a venture fund, and further carry out strategic management of their use. Investors tend to be very large institutions such as pension funds, financial firms, sovereign wealth funds (public investment funds), pension funds, trust funds, insurance companies, and university funds all invest a small percentage of their total funds in high-risk investments. They expect a return of 25% to 35% per year over the entire investment period. Since these investments make up such a small part of their portfolios, institutional investors have a lot of leeway. However, individuals, or so-called business angels, can also act as venture investors. Basically, these are people with a capital of more than $1 million in liquid assets and with entrepreneurial experience [1, 7].

Thus, the parties give their money to experienced venture fund managers who are responsible for investing this capital in promising start-ups and getting a return on investment. Venture funds are pools of money collected from various investors that the fund manager invests in innovative projects. Basically, such projects are startups. Thus, it is logical to define a venture fund as a financial instrument that is created to carry out venture investment activities with or without the creation of a legal entity. At the same time, a venture fund expresses the interests of all its participants [6].

A venture fund may be presented in the form of a partnership, partnership, union or association. However, according to world practice, the most common are private limited partnerships. They consist of general and limited partners [6]. General partners (most often in the form of an experienced team of investors, also called a venture capital company or venture capitalist) are responsible for making investment decisions and maximizing profits for limited partners who invest in funds.

General partners contribute no more than 1% of the funds to the fund [5]. General partners' responsibilities include:

- raising funds from limited partners; –search and selection of the best startups;
- conducting due diligence (legal assessment of investment risks, investment object);
- investing the fund's capital in promising start-ups;
- providing returns to limited investors in the fund;
- providing added value to the fund's portfolio companies in addition to ordinary capital, including advice, the introduction of subsequent investors, etc. [5].

Limited partners are wealthy individuals, institutional investors, etc. Thus, limited partners are the venture investors that were discussed above - the main subjects of venture investments. They contribute 99% of the funds to the fund without the right to dispose of the fund itself.

Venture capital funds typically charge 2-4% of the total size of the fund per year as a management fee - operating and legal expenses necessary for the operation of the fund - and 20% of the profits generated by the fund. Limited partners receive the remaining 80% of the profits [4].

Today's venture fund (usually in the form of a limited partnership or limited partnership) is structurally similar to its predecessors of the late 1970s and early 1980s: partnerships include both limited and general partners, and the life of the fund is from seven up to ten years old. Typically, the fund makes investments only for the first two to three years, and any investment is active for up to five years. The fund collects returns for the last two to three years of its existence. However, both the size of a typical fund and the amount of money managed per partner have changed

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dramatically. In 1980, the average fund was about $20 million, with two or three general partners managing three to five investments. Today, the average fund is ten times larger, around $200 million, and each partner manages two to five times the amount of investments [1].

Venture capital funds usually make investments in accordance with certain specifics - for example, they support start-ups at a certain stage, in a certain industry or a certain geographic region.

However, funds seek to diversify their investment directions and invest in several startups in different industries to maximize their chances of getting into a startup that generates income that more than compensates for all unsuccessful investments [1,6].

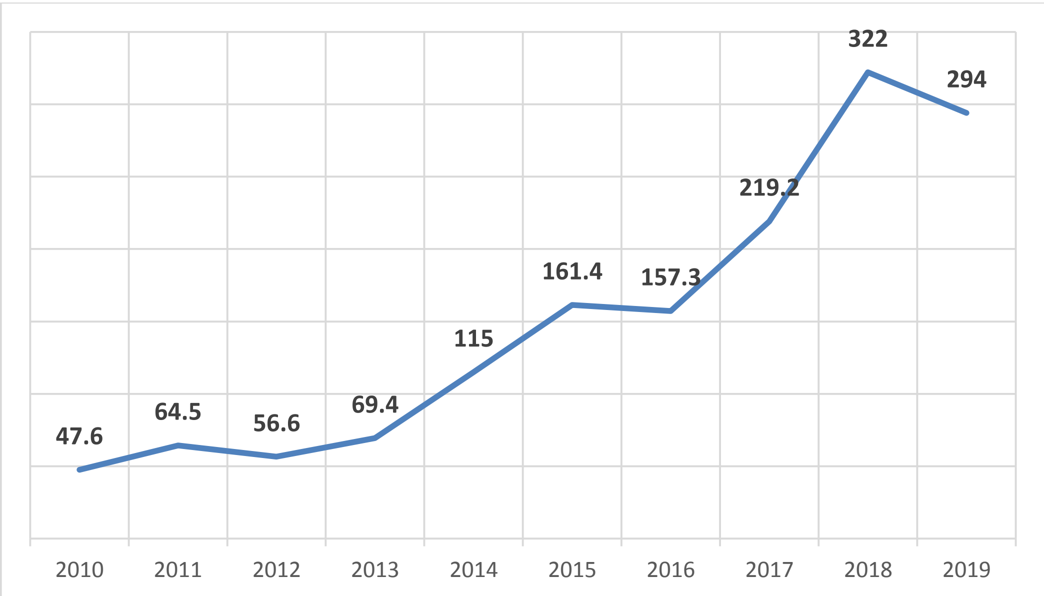
According to Wealthfront, out of 1,000 funds, the top 20 - that's 2% of funds - brought in 95% of the returns from all funds [2].

Venture capital enterprises are recipients of venture investments in order to create competitive advantages in the implementation of high-risk projects and, in this regard, to increase the cost of equity capital. Most often, a venture is a startup that, without venture capital investment, took a huge amount of time to turn into a profitable company. Examples are the well-known Google, Amazon, Apple, Facebook, Uber, Zoom, Airbnb, etc.

Startups usually don't have enough collateral to get a loan. Therefore, there is no certainty that, in case of failure, the borrowed amount will be returned to the lender. However, there is no need to return venture capital in case of failure. With venture investments, the founders of a startup grant investors the rights to receive a certain percentage of the company's profits for an unlimited period, which can amount to huge amounts of money if they are successful [5].

However, venture investing also has its own rules. For example, a venture fund makes a decision to invest only after a thorough study of all available information and the formulation of conclusions about the appropriateness of this investment.

Currently, the venture investment market continues to develop. From 2010 to 2019, the compound annual growth rate (CAGR) was 19.97%. And in 2019, the total volume of venture investments amounted to $294 billion (see Figure 1).



Rice. 1. - Dynamics of the global volume of venture investments in monetary terms (billion US dollars)

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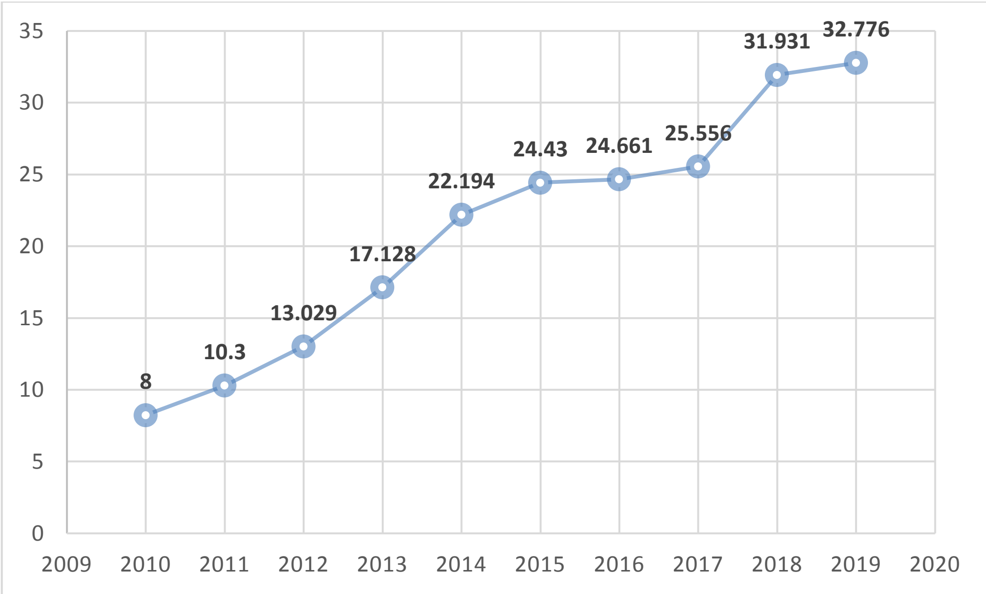
When analyzing the dynamics of the volume of venture investments from 2010 to 2019. in numerical terms, a steady increase can be noted. The average annual growth rate is 14.8% (which is 5.17% less than the same economic indicator when analyzing the monetary volume of transactions). Thus, we can conclude that the average amount of investment per project also increases (see Figure 2).



Rice. 2. - Dynamics of the global volume of venture investments in quantitative terms (thousand transactions)

Also, venture capital was at an all-time high before the pandemic crisis, according to the Global Innovation Index. Venture deal activity in North America, Asia, and Europe was healthy, and total deal value was on the rise. However, at the end of the first quarter of 2020, the number of transactions decreased sharply and fell to the lowest level in the last 2-5 years. Because instead of funding new startups, venture capitalists began to focus on supporting a select number of large firms. These investments and the pursuit of the so-called "unicorns" were not as positive as expected [3].

Although some countries have already begun to open up their economies amid the pandemic, it is likely that more problems will arise in the near future. The crisis and uncertainty are also causing many VCs to focus more on their local markets. This can negatively impact growing companies in less mature markets dependent on international investment. At the moment, venture capital investment is concentrated in a few places, and only a few of them are in emerging economies - especially in China and India (in China, the venture capital investment industry has already begun to recover). The rest of the countries with the most developed venture investment industry are Singapore, Israel, Luxembourg, the United States of America and the United Kingdom [3].

As for the areas of venture investment, at the moment they are mainly aimed at projects developing in the field of healthcare, online education, Big Data, e-commerce and robotics [3].

Thus, we can conclude that venture investments are a type of investment in high-risk assets, which are high-tech and innovative projects. Four groups of participants participate in the process of venture investment - venture investors (individuals or legal entities providing their own or borrowed funds), venture funds (collecting money from venture investors and investing them in the most promising, in their opinion, projects), venture management companies (experienced teams of professional investors, or venture capitalists) and venture capital firms (recipients of venture capital investments).

With regard to current trends, until 2018, there was a steady growth in the field of venture investments. But, already in the first quarter of 2020, due to the coronavirus pandemic, there was a noticeable decrease in venture investment transactions. In addition, the focus of venture investors on larger companies and local projects was noted. Among the areas of investment, the focus is now on healthcare, online education, big data processing technologies, e-commerce and robotics.

Also, taking into account the Global Innovation Index 2020, the main countries most active in the field of venture investments were Singapore, Israel, Luxembourg, the USA, the UK, India and China.

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