

Actual trends of projects financing at early stages

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Abstract – The paper is devoted to the current trends of financing small and medium-sized businesses at the early stages of development. Expected and real sources of financing are discussed. Internal and external problems of start-ups development are analysed.

Key words – innovative projects, financing, start-up, business incubator, "business angels", venture capital investments.

I. Introduction

In today's competitive environment all companies have to deal with innovations. However, investment activities are often faced with difficulties in finding the necessary investment. This is especially important for small and medium-sized businesses that do not have their own sources of funding and that is difficult for them to obtain bank loans.

II. Stages Start-up Financing

Start-up is a young, small company whose activities are connected with any innovative technology (the Internet, nanotechnology, medicine) [1]. Typically, these companies are in the stage of development or research perspective markets. The most important thing for them is to interest investors willing to finance. More details of the development of start-ups are shown in Fig. 1.

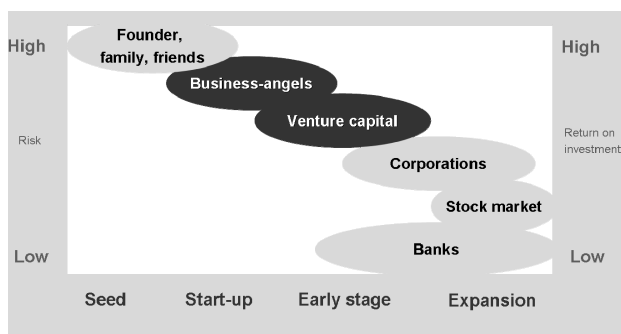


Fig. 1. Stages of business development and sources of financing.

The graph clearly shows that at the stage of initial capital, as a rule, it is not about profitability. Funding is provided by relatives, friends or business angels, who managed to get through. If the idea survives to the early stage, it can get into the incubator, then the accelerator, and then get venture funding [2].

A start-up project may require several rounds of financing before it can generate stable cash flow. The amounts and sources of financing could be different for and depend from company and industry. Companies need this financing to

provide such operations as product development, testing, trial sales, administration and marketing.

Thereby the foreign practice allocate 5 main sources of financing for start-ups: the financing of their own funds team, 3F (family, friends, fools), private investors (business angels) and their associations, specialized venture capital fund [3].

1) Financing of their own funds team. This option is suitable only at an early stage in the creation of the company. As a rule, this is a very small amount of money to carry out ad hoc tasks: PR on the Internet, creating a portal for a project, the creation of legal face and so on.

2) «3F» - is called « Family, Friends, Fools» because of very high risks of investment in the project at the idea stage.

3) Business incubators. Support for start-up projects by young entrepreneurs at all stages of development (from idea to its commercialization) engaged in business incubators.

This variant is typically used in step idea. Its advantage is that you will get a small monetary support and a startup gets a place in the incubator (office, sometimes office equipment, access to the infrastructure of the incubator) and a mentor who follows the development of the team and the project.

Business incubators have proved so successful form of support for a new business, that in recent years their number continues to grow not only in the US, where they are united in the National Association of Business Incubators, but also in other countries. In the world there are already more than 2,000 independently operating business incubators.

Recently, the services of business incubators available and for Ukrainian businessmen. In Ukraine today there are 7 business incubators: WannaBiz; Happy Farm; iHUB; EastLabs; GrowthUP; Polyteco; Founder Institute [4].

4) Business angels are individuals and legal entities who invest part of their own funds to startups in the very early stages of development. The purpose of "business angels" is to maximize the value of the company they grown and after a specified period of time (usually ranges from three to seven years) to sell its stake to do the following project that needs angel investment.

The number of active business angels in Europe is estimated at 125 thousand and the number of potential investors was estimated to be one million.

In the US, about 80% of the projects in the start-up stage was funded by business angels. In the UK, about 18 thousand. Business Angels invest about 500 million pounds to 3.5 thousand companies [5].

As for Ukraine, the relevant association consists of about 50 people, but according to experts, in fact, being an individual investor in Ukraine is much more popular.

5) Venture capital funds are a collective investment mechanism, based on the creation of the general fund by investors, and this fund, adhering to the policy of diversification of risk by creating its portfolio, is financing risky projects for profit above the market average.

The main part of professional market of venture capital investments are venture capital funds. For the majority of Ukrainian investors, funds of venture capital investments are unfamiliar instrument. While the rest of the world attraction such investment is a conventional method of business.

Venture Investment Program is successfully used in the United States, Finland, Singapore, Israel and the UK. According to recent studies in Europe and the United States, investment in venture capital investments are the most stable and profitable.

In Ukraine, venture capital investments are at an embryonic level. Since the past 10 years, venture capital start-ups attracted only foreign investors. Venture funds with Ukrainian capital have started to appear only since 2003.

III. Problems of Venture Capital Investment

According to Global Entrepreneurship Monitor the sources of financing which entrepreneurs expect and which they really reach are quite different (several sources could be notified by respondents):

- 1) Sources of financing expected by entrepreneurs:
 - 42.2% – banks and financial institutions;
 - 32.9% – family;
 - 9.7% – governmental grants;
 - 15.3% – friends and neighbors;
 - 14.7% – colleagues;
 - 14.5% – other relatives;
 - 19.6% – other.
- 2) Real sources of start-ups financing:
 - 48.9% – family;
 - 26.4% – friends and neighbors;
 - 8.4% – other relatives;
 - 7.7% – colleagues;
 - 8.5% – other.

As we can see from statistics, friends and neighbors are underestimated factor in entrepreneurs' expectations regarding start-up financing.

Formal sector is formed by venture capital firms, funds of small innovative enterprises support and assistance, business investment companies, corporate investors (i.e. pension funds, insurance companies), non-financial corporations, industrial-financial groups, banks. Infrastructure of formal financial sector in Ukraine is well-developed but activity of such institutions in venture investments is very low.

Problems with start-ups financing are related not only to external conditions and venture capital market infrastructure, but caused by inner problems and mistakes. German Institute «Marktforschungsinstitut Market Lab & Risikokapitalunternehmen Econa AG» analyzed more than 500 business-plans and came to next conclusions:

- 81,8% - superficial market analysis;
- 79,4% - mistakes in client orientation;
- 52,4% - overestimation of own possibilities and unrealistic picture of expenses;

- 42,5% - chance of «first idea right» is considered as guaranty of success;
- 72,2% - mistakes in SWAT analysis;

Deficit of qualified entrepreneur's education programs in Ukraine makes mentioned above problems much more significant and increases risks for investor.

It's very important that innovative project corresponds to the goals of investor, which could be:

- 1) Enhance - investment would strengthen current business position and protect from competitors.
- 2) Finance – investment of temporary free resources to get additional profit from business or to buy currently underestimated assets for future sale;
- 3) Information – to get access to new innovative technologies and products;
- 4) Protection – to set market barriers.

Conclusion

After analyzing the current trends of financing projects in the early stages of development in Europe, the USA and Ukraine, we can conclude that the investments of new and growing companies in the Ukraine, has not yet reached the level of European countries and the United States.

The main reasons for this are related to the problems of Ukraine's investment climate, underdeveloped capital market, the prevalence of low technological structures of the national economy, the imperfection of the legal system in the field of investment, low transparency of the business, a limited amount of real investment for attractive and innovative proposals.

However, it does not mean the lack of financing as such. Today the main investors in Ukraine - a single venture capital funds and investment companies, business incubators and accelerators, "business angels" and a serial entrepreneur.

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