WPS-0053

Policy, Planning, and Research

WORKING PAPERS

World Development Report

Office of the Vice President
The World Bank
August 1989
WPS 53

Background Paper for the 1989 World Development Report

Venture Capital and Entrepreneurial Development

Fernan Ibanez

The same doubts being expressed about the possibilities for venture capital in the developing countries were expressed a decade ago about Europe and the Far East, two regions where venture capital is now growing fast. Venture capitalists tend to invest in good entrepreneurs, not good projects.

Policy, Planning, and Research

WORKING PAPERS

World Development Report

Venture capital is a temporary-equity or quasi-equity investment in a growth-oriented, usually small or medium-size business managed by a highly motivated entrepreneur. Management assistance often comes with the investment. For the investment, the investor expects either a minority share in the company or the irrevocable right to acquire it.

Unlike traditional investors, venture capitalists prefer good entrepreneurs to good projects — and minority rather than controlling interest, which tends to turn an entrepreneur into an efficient employee. Collateral often takes the form of such intangible assets as research results, innovative marketing ideas, or technical skills. Venture capitalists usually expect more risk and a longer initial period of negative cash flow than traditional investors.

Venture capital cannot be expected to grow in the developing countries at the same pace as it did in its early years of development in the United States and Canada. But there is no reason to believe than enabling conditions cannot be improved so that it can contribute to industrial and entrepreneurial development in the Third World. The same doubts being expressed about venture capital in the developing countries were expressed a decade ago about Europe and the Far East, two regions where venture capital is now growing fast. In many countries, the right conditions already exist for venture capital to succeed.

Governments can create an enabling climate for venture capital by improving the macroeconomic environment, trying to change attitudes about risk and entrepreneurship, improving information and infrastructure, and providing and promoting the availability of venture capital funds.

Hard facts about venture capital are scarce, as participants have not been eager to spread the word about the results of their investments. Most of the information available is through self-promoting success stories. The Bank might consider:

- A systematic review of the experience with venture capital in selected countries.

- Interviews with investee companies to assess the impact of different types of investment.

- Assessing the efficiency of different types and procedures of investment.

- Comparing the results of equity and venture financing with conventional or developmental term credit financing.

- Analyzing the essential characteristics of a successful entrepreneur.

This is a background paper for the 1989 World Development Report. Copies are available free from the World Bank, 1818 H Street NW, Washington DC 20433. Please contact the World Development Report office, room S13-060, extension 31393 (38 pages).

Produced at the PPR Dissemination Center

Venture Capital and Entrepreneurial Development

by
Fernan Ibanez

Table of Contents

1.	Background	1
2.	The Venture Capital Industry Today	8
3.	The Economic Environment for V.C. Development	13
4.	V.C. Potential in LDCs	18
5.	Concluding Remarks and Recommendations	20
6.	Further Research Suggested	24
References		27

VENTURE CAPITAL AND ENTREPRENEURIAL DEVELOPMENT

1. Background

1.1 Definition of Venture Capital

Venture capital is still a relatively new expression in the business communities of both developed and developing countries. Although the term is being increasingly used, there remains much confusion about its meaning as there is as yet no generally accepted definition. Venture capital is often thought of as only "the early-stage financing of new and young companies seeking to grow rapidly". Others identify venture capital almost exclusively with advanced technology and with the Silicon-Valley-type of new enterprises. Venture capital includes both aspects but it goes beyond them. Although historically it started only with early-stage financing, and although in recent years, and particularly in the US, high-technology has been the main focus of most professional venture capital investors, the industry covers today a broad spectrum of interests. Venture capitalists can provide seed, start-up, development and expansion financing to companies which, having demonstrated the viability of their business, do not yet have access to public or credit-oriented institutional funding. Venture capitalists have also provided management/leveraged buy-out financing to assist operating managements purchase and revitalize absentee-owned private companies.

Venture capital is equity financing based on the principle that a partnership can be forged between the entrepreneur and the investors. As such, any idea--whether involving high, low or no technology--qualifies for venture capital support and in fact, ex-post data for different countries show investment in all kinds of productive and commercial activities. In addition, and signaling an important difference with conventional bankers and with passive investors, venture capitalists add value to their investments through the provision of an active managerial assistance to its affiliates. The venture capital industry represents a successful attempt to institutionalize entrepreneurship, and particularly entrepreneurship associated with innovation (not restricted to technical innovation). It is one of the least understood but most important business developments of the post-war era and one of the most significant contributions to development of new entrepreneurial capabilities. Venture capital emerged in response to the growing complexities of industrial financing and to the growing demand for the appropriate kind of financing which gave origin, first in the US and then in other developed countries, to a professional approach to equity/risk financing. It is no surprise that venture capital has shown an important growth in the 1980s in a scenario of increasing real interest rates and growing financial requirements for productive development.

While, given its wide range of activities, an all-encompassing definition of venture capital would be impossible, a brief description of it could be as follows: "a minority and temporary equity or quasi-equity investment, in a growth oriented small- or medium-size business managed by a highly motivated entrepreneur. The investment will be often accompanied by management assistance. For his investment the investor would expect to receive a minority shareholding in the company or the irrevocable right to acquire it". The main differences between venture capital and conventional investments, through holding companies or mutual funds, can be found in the proportion and duration of investments and in the importance attached, by the venture capitalist, to quality of the entrepreneur. In fact, venture capital investors prefer good entrepreneurs rather than good projects, and since controlling interests ten transform good entrepreneurs in, at best, efficient employees the majority shareholder, venture capitalists tend to prefer minority investments in association with good entrepreneurs. The professed objective of a venture capitalist is not to seek a majority or controlling interest in the investee nor to remain forever as a shareholder. A takeover of the company would only be considered under special circumstances. With respect to credit, the difference between venture capital and conventional term financing, lies in the preferred investment instrument or mix of such instruments, in the type of collateral accepted and in the magnitude of the risk involved. For the typical venture capital client, collateral often takes the form of intangible assets such as research results, innovative marketing ideas or technical skills. Their cash flows, almost invariably start with a long period of negative results. Financial resources have to be adequate in quantity and duration to that type of needs.

This paper attempts a review, on the basis of existing information, of potential advantages to developing countries of the venture capital approach. Unfortunately, existing data on venture capital tends to be rather scarce. This is particularly true with respect to country-wide investment performances and to the effectiveness of different incentive schemes. The attempts of this paper would, therefore, be subject to such limitations.

1.2 Evolution of the Venture Capital Industry

The concept of venture capital is not new. The discovery of America, the English Merchant Venturers and many of the businesses of the Italian City States, were based in the venture capital principle: a few very rich individuals were willing to risk a part of their wealth in exchange for the prospect of considerable financial or territorial rewards. Even in modern times, venture capital began as a hobby or sideline of the rich and, until today, a few wealthy individuals continue to play the game. However, after World War II, the business was institutionalized, and several of the pioneering investment firms, although still related to the wealthy individuals (L. Rockefeller, J.H. Whitney, etc.) helped start a new era for the business. The formation of American Research and Development Corporation (ARDC), in Boston in 1946, is usually mentioned as the first step towards institutionalization of the venture capital investment process. ARDC was not only the first, but also one of the most successful venture capital firms on record, under the leadership of a french-born former American brigadier-general, George F. Doriot, who eventually became assistant dean of the Harvard Business School until his retirement, in early 1972. Gen. G. Doriot set forth some of the main principles of the initial venture capital firms. He said: "our aim is to build up creative men and their companies, and capital gains are a reward, not a goal". The same objective was printed in each of the company's annual reports: "Seek out creative men with a vision of things to be done. Help breathe life into new ideas and processes and products with capital--and with more than capital--with sensitive appreciation for creative drive". His ideas were anticipating the phenomenal expansion of entrepreneurship which can now be observed in many countries in the world. Following his philosophy, ARDC invested in one of the first and most successful textbook cases of venture capital, Digital Equipment Corporation, which started in 1957 with one desk and two people, and with an ARDC investment of US$61,400. By 1971 DEC employed 7,000 people, its annual sales were US$147 million and ARDC's seed money, representing 45 percent of DEC's shares, was worth US$345.6 million.

An important step in the development of venture capital in the US was the passage, in 1958, of the Small Business Investment Act, which provided the basis for the creation of the Small Business Investment Companies (SBICs), as vehicles for small business financing under the assistance and regulation of the Small Business Administration. SBICs are funded through a contribution of privately raised capital and government loan funds, on an amount of up to three times the private capital. After an initial slow acceptance by the business community, the SBIC program took off and in the first two years of operation (1960 to 1962) nearly 600 SBICs obtained their licenses. With a few ups and downs the SBICs were the most popular venture capital organizations during the 60s and the 70s. While many of today's professional operators tend to think of the SBICs as a "minor" form of venture capital, those companies have repeatedly been recognized as the seed for the present private venture capital organizations. In the words of S. Pratt, the owner-editor of Venture Capital Journal: "SBICs were a major factor in building a venture capital industry. Today, the survivors of those early years, along with many new SBICs, form an important core of the venture capital investment community".

By the late 1970s, venture capital was already a mature industry with a capital pool of US$2-3 billion. In spite of cyclical downturns in the mid-60s and the mid-70s, it became evident that all of the hard work and value added services provided by the venture capitalists to the entrepreneurs had created exceptional values. The shares of these venture backed companies were accepted by the public with enthusiasm. It was not unusual to find investments increasing in value 10 to 20 times, causing additional capital to flow into the industry. In 1978, the Government provided an additional incentive through a reduction of capital gains tax, first from 49 percent to 28 percent, and then to 22 percent, in 1981. Such reduction, combined with the maturity of the industry and a restoration of the business confidence, produced a significant increase of the venture capital pool from US$2.5 billion in 1977, to more than US$22 billion by 1987. Financial return to investors has greatly exceeded those of stocks and bonds over the past decade. Now that pension fund, endowments, and other institutions, are supplying capital to the venture capital industry, SBICs have been largely overshadowed by independent venture firms. Today, the industry consists of over 600 companies divided into three broad categories of specialized firms: i) about 150 independent venture capital firms, which manage about 70 percent of the available funds; ii) about 430 licenses SBICs (including 128 MESBICs-Minority Enterprises SBICs), which manage about 12 percent of the funds; and iii) subsidiaries of major corporations which administer the balance (18 percent) of funds. It should be noted that subsidiaries of financial institutions which take the form of an SBIC, appear under such category.

In Europe, venture capital appeared much later than in the U.S.A. and Canada. By the end of the 1970s the European venture capital industry consisted only of less than 20 institutions investing no more than US$60 to 70 million each year. By 1986, however, there were over 400 firms established in Europe and the European Venture Capital Association (EVCA), founded in 1983, had a membership of over 170 companies. The total pool of venture capital within the 10 Community countries was around US$8.9 billion. Nevertheless, the development shows important differences from country to country and only three countries--U.K, the Netherlands, and France--account for over 70 percent of investment, with the U.K., alone, concentrating over 50 percent of investments.

The 1980s have seen an important increase of venture capital in Europe with governments taking an active participation both as providers of incentives and as institutional players, but the venture capital development in Europe was not always easy.

One of the most experienced operators in the U.S., and one of the few operating on an international scale--Mr. P. Brooke, from TA Associates and Advent International--has summarized his experience in Europe as follows:

"When TA associates began its activities in Europe in the early 1970s it was struck by a number of differences which made Europe a more difficult place for venture capital than the U.S. These differences were as follows:

(i) Markets for goods and services were considerably smaller than in the U.S.

(ii) There were no organized markets for the provision of equity capital. In the 1970s the provision of equity capital for small business was unheard of. There were institutions that provided debt capital to small businesses on onerous terms but not equity.

(iii) There were no public stock markets which would provide a route to liquidity.

(iv) Finally, there was a cultural stigma against those who entered small businesses. The conventional wisdom was that only the best and brightest entered large successful companies. One was socially suspect if one joined a small enterprise, and talent was not available for new emerging companies.

The premise of government policies in the 1970s was that entrepreneurism played only a small role in the innovation of new technology and that, if innovation was to occur, it would be through large industrial units supported by public sector initiatives."

The same P. Brooke, considers that these attitudes and conditions have been changing in the early 1980s following changes in policies and the implementation of several government initiatives (e.g., establishment of secondary markets, provision of tax incentives for investments in emerging companies) which have favored the development of entrepreneurship and venture capital. Moreover, governments have taken a direct participation as fund providers and as institutional players. While portfolio companies are still confronted with small national markets, venture capitalists have provided assistance to them, through "hands on" management support, to break through the constraints of local markets.

The United Kingdom has the largest venture capital market in Europe. Most growth has occurred since the end of the last decade, after the creation in 1980 of the Unlisted

Securities Market (USM), and after the enactment of several incentives which can be grouped under three schemes: the venture capital scheme, the business expansion scheme and the share incentives scheme. The U.K. industry consists of four types of specialized venture capital funds: i) independent companies which raise money from external sources; ii) bank subsidiaries and financial institutions (including investors in Industry--3i); iii) venture capital funds established under the government's Business Start-Up Scheme (BSS), later renamed Business Expansion Scheme (BES); and iv) government/local authority backed venture capital firms in the U.K. rose from 19 in 1979 to 57 in 1982 and to around 120 in 1987. The capital pool increased from nearly US$2.0 billion in 1982 to over US$4.5 billion in 1987. Captive investors--bank subsidiaries and other financial institutions--account for the "lion's share" of the total amount invested in the U.K. This can be explained by the emphasis which capital investors place on the latter stages of financing, such as expansion financing and management buy-outs. Among them, 3i still provides over one-quarter of the industry's total funds.

Investors in Industry (3i), formerly Industrial and Commercial Finance Corporation (ICFC), which was established in 1945 by the London and Scottish clearing banks in association with the Bank of England, provides a good example of the government-supported, sometimes privately-runned, venture capital institutions which have been more typical of the European scenario for the industry. Originally intended for term lending and with a central objective "to play a significant part in the evolution of the industrial and commercial sectors of the British economy", it has, in fact, been a private sector institution with a longer term view. 3i has provided the venture capital community with leadership, in the sense the SBICs did in the American market, but in a different way: it started the business in the post-war period when there were no private players ready for it, and it has supplied private firms with much needed scarce expertise. A survey by U.K. Venture Capital Journal, in early 1986, showed that 35 out of a total of 340 managers in 59 venture capital firms had worked at 3i. About two-thirds of 3i's disbursements go to small enterprises and most of them in the form of a package of loans and equity investments. As early as 1975, ICFC had 2,330 investments in 18 different branches of industry, into which it had invested over L.225 million annually. By 1987, the total assets of 3i were about L.2.2 billion in over 5,000 companies. Although 3i appears prepared to back any business, 44 percent of its investments are in the manufacturing sector. In some respects, 3i differs from a "pure" venture capital firm. It does not require its portfolio companies to commit themselves to a public flotation and is prepared to hold their shares for a longer time provided they pay dividends. Nevertheless, over the last ten years 3i has achieved a compound rate of return in excess of 20 percent per annum which reflects the soundness of its long-term investment policies. At the same time, 3i Ventures' pool of management expertise and its excellent recent record, have enabled the company to take the lead in managing many spectacular venture capital projects in recent years.

1.3 Venture Capital Results: Contribution to Entrepreneurship

There have been various attempts to measure the economic impact--in terms of jobs, sales, exports, taxes and other indicators-- of new venture-financed companies. While overall studies on the subject are rather scarce, the little available evidence is rather impressive. The most complete study, so far, was undertaken by the U.S. Government Accounting Office (GAO), in 1982, in a study ("Government-Industry Cooperation Can Enhance the Venture Capital Process") whose results were summarized as follows: "The experience of 1,332 companies that were started with venture, backing during the 1970s demonstrate benefits to the Nation's economy and productivity that are disproportionately large when compared with the amounts of capital invested. For example, with $209 million invested to create 72 of these firms, their combined sales in 1979 alone totaled $6 billion, growth in annual sales averaged 33 percent a year, and in the process, these firms created an estimated 130,000 jobs, over $100 million in corporate tax revenues, $350 million employee tax revenues, and $900 million in export sales. Moreover, most products were productivity enhancing, such as computer related equipment, fiber optics, industrial controls, lasers, robots, word processors, and numerous others."

With respect to the performance of individual venture capital companies, the information is both scarce and also difficult to assess. Although some funds will disclose information on how well they have done, a lot depends on the risk profile of the portfolio which is not always available (were they all start-ups? were they leveraged buy-outs? what is the average age of the portfolio? does it represent a downturn or an upturn business cycle? etc. Only as a reference, by the mid-1980s an annual compound rate of return of 35 percent was considered a realistic goal by independent venture capital funds. The scarcity of more quantitative information has been, to a certain extent, complemented by numerous press coverages about successful venture capital-started enterprises which, by now, have become textbook cases: Apple, DEC, Lotus, Federal Express, Atari, etc.

The link of venture capital with the rest of the economy has to build up on the existing data about the overall impact of small businesses. A number of studies have shown that new companies are the major source of new jobs in the U.S. and in Europe. As an example, D. Birch and S. Mac Cracken, at MIT, reported that 66 percent of all new jobs generated during the 1960s and early 1970s, came from the smaller firms that were less than five years old and had twenty or fewer employees. They also show that almost 70 percent of all employees work for companies employing less than 250 people. The message of this seminal work is that the engines of change are small and select, and we must gain a better understanding of those small but effective economics units. At the same time the most remarkable social development of the late 1970s and early 1980s, in the U.S., is the reemergence of entrepreneurship. The creation of new enterprises has increased from 90.000 a year in the late 50s to more than 600.000/year by the early 80s. It is not a si[illegible] coincidence that such growth has occurred in the country which records the greatest growth in the venture capital industry, which has provided essential support to a group of the most dynamic start-ups.

A reinforcing effect has taken place between venture capital and entrepreneurship, in the last two decades. While the existence of venture capital even in its initial stages, has encouraged many potential entrepreneurs to take the leap and try their ideas in the marketplace and has substantially increased the number of people looking for, and receiving, financing to prove their capabilities, the increase of entrepreneurship and ideas has stimulated governments and private investors to contribute resources to those new enterprises. Governments and investors around the world are looking with increased interest towards the U.S. experience. Their attitude towards venture capital are now more favorable than in the past due to the increased visibility of the innovation and productivity benefits of venture capital.

2. The Venture Capital Industry Today

2.1 Size of the Industry Today

Recent surveys on venture capital have reported operations in more than 20 countries, in 1985-86 (Table 1). While more than half of them record as their first year of start-up 1978 or later they show an important growth in recent years. According to those surveys, there were over 1,100 venture capital institutions operating in the world, in 1985, and a total capital pool of nearly US$30.0 billion, of which US$19.6 billion were managed by U.S. companies, although not necessarily invested in the U.S. market. A more recent survey on venture capital limited to European countries (Peat & Marwick, 1986), reports the existence, in Europe alone, of 458 companies, of which 170 are registered members of the European Venture Capital Association. Their pool of capital was estimated to be over ECU10.0 billion (US$8.9 billion) of which U.K., France, and the Netherlands represent 71 percent and the U.K., alone, nearly 50 percent.

The sources of funds show a clear difference between the European countries and the U.S. While banks and governments appear as the major sources of capital in Europe, pension funds, foreign investors and individuals hold the place of prominence as sources of funds for the U.S. private venture capital funds (Table 2). With respect to areas of investment of the aforementioned resources, Table 3 contains the results of a sample of 957 venture capital companies, established in several countries. The results show the ample diversification of venture capitalists' interests.

2.2 Forms of Organization and Operating Procedures of VCCs

In principle, it is possible to conceive many different organizational structures for venture capital companies, and indeed several different schemes have been used depending on countries, purposes, sponsors, etc. However, all of them recognize one common characteristic which is that venture capital requires specialized expertise and cannot be a part-time occupation of those involved. Moreover, the staff engaged in venture capital should have, or acquire, a different kind of background than that of most other financial services, including investment and commercial banking.

Most usual ways of organizing V.C. companies can be grouped either under the "everything-under-one-roof" (or single-tier) approach, or under the "fund plus management company" (or second-tier) approach. In the first case, used by early SBICs in the U.S. and by some private and by government-sponsored companies in Europe, the company has the structure of a corporation which owns (or borrows) and administers the available funds. The company has an in-house team that provides all the services required to select, monitor and assist investee enterprises. Under the second approach, the most common form presently in use in the U.S. and Canada, which is rapidly expanding to Europe and the Far East, the Fund is structured as a limited partnership to which investors contribute their capital. Management of the Fund is entrusted to a management company, structured as a general partnership. The management company provides all the services associated with selection, monitoring and assistance of the investees and gets compensated for them through a management fee and a proportion of the net capital gains. The limited partnerships allows, under the U.S. law, the mingling of taxpayer investors with non-taxpayers. Since they have a specified life, usually ten years, there is a day of reckoning where the performance of a fund can be measured over a given period of time. This contrasts with a corporation which continues indefinitely with a fluctuating capital and intermittent payments of dividends, and where the return on investments over a period of time is less easy to determine and very much less visible. In the case of a corporation, the size of its capital would be determined by its expected objectives and by the cash flow needs of its expected operations. In the case of a Fund, its minimum size would be such that the management fees (usually 1.5 to 2.5 percent of the Fund's paid-in-capital or of its net assets) would be enough to finance the day-to-day operations of the management company. The management team is usually structured around a small team (two to three people) of highly qualified staff, whose cost varies substantially from country to country. The greater the experience of the general partner, the more capital it will be able to raise from investors.

While every venture capitalist develops its own investment policies and procedures, it is possible to discern a great many similarities among them and to group the procedures under equivalent functions: i) deal generation; ii) due diligence process; iii) structuring of the deal (terms and conditions); iv) monitoring and adding value to the investment; v) portfolio management; vi) selling and liquidifying. Each of the above functions requires special skill, appropriate timing and its own procedures.

Successful venture capital investment depends heavily on generating a good "deal flow" from which to choose. Venture capital operators in the United States report that the best deals come from referrals of other entrepreneurs, from other venture capitalists seeking syndicate partners and from other business people such as: accountants, lawyers and financial consultants. Surveys in France have shown a similar pattern, highlighting the role of the banking community as referral source to the venture capitalists. Nevertheless, active marketing should not be disregarded and would usually include: direct mailing, newsletters, seminars, and workshops. The regular flow of projects is important because, as a rule of thumb derived of ex-post data of companies, in many countries only ten to twenty out of 100 inquiries, would survive the initial screening and would reach the due diligence stage, and only two or three of them are likely to lead to an investment.

The due diligence process is the careful review of the business plans, which are submitted by entrepreneurs in all different forms, sizes and circumstances. At the front end of the due diligence process is a screening mechanism for turning down deals that do not meet the overall venture capitalist's predetermined criteria. An experienced venture investor should be prepared to say "no" quickly if he wants to have enough time (four to ten weeks) to review the good proposals. The due diligence process, which is neither short nor sweet, would focus upon those areas which the venture capitalists has, through practice, identified as critical for the success or failure of most companies: i) quality of the entrepreneur; ii) depth of the management team; iii) potential size of the market; iv) vulnerability of the technology or idea (how easy is it to replicate?).

By far the most time-consuming and most important element of the investment decision relates to the quality of the entrepreneur. Drive, total commitment, willingness to work long hours, creativity, and honesty are among the key entrepreneurial traits. While a successful track record may also be useful, it is not considered essential, particularly in the case of start-ups. A well known axiom of venture capitalists is that they would rather invest in a first-class entrepreneur with a second-class project than the other way around. With respect to the project or product, either its price or its method of production or distribution, or both, should in some sense be unique and possess a competitive edge allowing for high profit expectations. Nevertheless, the nature of the venture business is such that, even after such thorough evaluation of projects and entrepreneurs, a certain degree of failure is inevitable. In fact, many years of experience have shown that is very difficult to choose more than 20 to 30 percent of "winners"; that 30 to 40 percent of investments would end up being "sleepers", which generate a return similar to that of a passive investment; and that 20 to 30 percent of investments would be total losses.

The <u>structuring of the deal</u> is the stage where the major variables of the investment are defined. It is essentially a negotiation process involving elements such as: valuation of the company, amount and proportion of the venture capitalist's participation, type of financing instruments, conversion rights for preferred shares or for convertible debt, expected exit time, expected divestment procedures (specially in cases were going public is not a feasible option). While the venture capital philosophy is not to take control over companies, the typical investment agreement would include a set of basic safeguards and the necessary covenants to allow for an efficient monitoring of the investee as well as for a possible takeover in special circumstances such as mismanagement by the majority shareholder.

The next step in the venture capital process is the <u>monitoring of investments</u>. In a way, venture capitalists start their most time-consuming part of the work just where conventional financiers stop. In venture financing, monitoring is not only essential to preserving capital but it is also the way in which the investor "adds value" to his investment. Successful venture-assisted entrepreneurs indicate that, in most cases, management/entrepreneurial assistance from their venture investors has proven even more helpful than their financial contributions. In fact, while the expertise of venture capital firms is usually strong in finance, in contracts with banks, in strategic planning, and in management recruiting; the experience of most young companies tends to be strong in technical areas and weak or inexistent in launching and managing enterprises. It has been said that venture capitalists who do not wish to add value to their portfolio companies would be better advised to invest as "passive investors" in a mutual fund or in the stock markets. In spite of the above, and although venture capital means active participation almost by definition, not all investors are equally committed to such idea. In Europe, the so-called "hands-on" management style has been identified with American-style venture capital and while it is credited with many of the success stories, it has only recently been receiving a wider degree of acceptance.

Selling and liquidifying (divesting) is the final step of venture capital; the hour of reckoning for the investor. At the stage of divestment is where the main differences appear between the US/Canada practices and the rest-of-the-world types of venture capital. While in the U.S. the venture capital industry had access, since inception, to well established capital markets and, more recently, to well developed over-the-counter (OTC) stock markets; venture capitalists in other latitudes had to rely, at least initially, on other "exit" avenues. In fact, secondary stock markets and OTCs, in most European countries, are a very recent phenomenon, as they were established only after 1980 and are yet at a preliminary stage of development. Up until very recently the most frequent avenues for divestment in most of those countries were, and still are: mergers and acquisitions by other investors; selling of shares, through private placements (to institutional investors) or through the use of informal brokers (lawyers, accountants, financial consultants, etc.); and buy-backs by the majority stockholder or management buy-outs by the companies' executives. While most of these procedures can produce, and have indeed produced, significant profits to investors, they are still considered a second-best when compared to public issues through a regular stock market. In recognition of that reality, most European countries and Japan have, in the early 1980s, taken initiatives to establish secondary stock markets, with lower listing requirements. By early 1987, the most active secondary markets in Europe were those in the U.K. and France, with 350 listings and 100 listings respectively. Following this trend, by the end of the decade all European countries, and a good number of the more advanced LDCs, are expected to have operational secondary markets. It is, however, worth noting that, in all the countries where the secondary markets exist today, they have followed and not preceded the establishment of venture capital activities. Consequently, the present lack of stock markets as divestment avenues in many countries should not discourage investors in those countries from starting venture capital activities.

3. The Economic Environment for V.C. Development

Different surveys and studies about V.C. suggest that local and national governments can play important roles in creating the right conditions for V.C. development in promoting V.C. activities. Indeed millions of company foundations occur in the world every day despite recession, inflation, high interest rates, economic uncertainties and fear of failure. The fact that they occur "in spite of" such obstacles should not preclude governments from taking every possible action to remove the obstacles. The governments can contribute not only by improving the macroeconomic environment but also by providing infrastructure, by improving educational attitudes towards risk and entrepreneurship, by improving information, and by providing and promoting the availability of venture capital sources.

3.1. "Cultural" Environment

The single most important feature a government has to look over in promoting venture capital is the general positive attitude towards entrepreneurs and private enterprise. Venture activities have today a strong ideological appeal. In recent years throughout much of the developed world and also in many of the developing nations, government intervention in industry has come to be regarded as less desirable. These practical and philosophical attractions have induced a number of countries to try to replicate the United States venture capital model. In Japan and the U.K., to mention just two countries, these attempts have resulted in venture capital activity on a substantial scale. However, ideology alone is not enough and, in many other countries, a host of policies and regulations militate against private enterprise, particular SMEs: e.g., high wealth and income taxes, endless licensing and permits necessary to operate a business, high entrance barriers to some branches of industry, and, worst of all, an overall negative attitude towards rapidly earned wealth. In such environment the national talent tends to seek safety and prestige through employment in government or large corporations, through academia or in well respected professions, or else emigrate to a more "accepting" environment. Government can actively promote the conditions of the operation of venture capital, and V.C. can, in turn, be instrumental in providing opportunities to the national talent and reinforce positive attitudes towards entrepreneurism.

3.2 Financial and Non-Financial Support to Small Business

Many times the reference to "assistance to SMEs" is misunderstood as a subsidized way of maintaining inefficient operations under a "social" justification. In the context of this paper, assistance to SMEs should be understood as supporting the entrance of newcomers into new fields or into profitable fields which are already being exploited by larger, older, and many times inefficient enterprises. In that context the availability of financial services specialized in dealing with "beginners", as well as the existence of reasonably-priced non-financial advisory services in areas such as: accounting, legal, marketing, and production management; can certainly facilitate the initiation of new activities and the generation of new business prospects for venture capital.

Examples of government-sponsored financial programs can take the form of: i) direct lending to small enterprises, usually through specially created agencies or through rediscount mechanisms in development banks or in Central Banks; ii) loan guarantee schemes, whereby the government covers partially or totally loans to SSEs made by banks (France, U.K., Canada, U.S.); iii) direct equity participations where regional or social development, rather than pure profit, are the final objectives. Spain and France claim to have had fairly good success with regional public sector risk capital institutions (SODIs in Spain, SDRs in France). Brazil's BNDESPAR is an example of a nationally-oriented institution; and iv) provision of financial support to specialized venture capital firms such as the SBICs, in the United States and Japan, which are discussed in other sections of this paper; or creation of state guarantee schemes for private venture capital firms (e.g., state guarantee in favor of Particuliere Participatie Maatschappijen (PPM) in the Netherlands).

Governments can also improve the environment for small businesses through the provision of infrastructure facilities, technical assistance and business advisory services. Facilities usually take the form of industrial estates (e.g., Malaysia, Singapore, Mexico, Ireland) or of "small business incubators", which include not only a common site, but also shared support services and on-site management assistance (e.g., Canada and U.S.). Technical assistance and advisory services have been established, with varying degrees of success, in most developed countries in several developing nations.

3.3 Investment Climate and Stock Market Operations

An active secondary market, whether it operates formally through a stock exchange or informally through the business community contacts, is an essential element of a venture capital mechanism. Stock markets are important because they offer a mean for fair valuation of companies and a vital divestment channel for venture capitalists. In view of the importance attached to stock markets in promoting V.C. and as consequence of the demand generated by the already established VCCs, several developed countries have, in the early 1980s, initiated reforms to improve the functioning of their stock markets, as follows: i) creation of secondary stock markets, with lower listing requirements (e.g., U.K., France, West Germany, Spain, the Netherlands, Australia, and Japan); ii) modernization or establishment of over-the-counter (OTC) markets (e.g., Sweden, Japan, U.K.). In addition, both steps have been reinforced by allowing, and sometimes encouraging through tax incentives (U.K.), the investment by mutual funds and investment funds in stocks traded in the OTCs and secondary markets (e.g., U.S., Canada, Korea, France). Likewise many countries have introduced schemes to facilitate foreign debt conversions into equity, which have stimulated management or third party buy-outs of existing highly-leveraged companies. The creation of special exchanges or "secondary stock markets", for shares of small companies, may have particular significance for venture capital. It is worth noting, however, that while some developed countries are moving towards encouraging investments in new and unquoted businesses (e.g., tax reliefs provided under U.K.'s Business Expansion Scheme, established in 1983), tax reliefs schemes and special funds in LDCs are restricted only to investments in larger companies traded in the primary stock exchange (e.g., Chile's tax relief scheme for new investments in stocks, established in 1984).

3.4 Tax Environment and Specific Incentives

The supply of V.C. can be largely influenced by the fiscal climate. Investments tend to reflect the fiscal advantages afforded to the investors. Many countries have used fiscal reforms to encourage the creation of new enterprises and the investment of new and existing monies in risky ventures. Major tax reforms tried in different countries include: tax deductions for capital subscribed for venture capital purposes (e.g., U.K., Australia, Canada, France); tax reliefs on dividend payments by venture capital-supported enterprises (e.g., Korea, the Netherlands, Brazil); reduction of capital gains taxes (U.S.); reduction of corporate taxes; and allowance for capital losses from one investment to be set off against capital gains on other investment or even against ordinary income (U.K.).

A prime concern in promoting venture capitalism has to do with providing a more equal fiscal treatment to contributions in equity as compared to debt financing. The usual practice is that dividends are generally subject to tax, while paid interests are tax deductible. Therefore, within companies' fiscal structure, there have been changes to encourage venture capitalism through: different tax treatment on retained earnings and on capital issued to shareholders, and tax reductions on share options to key employees (U.S.). Other relevant changes in fiscal regimes affect indirectly risk capital supply and are related to tax deductibilities on R & D expenditures, an established practice in most industrialized countries which is not sufficiently widespread in LDCs. According to a recent survey by IFC, most countries which have chosen tax incentive programs for venture capital, have chosen to link the tax incentives to investments in special V.C. vehicles, rather than attempting to define specific venture capital situations qualifying for tax preferences. Three cases are mentioned as examples: Australia's Management Investment Companies, where investors are allowed a 100 percent income tax deduction for their investments in those companies; Canada/Ontario's Small Business Development Corporation, where investors are allowed a 30 percent income tax rebate for their investments, and France's Fonds Communs de Placement a Risque, where investors receive tax-exempt income and capital gains from such funds at the end of five years.

3.5 Legal and Regulatory Framework for V.C. Companies

The legal framework under which venture capital investors have to operate, will certainly influence their attitudes towards investments and investment procedures. Legal restrictions can be grouped as follows: i) laws specifically defining venture capital companies and their procedures. By early 1987, several countries had legislation to this effect (e.g., France, Australia, Korea, Spain, Canada, Mexico). The existence of such legislation is usually associated with the existence of specific tax benefits ear-marked to venture capital vehicles; ii) laws regulation the operation of venture capital subsidiaries by banks, insurance companies and other financial institutions. While in the United States and the U.K. the legal system has encouraged the existence of wholly-owned subsidiaries of banks and merchant banks, in other developed and developing countries, the banking regulations specifically forbid banks from establishing wholly-owned venture capital subsidiaries (e.g., Belgium and Chile); iii) statutory restrictions on investments by pension funds and life insurance companies. For example, the relaxation, in 1979 in the U.S., of the Employment Retirement Income Security Act of 1974 (ERISA) prudent man rule (which requires prudent management of pension funds and diversification of their portfolios), allowing pension funds to invest up to 5 percent of their assets in venture capital, is credited as having had a major influence on the substantial increase on the flow of venture capital, in that country during the early 1980s. In the U.K. and Ireland, pension funds are also important venture capital investors; and iv) the overall legal framework affecting business transactions and including areas such as: rights of minority shareholders, incorporation regulations, treatment of bankruptcies, and legal liability of corporate directors.

3.6 Overall Conditions for Establishment of Venture Capital

As a summary of the above and comparing the general environment in the U.S.--where over the past twenty years the benefits of venture capitalism have been adequately demonstrated --with other realities, in Europe, the Far East, and developing countries, a few conditions for the success of venture capital can be identified.

First, there must be an environment where more venturesome people perceive self-fulfillment through creation and development of their own businesses. The public's attitude toward success and business should be, if not highly encouraging, at least non-critical. The community should feel as beneficiary and not as victim of successful business achievers. In that context, a high protection to employees (e.g., through social security or termination conditions existing in some European and some developing countries), tends to be a disincentive for entrepreneurs.

Second, investors should be able to dispose easily of their equity. While well developed capital markets are not an inescapable condition, they would certainly facilitate venture capital development. Apart from exit mechanisms like take-over, mergers or management buy-outs, a suitable organized public "secondary market" or OTC, with simpler registrations conditions, would be a must.

Third, the tax regime should be encouraging. While this does not mean that a punitive or neutral taxation regime would rule out completely any venture capitalism, a rewarding regime would certainly contribute to its healthy development.

Fourth, experience has shown that some venture capital structures (e.g., the fund plus management company, or second-tier approach) would increase the likelihood of success. In addition, it has shown that experienced and competent managers of venture capital are in short supply and not easy to train far away from practice. Venture capital is an apprenticeship which requires practical experience and, therefore, results cannot be expected overnight. As an example, experienced venture capitalists in the U.S. estimate that after nearly 30 years of trade development, there may be no more than 200-300 persons in that country with sufficiently broad skills to be called seasoned venture capitalists.

Fifth, there must be a supporting environment for the creation and growth of small businesses. An environment which can take the form of infrastructure facilities, of advisory services, of guarantee schemes, or of any other ancillary services. Furthermore, the support should go even beyond direct services to SMEs and should include the removal of bureaucratic barriers limiting the entrance of new players. As an example of such barriers, an enquiry conducted in Belgium, in 1985-86, revealed that in some instances more than 150 different authorizations were needed before entrepreneurs could launch a new business.

All of the above enabling conditions should be considered in addition to, and not as a substitute for, a good macroeconomic performance and to the existence of a healthy private sector. Finally, with respect to the size of the market, which in the case of the U.S. has been considered as one of the essential elements behind that country's venture capital success, the best option for smaller developed or developing countries to circumvent such limitation seems to be to concentrate their venture capital investments in export oriented enterprises.

4. V.C. Potential in LDCs

At first glance, the situation in most developing countries may not seem encouraging for the development of venture capital. Not only some of the above mentioned enabling conditions seem to be missing, but also the concept of venture capital is still rather unknown and equity participations are usually associated with takeovers by economic groups or by wealthy individuals. Investment opportunities seem restricted by the existence of only a limited number of well-trained entrepreneurs and by the reluctance of family-owned companies to have outsiders participate in its capital. Little new technology is locally developed, while competitive practices are rather unfair. Finally, because divestment avenues are less clear than in the leading venture capital countries, capital gains are assumed to be less attractive.

As a consequence, many venture capital operators have expressed some doubts about the applicability of the venture capital concept to LDCs. To counter such arguments it should be remembered that, some of these same operators expressed similar doubts, ten or more years ago, concerning the potential of venture capital in Europe and the Far East. The main objections were, as they are now, the lack of well developed capital markets, lack of entrepreneurial incentives and the attitude of family-owned business towards outsiders. Yet venture capital is now growing fast in the two regions. V.C. is also practiced everyday, in an informal way, in many LDCs where organized V.C. would only be a way of professionalizing the informal risk capital operations. Other operators believe that risk capital and venture capital are commodities whose availability creates their own demand. It is also a fact that, in many developing countries, economic growth, even in the recent years of recession, has been higher than in the developed economies, that new market "niches" are being created everyday, that there are excellent business opportunities related to the transfer of both "hard" and "soft" technologies and to the marketing of ideas already proven in developed countries, and that the lack of more trained entrepreneurs provides good opportunities for those few who are willing to take the risk and take advantage of their training and capabilities. Recent entrepreneurial surveys in some fast growing economies in the Far East as well as in Latin America, although restricted and incomplete, have identified dozens of cases of fast growing small enterprises which show that entrepreneurial talent is always latent and that it can be easily stimulated through appropriate macroeconomic policies and specific incentives.

Even in that case, what will be needed, as was the case in Europe in the late 1970s, is an active participation of governments in creating or/and in stimulating the appropriate environment, the road towards venture capital should not be expected to be either rapid or easy. As an example, a recent survey by IFC of its accumulated experience through participation in nine VCCs, from 1978 up to date, concludes, as it could be expected, that: "venture capital is not suited for all developing countries." In fact, IFC's results have been mixed. While at least four out of nine investments appear to be doing reasonably well, some others are yet too new to be assessed and at least three of them are considered failures. The cases of failure have been mainly attributed to: lack of commitment by local partners, lack of involvement in the monitoring of affiliates, poor macroeconomic performance of some countries, inefficiencies in the single-tiered structure of VCCs which was used in the early IFC investments, and worse-than-expected divestment results. But in spite of the failures IFC's experience has been positive in demonstrating the viability of venture capital in cultural and economic environments as varied as Korea, Kenya, Malaysia, and Argentina.

Other limited results available from LDCs, plus the recent results from Europe and the Far East and the long experience in the U.S., appear to indicate that, after overcoming the initial launching difficulties, venture capital can make a significant contribution to the economic development of those countries which are willing to provide an encouraging economic environment for entrepreneurial development. Moreover, recent privatization trends all over the world, have reached developing countries. In order to facilitate privatization and, at the same time, avoid excessive concentration of wealth in a few large investors, local entrepreneurship needs to be further stimulated. Venture capital could be one of the best sources of funds and assistance to help new entrepreneurs and to facilitate buy-outs of existing firms. Furthermore, in the absence of true risk capital, expanding businesses, as well as startups and buy-outs, may be forced to either rely heavily on debt or to restrict their growth. Growth based on imprudent financial structures has been a frequent case among the small and medium clients of private and public DFCs. Results in recent years are well known to the Bank, through the portfolio reviews of its client DFCs. Because venture capital expertise is so scarce, the leading venture capital countries can play an important role in providing the necessary technical assistance and training which will not only help developing countries but could also help internationalize the venture capital business.

5. Concluding remarks and recommendations

While a precise and strict definition of venture capital is not available and the exact contours of industry vary from country to country, there are a number of characteristics which are present in all cases: i) the existence of an individual or group of individuals with a marketable idea seeking to bring it to the market and someone else prepared to assist in the financing and management needed to bring the venture to success; ii) while venture capital is mostly equity or quasi-equity, it is not limited to any financial instrument. In addition to technical expertise and know-how, a venture capitalist is expected to have sufficient flexibility to adjust his response to the particular needs of any given project; iii) although in some countries ex-post data show an important preference for technology based projects, any innovative idea--whether involving high, low or no technology--qualifies for venture capital support; iv) while there is no limit to the size of enterprises receiving venture capital, ex-post data shows an overwhelming preference for growth-oriented small- and medium-size businesses (relative to their environments); v) venture capitalists' participation are always temporary and take, in most cases, the form of a minority shareholding or the irrevocable right to acquire it.

The complexity of developments in industrial finance markets needs to be recognized from the outset. Venture capital is one of the elements of those markets. In its most highly developed form, its an amalgam of financial, managerial and marketing know-how. Venture capital clients have assets structures and cash flows which do not meet the eligibility criteria of traditional financing, as their collateral is often in the form of intangible assets such as research results, new ideas or technical skills. They require different kinds of industrial finance such as equity and managerial support. Venture capitalists support entrepreneurs rather than projects and are not scared by initial long periods of negative cash-flow. The difference between venture capital and conventional financing lies in the preferred investment instruments or mix of such instruments, in the type of collateral required and in the magnitude of the risk involved. A venture capitalist has, therefore, to develop specific expertise, distinct from that of established bankers.

The successful development of venture capital markets also requires the recognition of the role of small and medium sized enterprises in providing alternative employment opportunities and their contribution to the development and promotion of new technologies and services. Public attitudes towards entrepreneurship, risk taking and business failure are also important factors underlying the development of venture capital markets. There is at least plenty of anecdotal evidence, from USA and from Europe, to suggest that the increase in venture capital has stimulated entrepreneurship, and made people more willing to start businesses. Recent years have seen an important shift towards an increased role of private sector entrepreneurship as a main engine of development. Within the private sector, small entrepreneurs have played a major role in promoting innovation and in generating employment.

Governments (local and national) can play an important role in creating the right conditions for venture capital development and in promoting venture capital activities. In fact, governments can contribute not only by improving the macroeconomic environment, but also by improving educational attitudes towards risk and entrepreneurship, by improving information and infrastructure, and by providing and promoting the availability of venture capital funds. Examples of government sponsored financial programs for equity or quasi-equity participations in SSEs can be found in several countries in Europe, North America and the Far East. An additional contribution of governments can be found in the development of primary and secondary capital markets, in the setting up of appropriate tax structures and legal regulatory framework.

With respect to the potential applicability of the venture capital concept to LDCs, the situation may not seem, at first glance, very encouraging. Nevertheless, the same doubts that are now expressed with respect to LDCs, were expressed a decade or so ago about Europe and the Far East, two regions where V.C. is now growing fast. While it is true that V.C. cannot be expected to grow in the LDCs at the pace it did in its early years of development in the US and Canada, there is no solid reason to believe that enabling conditions cannot be improved so that venture capital can make an interesting contribution to industrial and entrepreneurial development. In fact, the basic conditions already exist in many LDC countries to adopt venture capital as a financial mechanism which could contribute in: developing new entrepreneurship, assisting the transfer of new technologies and ideas already proven in developed economies, assisting the healthy start up and/or expansion of the most dynamic small businesses, facilitating buy-outs of privatized firms by local entrepreneurs, and assisting in the profesionalization of informal risk capital operations.

<u>Table 1 Estimated data on venture capital - several countries</u>
(committed capital in US$ million 1985-86)

Countries	Year First	Number of VCC	Committed Capital
United States	1946	600	19,600
United Kingdom	1947*	113	4,500
Canada	1962	100	1,200
France	1972	50+	800
Japan	1972*	60	750
Sweden	1973	50	400
Korea	1974*	4	11
West Germany	1975*	30	400
Spain	1978	26	250
Brazil	1979	25	100
Philippines	1980	17	5
Netherlands	1981	50	750
Denmark	1982	16	85
Kenya	1983	1	1
Australia	1984	11	80
Malaysia	1984	1	5
Singapore	1984	1	6
Argentina	1986	1	10
India	1986	4	35
Chile	1987	2	5

* Initially formed as Government-sponsored small business lending mechanism, with equity financial usually coming later.

<u>Source</u>: Author's estimates based on several publications for 1965-86.

Table 2 Sources of venture capital
(1985-86)

EUROPE	%	UNITED STATES	%
Banks	23	Pension funds	34
Governments	21	Foreign investors	18
Insurance companies	15	Individuals	15
Pension funds	14	Corporations	14
Other	10	Insurance Co.	13
Corporations	9	Foundations	6
Individuals	8		
	100		100

Sources: Europe: European Venture Capital Association; USA: OECD. Includes only private VCCs, not SBICs.

Table 3 Venture capital investments in selected countries, by sectors (sample of 957 enterprises, 1985)

Sector	No. of firms
Agroindustry	14
Biotechnology	53
Chemical products	13
Communications	152
Computer hardware	14
Computer software & services	104
Diversified industries	495
Electronic components	84
Automation	22
Health & medical services	136
Real estate	34
Retailing	29
Services	22

Sample covers: USA, Canada, UR, Europe and Asia

Source: Guide to International Venture Capital.

6. Further research suggested

One first conclusion that clearly emerges from the review of the few empiric studies available about V.C. is the scarcity of aggregate quantitative information ("hard facts") about the results and impact of the venture capital industry, a scarcity that affects both developed and developing countries. Several explanations could be advanced to justify such lack of data. Among them: i) Until recently, venture capital has been an inward looking business where neither investors nor investees had any interest in spreading information about the results of their investments; ii) venture capital is, almost by definition, a business where investments have to be close-to-home where they can be easily capitalists, including the very largest, have expressed interest in investing or expanding their business overseas and in assessing the applicability of their procedures in new markets; iii) government participation, and its interest to gather information about the industry, has been either limited (e.g., in the US to the SBICs), or only very recent as is the case in many European countries; iv) very few institutions, among which IFC and the World Bank seem to be the frontrunners, have "discovered" the developmental potential of this mechanism and expressed interest in studying its applicability to developing countries. In addition, the few private data-gathering institutions which are specialized in venture capital have, in accordance with their objectives, concentrated their efforts in producing information and industry directories, concerning potential suppliers of capital (e.g., Guide to Venture Capital Sources in the US) and describing procedures for preparing applications and for contacting venture capitalists.

As a consequence of the above, one first and major topic of research would have to address a systematic review of the venture capital experience in selected countries. A multi-country empirical survey, including some developed and a few developing countries, could be carried out with the aim of: i) collecting data about the extent, results and impact of venture investments; and b) reviewing and identifying specific factors of success and failure of venture investments in different economic environments. Some of the factors to investigate could include: impact of government incentives and of government's direct participation with resources, degrees of involvement of the local banking communities, participation of institutional investors, divestment alternatives in practice, etc.

A second conclusion of the review is that most of the information available about the investees is reduced to the press coverages of success stories as described by their protagonists (i.e., investors, entrepreneurs or government officials), with very few outsider's reviews attempting a benefit/cost analysis or a critical assessment of the contribution to success of each one of the different steps and procedures of venture capital (e.g., deal flow generation, due diligence, monitoring, valuation of investments and divestments, and managerial assistance). A second major topic of research should then focus at the investee companies and, through direct interviews with a sample of them, assess the impact of the different procedures and contributions by the venture capitalist. Some of the factors to investigate should include: Impact of equity vs. managerial assistance contributions, impact of pure equity vs. subordinated debt instruments, assessment of alternative due diligence methods, contribution of monitoring procedures, assessments of formal and informal divestment avenues, etc.

A third topic of research would address the different types of organization and procedures of venture investors, with the purpose of assessing the efficiency of those different structures and their adaptability to LDCs realities. The available information, however scarce, as well as personal interviews with a few operators, have identified past cases where the simple reproduction of foreign V.C. organization structures to local conditions have produced important initial failures causing not only damage to the local investors but also to the image of the business. On the other hand, there are cases where local investors, due to lack of appropriate information, have incurred in great costs to "reinvent the wheel" of an appropriate V.C. management company. The research in this area could survey different types of V.C. companies, mostly in the US and Europe, and assess their potential advantages and disadvantages for the LDCs environment. Some of the topics to investigate would include: relationships between investors and managers, participatory schemes and reward systems for VCC's personnel, government supported schemes for semi-public venture capital companies, use of local consultants for investment appraisals and for management assistance, etc.

A fourth subject of further research, which would build up on the information gathered for the first topic, could address the comparison of results between equity/venture financing of small businesses and their financing through conventional or developmental term credit financing. In fact, preliminary information would appear to indicate that venture capital financing--a supposedly riskier procedure of financing--has produced more profitable results than traditional term credit--a more conservative and supposedly safer financial practice in dealing with SSEs. Recent research undertaken by the World Bank on the subject of SSEs financing through DFCs could be compared with data on venture capital or equity oriented financing of SSEs, to be gathered under the first proposed topic of research, in order to assess alternative options for different economic environments.

A final tpic of research would address one of the essential ingredients of venture capital success: the entrepreneur. While abundant literature has been produced, in recent years, about entrepreneurship and intrapreneurship and about their impact in economic development, such literature concerns mostly the experience in industrialized countries (e.g., US, UK, France, and Italy). Similar studies are not easily available for LDCs, with the possible exception of India. As the entrepreneur has recently regained center stage as the main protagonist of development, the experience of venture capitalists in selecting and assisting promoters of ideas in becoming entrepreneurs, could be essential in investigating the essential characteristics of a successful entrepreneur. Even more important, their experience could be used to determin which of such traints can and which cannot be stimulated and trained. The accumulated experience of venture capitalists could, therefore, make a great contribution to LDCs in supporting the initiative, creativity and commitment of their own entrepreneurs.

References

1. David L. Birch and Susan J. Mac Gracken, "The Small Business Share of Job Creation". SBA, Washington, D.C., 1982.

2. Rodney Clark, "Venture Capital in Britain, America and Japan". St. Martin's Press, New York, 1987.

3. Spiro A. Coutarelli, "Venture Capital in Europe". Praeger Publishers, New York, 1977.

4. John Dominguez, "Venture Capital". Lexington Books, 1974.

5. EVCA Yearbook and Peat, Marwick & Mitchell Report, "Venture Capital in Europe", 1986. VUGA Publishers, The Hague, 1986.

6. George Fells, "Venture Capital in Canada - A Ten Year Review". Business Quarterly, Ontario, 1984.

7. General Accounting Office, "Government-Industry Cooperation can Enhance the Venture Capital Process". Washington, D.C., 1982.

8. Robert D. Hisrich, "Entrepreneurship, Intrapreneurship, and Venture Capital". Lexington Books, Lexington, 1986.

9. IFC, "Venture Capital". Capital Markets Department, 1980.

10. IFC, "Venture Capital Activities in Selected Countries". Capital Markets Department, 1980.

11. IFC, "Venture Capital Activities in Selected Countries - Another Look". Capital Markets Department, 1986.

12. John Naisbitt, "Megatrends". Warner Books, New York, 1982.

13. OECD, "Venture Capital", OECD, 1986.

14. Stanley E. Pratt, "Guide to Venture Capital Sources". Eleventh edition, Venture Economics, Boston, 1987.

15. Stanley Pratt & S. Lloyd, "Guide to European Venture Capital Sources", 1987.

16. SBA, "SBIC Digest - October 1987". SBA, Washington, D.C., 1987.

17. David Silver, "Who's who in Venture Capital". John Wiley, 1987.

18. David Silver, "Venture Capital, Guide for Investors". John Wiley, New York, 1985.

19. Thomas Tosta de Sa (editor), "Sociedades de Capital de Risco". CEBRAE, Brasilia, 1987.

20. "Venture Magazine". Several issues. 1986-88, New York.

21. "Venture's Guide to International Venture Capital". Venture Magazine, Simon and Schuster, New York, 1985.

22. John W. Wilson, "The New Venturers". Addision Wesley, Reading, 1986.

23. R. Bossuyt, "European Continent and Venture Capitalism", Revue de la Banque (Belgium), 1986.

24. T. Fournier, "Le Capital-Risque Francais", Banque (France), 1987.

25. M.F. Baud, "Ledossier de la Semaine: Fonds Propres", Moniteur du Commerce International (France), 1987.

26. M. Barret, "How to Succeed with Venture Capital", Euromoney (U.K.), 1987.

27. "Symposium on V.C. Financing in the Asian and Pacific Region", Discussion Papers, April 1988.

28. T. Tyebjee and A. V. Bruno, "A model of Venture Capital Investment Activity", Management Science Journal, 1984.

PPR Working Paper Series

	Title	Author	Date	Contact for paper
WPS32	Municipal Development Funds and Intermediaries	Kenneth Davey	July 1988	R. Blade-Charest 33754
WPS33	Fiscal Policy in Commodity-Exporting LDCs	John Cuddington	July 1988	R. Blade-Charest 33754
WPS34	Fiscal Issues in Macroeconomic Stabilization	Lance Taylor	September 1988	R. Blade-Charest 33754
WPS35	Improving the Allocation and Management of Public Spending	Stephen Lister	August 1988	R. Blade-Charest 33754
WPS36	Means and Implications of Social Security Finance in Developing Countries	Douglas J. Puffert	August 1988	R. Blade-Charest 33754
WPS37	Black Market Premia, Exchange Rate Unification and Inflation in Sub-Saharan Africa	Brian Pinto	July 1988	R. Blade-Charest 33754
WPS38	Intergovernmental Grants in Developing Countries	Larry Schroeder	September 1988	R. Blade-Charest 33754
WPS39	Fiscal Policy in Low-Income Africa	Stephen A. O'Connell	July 1988	R. Blade-Charest 33754
WPS40	Financial Deregulation and the Globalization of Capital Markets	Eugene L. Versluysen	August 1988	R. Blade-Charest 33754
WPS41	Urban Property Taxation in Developing Countries	William Dillinger	August 1988	R. Blade-Charest 33754
WPS42	Government Pay and Employment Policies and Government Performance in Developing Economies	David L. Lindauer	August 1988	R. Blade-Charest 33754
WPS43	Tax Administration in Developing Countries: Strategies and Tools of Implementation	Tax Administration Division		
WPS44	The Size and Growth of Government Expenditures	David L. Lindauer	September 1988	R. Blade-Charest 33754

PPR Working Paper Series

	Title	Author	Date	Contact for paper
WPS45	State-Owned Enterprises and Public Sector Deficits in Developing Countries: A Comparative Statistical Assessment	Govindan Nair Anastasios Filippides	December 1988	L. Mattheisen 33757
WPS46	The Management of Public Expenditures: An Evolving Bank Approach	Robert Lacey	January 1989	L. Matthiesen 33757
WPS47	Considerations for the Development of Tax Policy When Capital is Internationally Mobile	Robert F. Conrad	March 1989	L. Mattheisen 33757
WPS48	Do Taxes Matter? A Review of the Incentive and Output Effects of Taxation	Jonathan Skinner		
WPS49	Public Sector Pricing Policies: A Review of Bank Policy and Practice L. Mattheisen	Adelaida P. Alicbusan	DeAnne Julius	April 1989 33757
WPS50	Fiscal Policy and Stabilization in Brazil	Celso Luiz Martone	July 1989	L. Mattheisen 33757
WPS51	On Participating in the International Capital Market	V.V. Bhatt		
WPS52	On Financial Innovations and Credit Market Evolution	V.V. Bhatt		
WPS53	Venture Capital and Entrepreneurial Development	Fernan Ibanez	August 1989	WDR Office 31398
WPS54	Bank Restructuring in Malaysia, 1985-88		Andrew Sheng	
WPS55- WPS60	Assigned to WDR			
WPS61	Student Performance and Schools Costs in the Philippines' High Schools	Emmanuel Jimenez Vicente Paqueo Ma. Lourdes de Vera	August 1988	T. Hawkins 33678
WPS62	Universities in Arab Countries	George I. Za'rour	September 1988	C. Christobal 33640