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SPUR INNOVATION BY VENTURE CAPITAL

تحفيز الابتكار من خلال راس المال المخاطر

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ملخص :

رأس المال المخاطر هو شكل متخصص من اشكال التمويل المدار باحتراف؛ المصممة لتلبية احتياجات التمويل للشركات الناشئة، لاسيما في مجال التكنولوجيا والتي تسعى الى تحصيل فرص نمو كبيرة والتي توفر عوائد عالية. يتم توفير التمويل على اساس متوسط الى طويل الاجل مقابل حصة في الاسهم (من خلال راس المال المخاطر). يمنح الوصول الى راس المال المخاطر الشركات مزايا تترجم الى ابتكار ونمو سريع وخلق فرص عمل، وبالتالي فهي تؤثر بشكل غير مناسب على التنمية الاقتصادية. ومع ذلك؛ فان نشاط الاستثمار في راس المال المخاطر يتركز بدرجة عالية في مناطق قليلة فقط؛ ذلك بسبب تجمع المستثمرين في راس المال المخاطر في عدد صغير من المدن وتوطين الاستثمار من اجل تقليل المخاطر الى الحد الادنى

الكلمات المفتاحية: الابتكار؛ التمويل (المال) الاستثمار، الشركات الناشئة.

Abstract :

Venture capital is a specialist form of professionally managed finance designed to meet the financing needs of emergent firms, particularly in technology sectors, which are pursuing significant growth opportunities and which offer the prospects of high return. The finance is provided on a medium to long term basis in exchange for an equity stake. Access to venture capital gives firms advantages that translate into innovation, fast growth and job creation, hence they make a disproportionate impact on economic development. However, venture capital investment activity is highly concentrated in just a few regions – on account of the clustering of venture capital investors in a small number of cities and the localization of investing in order to minimize risk.

Keywords : the innovation; finance (money); investment process; emergent firms
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INTRODUCTION:

Venture capital emerged as a specialist form of business finance designed to meet the needs of emergent firms, particularly in technology sectors, which are pursuing significant growth opportunities . The financing needs of such firms typically exceed their capability of generating funds internally, while their ability to attract bank loans (debt finance) is restricted by their lack of collateral and negative cash flows. Indeed, the faster a firm grows the more voracious is its appetite for cash to invest in R&D, product development and testing, recruitment of key team members, premises, specialised equipment, raw materials and components, sales and distribution capability and inventories. Venture capital is intended to fill this gap in the supply of finance so that such firms can achieve their growth potential.

Venture capital can be defined as professionally managed money that is invested on a medium- to long-term basis in unquoted companies in exchange for an equity stake. Investors will share in the upside, obtaining their return in the form of a capital gain on the value of the shares at a 'liquidity event' which normally involves either a stock market listing (often termed an initial public offering, or IPO), acquisition by another company or the sale of the shares to another investor, but will lose their investment if the business fails. Venture capital investors therefore restrict their investments to businesses which have the potential to achieve rapid growth and achieve a significant size and market position [153] because it is only in these circumstances that they will be able to achieve both a liquidity event and a capital gain. However, very few businesses are capable of meeting these demanding investment criteria. Venture capital-backed firms therefore represent an out-of-the ordinary phenomenon.

Although the number of companies that are successful in raising venture capital is small they have a disproportionate impact on economic development, for example, in terms of innovation, job creation, R&D expenditures and export sales. The injection of money and support enables venture capital-backed companies to grow much faster than the proceeds from sales revenue alone would allow. Moreover, this superior growth rate is sustained over the long-run. Venture capital-backed companies are faster in developing products and bringing them to market, pursue more radical and ambitions product or process innovation and produce more valuable patents. It is of interest to economic geographers because venture capital investments within countries are highly spatially concentrated, hence the economic benefits which flow from such investments are restricted to a small number of favoured regions . Moreover, venture capital is one of the key drivers in the growth of technology clusters . It is also an area of increasingly active public policy with governments attempting to stimulate or create venture capital funds as a means of promoting economic growth in less favoured regions.

Glossary entries.

Bootstrapping: creative ways in which financially-strapped entrepreneurs can minimise or eliminate the need for money to access resources needed for business development: e.g. use of personal credit cards, barter arrangements, working from home.

Business angels: wealthy private individuals – often successful entrepreneurs – who use their own money to invest in new or recently started businesses. Typically they will also provide hands-on support to the businesses in which they invest. Business angels invest at an earlier stage in the development of a business than venture capital firms and their investments are much smaller. Indeed, it is quite common for business angels to provide the first round of external finance to get the company established, and for venture capital funds to provide subsequent rounds of financing. Some commentators have used the metaphor of the relay race to describe this complementary relationship between business angels and venture capital finds.

Debt finance: finance which a firm raises by borrowing from a bank or other lender. The borrower will repay the original amount borrowed (the principal) plus an agreed amount of interest over a set period. Bank lending is normally secured. In other words, the borrower has to provide an asset of equal or greater value to the loan (termed collateral) which, in the event of the borrower defaulting on the loan, is seized by the borrower and sold to repay the loan.

Equity finance: finance that is raised by companies selling shares (stock) to individuals and institutions who become part-owners. There are various classes or shares (e.g. ordinary, preference) which have different rights. Holders of equity are entitled to a share of any profits, via a dividend. However, investors in unquoted companies normally seek a return in the form of a capital gain, with the performance of the company enabling the investor to sell the shares that they own for a higher price than they paid for them when they originally invested.

Management buy-out (termed a leveraged buyout in the USA): the purchase of a company, or part of a company (e.g. a subsidiary or division) by its management, with the financial backing of a private equity firm. This occurs in a variety of situations including: family-owned companies where there is a succession problem; large companies which are restructuring their business; as a means of privatising state-owned companies; and companies that are in bankruptcy. (MARSHALL HARGRAVE, 2019)

Private equity: this relatively new term is now used to cover all forms of medium to long term finance which is provided to companies in exchange for an equity stake. It therefore covers investments at the seed, start-up and early growth stages of emerging entrepreneurial companies through to the much larger types of transactions involving the restructuring of established

companies, such as management buyouts and public-to-private transactions. In Europe the terms private equity and venture capital are often used interchangeably. However, in the USA the term venture capital continues to be used to refer to investments in emerging entrepreneurial companies.

Public-to-private transactions: the purchase of the shares of a company that is listed on a stock market (i.e. a publicly-quoted company) by a private equity firm with the intention of taking it out of the quoted sector and turning it into a privately-owned firm. This would normally occur when the investor thinks that the company's shares are under-valued by the stock market and that it would perform better as a private company.

Stock markets: institutions which facilitate and regulate the buying and selling of company shares and other financial instruments. While this may be a physical place (e.g. Wall Street) most transactions are now made electronically. Companies whose shares are traded in this way are termed public, or publicly listed, companies. Most large companies are publicly listed. However, stock markets also include numerous smaller companies who achieve a listing as a means of raising finance and giving their existing shareholders (which may include their employees) an opportunity to trade their shares. A company which joins a stock market is said to be making an initial public offering, or IPO.

1. VENTURE CAPITAL : DEFINITION AND SIGNIFICANCE

Firms which are pursuing significant growth opportunities are likely to find that their financial needs exceed their capability of generating funds internally while their ability to attract bank loans is restricted by their lack of collateral and negative cash flows. Indeed, the faster a firm grows the more voracious is its appetite for cash – investments in R&D, product development and testing, recruitment of key team members, premises, specialised equipment, raw materials and components, sales and distribution capability, inventories and marketing all add up (bygrave & timmons, 1992). These firms will need to turn to venture capital in order to achieve their growth ambitions. Venture capital can be defined as finance that is provided on a medium to long term basis in exchange for an equity stake. The investor will share in the upside, obtaining their return in the form of a capital gain on the value of the shares at a 'liquidity event' which normally involves either a stock market listing, the acquisition of the company by another company or the sale of the shares to another investor, but will lose their investment if the business fails. Venture capital investors therefore restrict their investments to businesses which have the potential to achieve rapid growth and achieve a significant size and market position because it is only in these circumstances that they will be able to achieve both a liquidity event and a capital gain. However, very few businesses are capable of meeting these demanding investment criteria. So, as (Bhidé, The origin and evolution of new business, 2000) observes, venture capital-backed firms "represent an out-of-the ordinary phenomenon"

Although the number of companies that are successful in raising venture capital is small they have a disproportionate impact on economic development in terms of innovation, job creation, R&D expenditures, export sales and the payment of taxes (bygrave & timmons, 1992). The injection of money and support enables venture capital-backed companies to grow much faster than the proceeds from sales revenue alone would allow. Moreover, this superior growth rate is sustained over the long-run (lerner & all, 2001a). Venture capital-backed companies are faster in developing producs and bringing them to market, pursue more radical and ambitious product or process innovation and produce more valuable patents (Hellman & Puri, 2000). It is because venture-backed play such an important role economic development that venture capital attracts the attention of both scholars and policy-makers.

The scope of this chapter is as follows. It starts with a brief consideration of the demand side in order to highlight the sources of finance available to companies at different stages in their development. This highlights three major sources of finance – the founders, family and friends ('3F' money), business angels and venture capital funds. By definition '3F' money is restricted in its availability: these sources will only invest in businesses in which there is a family or friendship connection. Accordingly, the chapter focuses on business angels (or informal venture capital) and venture capital funds (or formal venture capital) as they are potentially available to any firm that offers the promise of rapid growth. The chapter adopts an investment process perspective, considering the characteristics of investors, their investment activity, sources of deals, investment criteria, deal characteristics, post-investment involvement and harvest. The chapter concludes by noting that these two sources of venture capital, which used to be complementary, are now diverging as a result of the relentless increase in the minimum size of venture capital investments and shift to later stage deals, and considers whether the growing professionalization of the informal venture capital market, in the form of angel syndicates, can fill this new finance gap.[1]

As a final introductory point, it needs to be acknowledged that this chapter takes an 'Anglo-Saxon' perspective focusing largely on the US and UK

[1] Space limitations prevent any discussion of private equity from an industry perspective (e.g. history, investment trends, economic impact) or the role of public policy. However, these and other aspects are well covered elsewhere. Bygrave and Timmons (1992) provide a very good account of the origins and growth of venture capital to the late 1980s, Gompers and Lerner (2001a; 2001b) provide an excellent overview of the development of the venture capital industry, Campbell (2003) offers a journalistic account of the European venture capital industry, while van Osnabrugge and Robinson (2000) provide an overview of business angel investing. The recent spate of 'handbooks' on entrepreneurship also contain overviews of the topic (e.g. Parker, 2006; Landström, 2006; Acs and Audretsch, 2003; Sexton and Landström, 2000). A collection of classic papers on venture capital has also been published recently (Wright et al, 2003).

literature. Venture capital was pioneered in the USA immediately after the Second World War and it was not until the early 1980s that it began to develop in Western Europe, initially in the UK and subsequently on the Continent. During the 1990s embryonic venture capital industries began to appear in emerging markets such as Asia and central Europe, and these regions are now beginning to attract attention from researchers (for example, see Lockett and Wright, 2002 and Wright et al, 2002). However, venture capital in Europe and Asia is rather different to its namesake in the USA, being less technology-oriented and focussed on more mature and later stage deals rather than young, rapidly growing entrepreneurial companies. These differences are reflected in terminology. In Europe the term ‘venture capital’ and ‘private equity’ are often used interchangeably to cover all types of equity investment from start-up through to management buy-outs (MBOs) and buy-ins (MBI), that is, the funding of incumbent or incoming management teams to buy companies from their owners to run as an independent businesses.

However, in the USA the venture capital and MBO/MBI investments (termed leveraged buyouts, or LBOs) are regarded as entirely different industries, with the term ‘venture capital’ restricted to investments in new or recently started companies (Campbell, 2003).[2] This chapter follows the US definition of venture capital, focusing on the financing of the seed, start-up and early growth stages of business development.

2. FINANCING ENTREPRENEURIAL COMPANIES: A DEMAND SIDE PERSPECTIVE

Entrepreneurial companies typically evolve through multiple stages of growth and development, with attendant changes in their capital requirements and the source of the finance. At the seed stage (or zero stage) a business is will be in the process of being established, is undertaking R&D, solving key product development issues and moving to an operating demonstration prototype of the initial product. This phase typically occurs in the founder’s home while the founder is working full-time.

There may not be a formal business plan at this stage. Financial needs are likely to be fairly minimal and will be met by a combination of the founder’s own personal savings, family and friends (the 3 Fs) and ‘bootstrapping’ techniques.[3] Commercial investors will regard such ‘pre-ventures’ as being too high risk. However, government support may be available in the form of

[2] Although many MBOs and MBIs involve the corporate sector, often involving investments in excess of £100m, there are also a lot of smaller deals below £10m where the newly independent company would be classified as an SME. However, space limitations preclude a discussion of this type of investment. Moreover, studies of MBOs and MBIs have not tended to examine the process from an SME perspective.

[3] Bootstrapping can be defined as strategies for marshalling and gaining control of resources at minimal or no cost (see Bhidé, 1992; Freear et al, 1995a; Winborg and Landström, 2001; Harrison et al, 2004).

R&D and proof-of-concept grants for technology-based firms. The start-up stage begins with the founding of the company, demonstration of commercial applicability, securing of initial sales and seeking new sales channels. The financial needs increase as the company invests in capital equipment, begins to employ staff and for working capital. Investment in businesses at this early stage are very high risk – the management is unproven and the product or service has yet to demonstrate widespread acceptance - and any return may not materialise for five to ten years. Thus, businesses are likely to continue to rely upon a combination of 'love money', bootstrapping and government support, although those with growth prospects may be able to raise finance from business angels.

Particularly in Europe, few venture capital funds will be interested in investing at such an early stage unless they have been established with an economic development mandate. Companies which come through the start-up stage with a product or service which is in demand enter the initial growth stage. The business will be seeking to improve product quality and lower its unit costs and develop new products. The business may be reaching profitability but this is insufficient to fund the growth that is required to expand plant and equipment, bigger premises, additional staff to fill out each of the functional areas and bigger working capital requirements. Risk and uncertainty have declined.

By this stage the business will no longer be reliant on 3F money. The main source of funding will be business angels. However, they typically make relatively small investments (less than £250,000), so larger funding requirements and follow-on financing are likely to be met by venture capital funds.

Companies that continue to grow enter the sustained growth stage. These companies are often termed 'gazelles', and can expect to grow to beyond £10m/$20m in sales and 100 employees. Profits and cash flow are sufficient to meet the majority of its capital requirements but additional finance may be required to grasp new growth possibilities (including acquisitions). Such companies will look to venture capital funds specialising in development capital and even to more esoteric financing instruments and ultimately to a stock market listing where its shares are available to the public (Roberts, 1991a)

Thus, there are a variety of potential funding sources available to finance new businesses through these stages of growth and development:

a) **Personal savings of the entrepreneur or team** : this is typically the primary source of initial funding. Even though the amounts involved are typically quite small, this funding is important for two reasons. First, subsequent investors will expect to see that the entrepreneurs have committed themselves financially to the business. Second, the effect of raising outside capital will be to dilute the proportion of the business owned by the original

entrepreneurs. Thus, the bigger the amount that they are able to invest, and the longer that they can survive on this and other non-equity sources of funding and bootstrapping then the less dilution they will experience when they come to raise external capital. The entrepreneur is also likely to contribute 'sweat equity' by working for no salary or at a level below what could be obtained by working for someone else until the business is on a solid financial footing.

b) **Family and friends** : Recent research by the Global Entrepreneurship Monitor (GEM) consortium, an international consortium of 38 countries which collect data on entrepreneurial activity on a consistent basis by means of large scale household surveys, reports that close family members, friends and neighbours are by far the biggest source of start-up capital after the founders themselves (Bygrave, Hay, M, Ng, E, & Reynolds, P, 2003). Such investments typically take the form of short-term loans which may be converted into equity at a later stage. This form of finance is relatively easy to get, although the amounts involved are relatively small. The providers are unlikely to regard their investment as a commercial one and, indeed, may not expect it to be repaid. However, entrepreneurs may be reluctant to 'take advantage' of kinship and friendship ties and may feel under emotional pressure not to lose the money (Roberts, 1991a).

c) **Business angels** : These are wealthy private individuals, generally with a business background, and often cashed-out entrepreneurs, who invest their own money – either on their own or with a syndicate of other angels - in new or recently started businesses with growth potential. Their motives are economic but not totally so. Non-economic motivations include the fun and enjoyment that comes from an involvement with a young growing company and social responsibility. Their investments are typically at, or soon after start-up and range from under £10,000 to over £250,000, although the norm is £50,000 to £100,000. These investors do not normally seek a controlling interest or management position in the business but it is usual for them to perform an advisory role and they would expect to be consulted on major management decisions.

d) **Venture capital firms** : venture capital firms are financial intermediaries which attract investments from financial institutions (banks, pension funds, insurance companies), large companies, wealthy families and endowments into fixed life investment vehicles ('funds') with a specific investment focus (location, technology, stage of business development) which are then invested in young, growing businesses which offer the prospects of high reward. The function of the fund managers (the general partners) is to identify promising investment opportunities, support them though the provision of advice, information and networking and ultimately exit from the investment. The proceeds from the exit – or liquidity event – are returned to the investors (the limited partners). Most venture capital firms are independent organisations. Some are subsidiaries of financial institutions (termed

'captives'). A few large non-financial companies, particularly technology companies, have their own venture capital subsidiaries which invest for strategic reasons to complement their own internal R&D activities (corporate venture capital). Venture capital firms rarely invest in basic innovation. Rather, venture capital money assumes importance once the business model, product and management capabilities have been proven, market acceptance has been demonstrated and uncertainties about the size of the market and the profitability of the business have been reduced (Bhidé, 2000) Companies at this stage are looking to commercialise their innovation and need funding to create the infrastructure to grow the business (Zider, 1998). Thus, venture capital firms tend to invest significantly larger amounts than business angels and invest at later stage sin business development.

e) **Government-backed investment organisations** : in most countries governments have created investment vehicles to fill what are perceived to be gaps in the supply of venture capital which results in funding difficulties for particular types of company. In the past it was common for governments to use its own money to provide the investment funds. However, it is now common practice for government to create investment funds under private management by leveraging private sector money by using the tax system or other financial incentives to alter the balance of risk and reward for the private investor. Examples of venture capital funds that have been created as a result of tax incentives are Venture Capital Trusts (VCTs) in the UK and Labor-Sponsored Venture Capital Funds in Canada. Examples of investment funds created as a result of government co-investment alongside private money but on less favourable terms, thereby improving the investor's return, include Small Business Investment Companies (SBICs) in the USA, the KfW and DtA programmes in Germany and the Regional Venture Capital Schemes in England (Sunley, Klagge, B, & Berndt and Martin, R, Venture capital programmes in the UK and Germany: in what sense a regional problem?, 2005)

f) **Public stock market** : Gaining a listing on a public stock market may be the logical final step for a fast growing company to fund its ongoing growth. Further shares in the company can be sold to institutional and private investors to raise additional finance. Raising debt finance also becomes easier with a public listing. Public companies can also use their shares to make acquisitions. And a listing is also an important way in which existing shareholders – notably the founders and their families, business angels and venture capital funds – can realise their capital gains. However, the costs of obtaining and maintaining a stock market listing means that it is only an option for larger companies.

3. How Venture Capital Works (the venture capital finance innovation)

Venture capital is dedicated for financing various types of projects which, give the possibility of above-average chances of success and profits, taking into account a huge risk (Lerner, 2001). Venture capital institutions specialize in financing of all sorts of new economic projects with significant growth potential, but on low level of economic maturity.

As a rule, venture capital is burdened with at least five types of risk:

- risks in the development and implementation phase,
- risk in the production phase, i.e. whether it is possible to manufacture,
- risk in the sales phase – marketing, i.e. whether the product finds a buyer,
- the risk of profitability, i.e. whether the product can be sold with profit,
- the risk of rising: will it be possible to increase the production and development of the project?

a) Venture capital in financing of innovation (european start-ups in selected countries)

Public investors (government agencies, local authorities) and private ones create venture capital funds (banks, insurance companies, corporations, pension funds, universities, individuals). Most frequently, however, this method of financing investment applies to companies with insufficient financial liquidity (often unlisted on stock market). In Poland, target of venture capital funds are companies offering a good product with fist success on the market, and obviously the lack of capital for faster development and increased production capacity (Tamowicz & Rot, 2002). The image of Polish reality in this area compared to selected European countries is presented in Table (01).

Table (01). Investment venture capital in relation to GDP in selected countries

2007	2008	2009	2010	2011		2012	2013	2014	2015
Greece	0.000	0.002	0.006	0.002	0.004	0.000	0.001	0.000	0.000
Germany	0.034	0.039	0.029	0.029	0.029	0.021	0.023	0.021	0.025
Denmark	0.092	0.074	0.051	0.059	0.067	0.070	0.078	0.075	0.109
France	0.049	0.057	0.048	0.042	0.035	0.032	0.037	0.035	0.034
Poland	0.006	0.016	0.001	0.002	0.007	0.002	0.006	0.006	0.007

Source : Monika Burżacka, Elżbieta Gąsiorowska, THE IMPORTANCE OF VENTURE CAPITAL FINANCING OF START-UP COMPANIES, Poland, 2016 , p146

On the basis of this statement, it is obvious that Poland doesn't have specific results in the use of VC in relation to GDP, although there is a noticeable positive, upward trend in this regard. Countries such as France, Denmark and Germany are significantly ahead of us. In the literature one can even meet with the statement that development of the company, because of

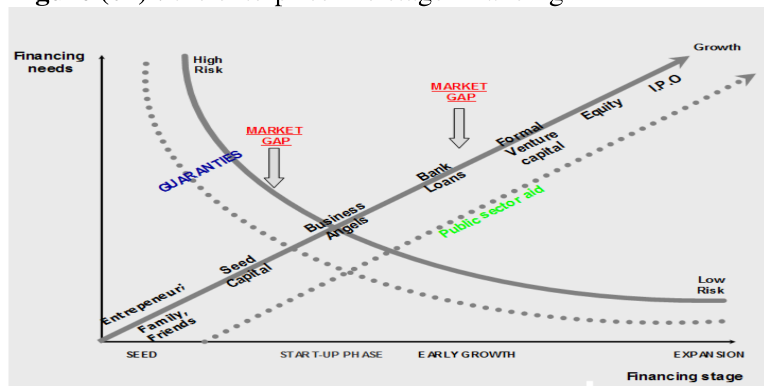
shortages in VC takes an entire generation (Akim, 2011). There is a very important question: does a limited access to venture capital funds effectively reduce the creation and development of start-up companies? The answer is not so obvious. The financing gap, understood as a lack of funding opportunities for companies in the early stages of development, certainly is a factor strongly limiting or even excluding the activities of start-ups. At the same time, it doesn't mean that the role of the VC is so exceptional. (Papachristou, & Geronikolaou and, 2012) proved a dif ferent relationship: the development of financing needs in innovative start-ups provokes a development of VC but the development of start-ups is definitely not the result of the activity of VC funds ((Burżacka, & Gąsiorowska , 2016)

In 2012, risk investment funds in Europe reached 36.5 billion Euros, of which 3.2 billion was related to investment of Venture Capital funds in the seed stage, start-up and later venture stage. On the other hand, in Central and Eastern Europe, the value of all investments in 2012 amounted to 1 billion, but only a little over 100 million Euros were invested in companies in a seed stage, start-up and later venture stage (seed and start-up - 99 million). Almost half of the capital invested in this part of Europe was invested in Poland (478 million Euros). This is presented in Figure 2. According to the data the European Venture Capital Association (EVCA), 2012 was another period of decline in the value of investments held in this part of the continent (Zelek, 2013)

b) The financing of the enterprise life stages

On the basis of the following curve, it is obvious that the financing of the enterprise specially the innovate one throw the differrent stages of life wish are (seed _ start_up thase _ early growth _ expansion financing stage). is needed a deffirent sources of financing wish are (entrepreneurial ; family ; friends_ seeds capital _ business angels_ bank loans _ formal **venture capital_** equity_ I.P.O)

Figure (01) : the enterprise life stage financing



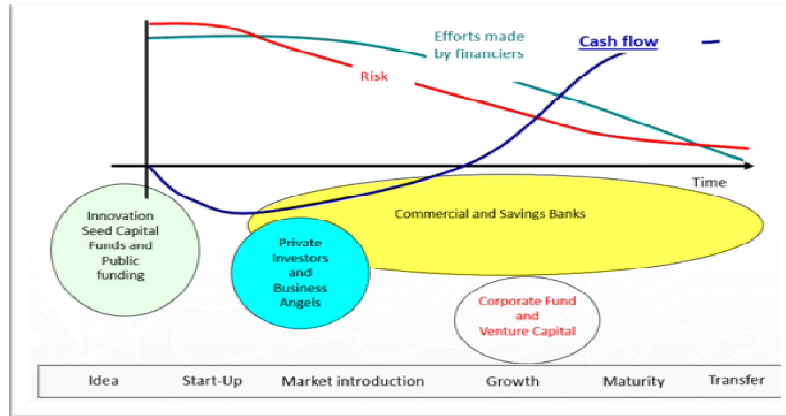
Source: Guriqbal Singh Jaiya, The Relevance of IP for Acquiring/Securing

Financing: Making Intangibles More Tangible, www.wipo.int/sme p 41

4. Determinants of innovation financing

Many varibales control the success of innovation financing which the following figure clarify and show the relationship between them.

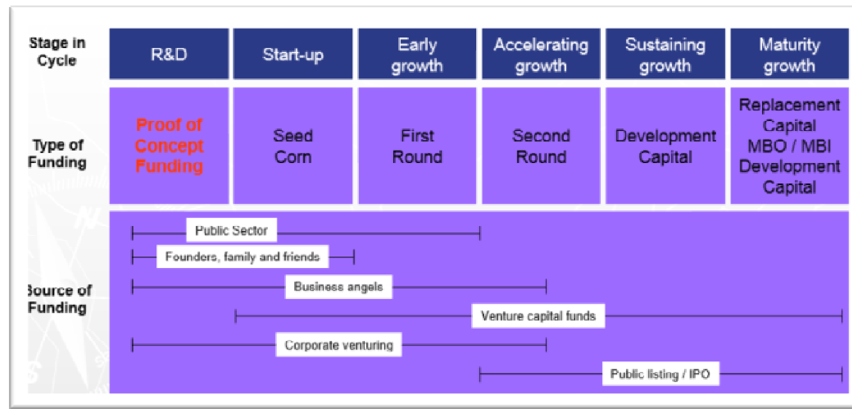
Figure (02) : innovation financing determinants



Source : Guriqbal Singh Jaiya, The Relevance of IP for Acquiring/Securing Financing: Making Intangibles More Tangible, www.wipo.int/sme, P42

try throw this graph showing that each stage of funding needs a specific source and type of funding (first determinant);we can see the red curve show that the risk level (secand determinant) is reduced to fund enterprise (innovate projects) as they move to another stage. the green curve in the same time show that the efforts mades by the financiers (thired determinant) become less at each stage when the blue curve apears that the incom or the cash flow(forth determinant) become more higher precisely from the growth stage and this is what gives the financiers a courage to financing hight riske projects or innovation (Lis, 2016) The following table summarizes what was presented by the previous two figures

Table (02). The enterprise financing process

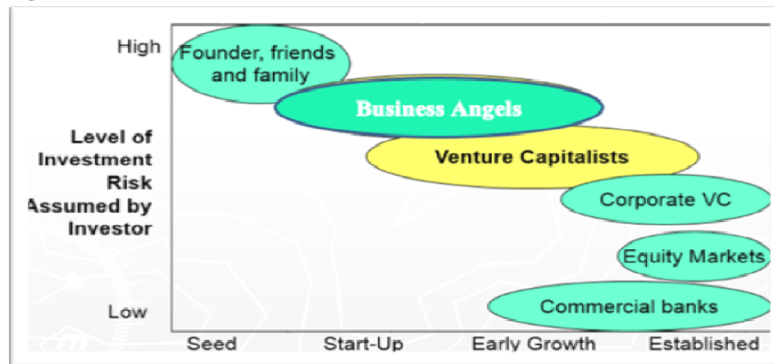


Source : Guriqbal Singh Jaiya, The Relevance of IP for Acquiring/Securing Financing: Making Intangibles More Tangible, www.wipo.int/sme, P44

5. Investment continuum

the following figure focuses on the level of risk at each stage of funding.

Figure (03) : investment's risk levels



Source : Guriqbal Singh Jaiya, The Relevance of IP for Acquiring/Securing Financing: Making Intangibles More Tangible, www.wipo.int/sme, P43

Throw this figure we notice that the investment risk level assumed by investor decreases as we move into another phase of financing . as we can say the more the enterprise grows ; the investment risks become lower.

CONCLUSION:

The strong geographical effects that characterize venture capital investing contradicts the economist's concept of perfectly mobile capital markets. Although venture capital firms can, and do, raise their investment funds from anywhere, there are strong geographical constraints on where they make their investments. Given the positive effect that venture capitalists have on new firm formation and growth, as both capitalist and catalyst, the effect of the

geographical clustering of their investments, in turn, contributes to uneven regional economic development .Access to sources of venture capital gives young businesses substantial first-mover advantages, which translates into fast growth, profitability, and job creation. For these reasons Governments see venture capital as an essential ingredient in their efforts to promote technology-led economic development in lagging regions. However, simply making venture capital available will not create the conditions under which high technology entrepreneurship will flourish. Venture capital needs to be combined with talented individuals who can start and grow companies on the basis of innovative ideas. Moreover, providing money is only part of the role of venture capitalists. It is difficult for governments to replicate the value-added skills of venture capitalists. Trying artificially to create a regional pool of venture capital is therefore unlikely to be effective as a means of generating economic development in lagging regions. However, venture capital will flow to areas with world class science and technology. Policy-makers should therefore concentrate on developing the region's technology base, encourage business start-up and growth, and enhance the business support infrastructure.

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