



4th World Conference on Business, Economics and Management, WCBEM

Venture Capital a Catalyst for Start-Ups to Overcome the "Valley of Death": Lithuanian Case

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Abstract

Research so far have indicated that start-ups in early stage of development encounter with the financial gap which limits companies' ability both to innovate and to commercialise its products (valley of death) (Hudson & Khazragui, 2013). Moreover limited human capital, high uncertainty in terms of product and market, volatile development process, weak partnership ties are the utmost impediments for successful start-ups development (Fielden, Davidson and Makin, 2000). It has been finalised that venture capitalists are valuable contributors in both filling the financial gap (1), and providing value added services (2) like financial, technological, managerial support, and contacts (Hellmann, Puri 2002; Dubocage, Rivaud-Danset & Redi, 2012; Caselli et al., 2009; Bertoni & Tykvova, 2012). Still the research on venture capital role on the start-ups performance is fragmented the impact on the companies' performance indicators is revealed in some extent (Peneder, 2010). Having all mentioned the scientific problem emerges: what is the role of venture capital in start-ups development specifically on the performance indicators (turnover, number of employees). Purpose of study is to explore the role of venture capital funds as a catalyst for start-ups to overcome the "valley of death" especially focusing on the value added provision in terms of financial and innovation perspectives. Research is carried out by combining qualitative and quantitative research techniques including analysis and synthesis of the scientific literature, case studies and statistical data as well. The literature research has identified the characteristics of venture capital financing, specifically there are evidences that venture capital funds trigger the growth of company, product development, inspire entrepreneurship and thus enhancing the competitiveness of start-ups. Regarding the analysis of venture capital backed companies' cases in Lithuania it has been revealed that investments were made not only in start-ups, but for mature companies as well and covered various sectors, not solely high-tech, but also including energy, food, and textile sectors.

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Peer-review under responsibility of Academic World Research and Education Center

Keywords: venture capital, "valley of death", financial gap, start-up

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1. Introduction

Start-ups in their early stage of development encounter with the various barriers including financial gap which limits companies' ability both to innovate and to commercialise its products (valley of death) (Hudson & Khazragui, 2013) and limited human capital management capabilities, high uncertainty in terms of product and market, volatile development process, weak partnership ties (Fielden, Davidson and Makin, 2000). On the other hand it has been finalised that venture capitalists are valuable contributors in both filling the financial gap (1), and providing value added services (2) like financial, technological, managerial support, and contacts (Hellmann, Puri 2002; Dubocage, Rivaud-Danset & Redi, 2012; Caselli et al., 2009; Bertoni & Tykvova, 2012). There is empirical evidences that "VC financing is associated with faster firm growth and an acceleration of the innovation and commercialization process" (Kelly & Hankook, 2013).

Micro and macro perspectives are the main angles of research in measuring venture capital invests effect on the economy. In macro perspective the research includes various theoretical frameworks (for instant, Cobb Douglas equation is used) in measuring venture capital investments relation to the economy growth, productivity growth and innovation. For instance macro perspective research have revealed the impact of VC sector on the R&D and patent statistics (Ueda and Hirukawa, 2003), relation between private equity and employment, R&D expenditures, patent statistics (Da Rin & Penas, 2007).

While in term of micro perspective the research so far have measured the venture capital investments regarding the changes in the venture capital backed companies' performance indicators (Kelly & Hankook, 2013; Paglia & Harjoto, 2014). Research so far provides evidences that venture capital financing reveals in positive effect not only by providing financial capital but increasing portfolio companies value in the following perspectives: increase in professionalization (Hellmann & Puri, 2002), product market and strategy formation (Peneder, 2010), internationalization (Fernhaber & McDougall-Covin, 2009; Peneder, 2010); innovation creation in terms of productivity (Ueda & Hirukawa, 2003) and innovation creation in terms of patent (D'adda, 2009; Caselli et al. 2009; Bertoni & Tykvova, 2012). The relation between VC investments and innovation strategy is revealed in some studies as well (Hellmann & Puri, 2000; Da Rin & Penas, 2007; Peneder, 2010; Venckuviene, 2014).

Still the research on venture capital role on the start-ups performance is fragmented the impact on the companies' performance indicators is revealed in some extent (Peneder, 2010). Having all mentioned the scientific problem emerges: what is the role of venture capital in start-ups development specifically on the performance indicators (like turnover, number of employees).

The research aims at exploring the role of venture capital funds as a catalyst for start-ups to overcome the "valley of death" especially focusing on the value added provision in terms of financial and innovation perspectives. Objectives include as follow: 1) To identify the main features of start-ups and the role of venture capital in overcoming the "valley of death"; 2) To reveal the methodological aspects of measuring the venture capital effect at micro-level; 3) To explore the venture capital financing aspects in Lithuania, specifically focusing on the financial indicators of venture-backed companies. The methods embed qualitative and quantitative research techniques including analysis and synthesis of the scientific literature, case studies and statistical data as well.

2. Venture capital financing effect on SMEs: theoretical background in terms of micro-perspective

2.1. *Venture capital financing features*

Technology intensive start-up is the spotlight in many countries strategic and political level. It is considered that creating favourable environment for business will shed lights for the start-up development particularly mitigating the financial gap and lack of management capability. Research so far indicates that start up encounter with various obstacles hindering their development. The indicated "valley of death" means the shortage of financial resource as well as business development knowledge are among the key ones.

It is considered that start-ups from their nature are very sensitive to the uncertainty related to market dynamics, and growing competition pressure. But the utmost boundary for them is financial capital availability to maintain the viability and what is more the lack of managerial capability to overcome the shocks of viability companies.

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