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## Effects of State-owned and Hybrid Venture Capital Funds in Hungary

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### Abstract

State has got an important role in the venture capital industry in Hungary. On the one hand this study analyses the investments of three state investors in the middle of the previous decade. It presents location of target companies and effects on employment. The results show that state has got a positive role in job creation, but the indirectly job creation is very low at national economic level. Financing businesses in peripheral regions is a rational reason for the intervention of the state, but it was not realized. Activity of state investors which provide equity to firms directly was in the core economic region. On the other hand the study analyses the investments of JEREMIE Venture Capital Program. The investments of hybrid funds – thanks to the legislation – financed a higher proportion of SMEs operating in the country. The regional targets formulated as general objectives do not seem to have been fulfilled until the regulatory system does not separate specifically the outstanding capital in the centre and in the peripheral regions.

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### 1. Introduction

The significance of small and medium-sized enterprises and the financing problems some of them is well-known. The authors' aim in this paper by carrying-on a part of an earlier research to analyse the venture capital investments' role in the SME's financing and some impacts on the Hungarian economy. The number of investments of start-up or already operating businesses in Hungary is negligible. Behind many of the financing transactions aiming the early and expansive stages stood a public organisation in the middle of the previous decade. In the current decade the roleplaying

of state changed and the most active investors are the hybrid venture capital funds due to JEREMIE\* Venture Capital Program. Due to the weight of these investments and the difficulties concerning complete mapping of private transactions the authors focused on the public and hybrid investments during the primary research.

## 2. Justification of the topic, objectives

The stimulation of economic growth, the rise of competitiveness, and the reduction of unemployment is expected partly from young firms with ability of strong growth, and it is an important thing for the economic politicians, that venture capital industry could offer a proper supply of capital for the development of these firms (Karsai, 2002). The state recognized early that the venture capital (VC) market will not solve itself the SME's financing, therefore it intervened.

The role of the state in venture capital industry is based on two suppositions. On the one hand, private sector does not assure a proper amount of capital for a specific section of firms, which are able to new, rapid growth, which are innovative or which run far away. On the other hand, another supposition is that government is able to revise this situation. It is capable to identify investment possibilities, which offer huge social benefits, and it can recommend to financial mediators (investors in private sector) to pay attention to these firms (Karsai, 2004).

The situation, when market members do not assure a proper amount of capital, is called equity gap. Equity gap can evolve for the sake of insufficient supply and inadequancies on the demand side (Lawton, 2002, Bergquist and Dahg, 2008). This equity gap is a typical problem for many enterprises, and one of the reasons can be the location of the business: business peripheral regions have less access to equity finance than those in central regions (Harrison and Mason, 2000). Makra (2007) documented this also in Hungary: venture capital industry was Budapest-centric.

The aim of the regional policy is to reduce the regional disparities and to catch up the peripheral regions. These objectives emerged by the studied Hungarian JEREMIE program<sup>†</sup> and state-owned organizations with different emphases. Regulation of JEREMIE contains these objectives the most definitely. There are eight funds<sup>‡</sup> and seven of them have to invest in peripheral regions.<sup>§</sup>

Another important goal of the economic policy is increasing the employment. The governments in power regard that attainable by inter alia solving the problems of the SME sector. In the target-setting of the investment implementing organizations and programs appears directly the intention of the increase in employment.

In the light of the above mentioned the authors examine whether the state got closer to some proposed objects (especially to employment and regional targets).

## 3. Results of state-owned investors in the previous decade

Kovács (2013) analysed the activities and transactions of certain public organisations. These organisations are:

- Corvinus Venture Capital Fund Management Ltd. (CKTA, its managed fund: Corvinus First Innovation Venture Capital Fund, CELIN),
- Information Technology Venture Capital Fund Management belonging to Regional Development Holding Co (IKTK, its managed fund: IT Venture Capital Fund, IKTA)
- Hungarian Development Bank (MFB)

Investments were made between 2004 and 2007, and to my knowledge, in the case of CELIN and IKTA all transactions are included (4 and 11 investments). CELIN and IKTA transactions were chosen because they were active

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\* Joint European Resources for Micro to Medium Enterprises.

† JEREMIE venture capital program.

‡ There are four rounds of JEREMIE in Hungary. Eight funds were established in the first one in 2010.

§ Seats of target companies are not in Central Hungary.

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