# ANALYSIS OF CHOSEN FIRMS USING THE VENTURE CAPITAL*

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**ABSTRACT**
Venture capital is rather up-to-date form of financing of small and medium enterprises and it can help them to obtain important financial sources for proving business activities. A paper focuses on such chosen firms using the venture capital as a financial source. Paper also provides the information how successful firms and venture capital investors were after the investment was provided.

**KEY WORDS**
venture capital, financial source, firm, investor

## 1. Introduction

Transformation of the economies would not be possible without private capital. There are several different sources that can contribute to the growth of the economy. Submitted paper aims to describe private capital of small and medium size enterprises and focuses mainly on up-to-date form of capital – a venture capital.

Fundraising with venture capitalists can remain a largely mysterious process. In a world shrouded with non-disclosure agreements, the entrepreneurs are often unaware of the common practices of deal terms and are unable to benchmark their term sheets with respect to those given to others. Inherent conflicts of interest in the split of the financial returns, liquidation, and control of the company lead the venture capitalists to structure the deals which benefit their interests at cost to the interests of the entrepreneurs.

Venture capital financing is attractive due to many reasons. Venture capitalists (VCs) allow the entrepreneur to raise the money all from one place. Given that VCs are in the business of building businesses, they have plenty of experience with the challenges of start-ups. Also, VCs usually have been through the process growing the company to Initial Public Offering (IPO) and other desired liquidation events **[1].** VCs usually have a large rolodex of contacts which can help the company become successful. VCs can also give assistance in hiring members of the management team if necessary.

Furthermore, venture-backed firms also perform significantly better after they go public than similar non-venture-backed firms.

Although the reasons to seek venture capital are obvious, the entrepreneur and the venture capitalist must be aware of the conflicts of interest that exist between them. Deal terms structured by the venture capitalist should address these conflicts of interest by minimizing the risk and maximizing the returns for the VC. Structuring deal terms in the venture capital world can be a very complex process. Venture capitalists have the daunting task of taking huge risks by investing a very significant amount of money into sometimes nothing more than a business plan. They also have the luxury of rejecting 99% of all investment opportunities that come their way. Conflicts of interest occur between the VC and the entrepreneur because there is a difference between some of their goals and objectives. In an effort to minimize their risk and maximize their ROI (Return on Investment), the VC often asks for provisions that align their interests with the interests of the entrepreneur.

## 2. Body of Paper

For the purposes of a paper I have chosen four firms from Slovakia and Hungary that used venture capital as a financial source and are good example of successful stories.

- **Justification:** Full justification of the document

- **No headers and footers, no page numbers**.

### 2.1 BALA

Joint-stock company BALA was founded in 1998. Its headquarters is in Holice, 35 km away from Bratislava, where they have own places of office, operation and production at their disposal. They are presented as a medium-sized firm at their market. The work of employees is directed by qualified experts - building engineers and technicists - who are at customers' disposal in order to offer services over the standard. In 2002 firm BALA received the certificate of a quality management system pursuant to the standard STN EN ISO 9002 : 1997, recertification to the standard STN EN ISO 9001 :

2000 was realized in 2003. They also possess a certificate for their products of steel-constructions used for telecommunication purposes.

Seed Capital Company entered BALA Company in June 1999. The structure of financing was realised by increasing the basic capital 2 mill. Sk for 23% share in BALA Company and by offering a loan of 1 mill. Sk with 17 % interest p.a. due in 3.5 years. The aim of financing was to purchase raw materials and investment property to spread out the ironworks. Seed Capital Company offered next 5 mill. Sk. in the second round of financing.

BALA Company reached following positive effects after the seed capital entry:

- specialisation of the activities provided,
- expansion on foreign markets of Hungary, Austria, Switzerland,
- receiving of Certificates of quality mentioned above,

increasing of revenues and market share.

Chart 1: Reached positive effects of BALA, ltd. – operative ER, net ER, earnings.

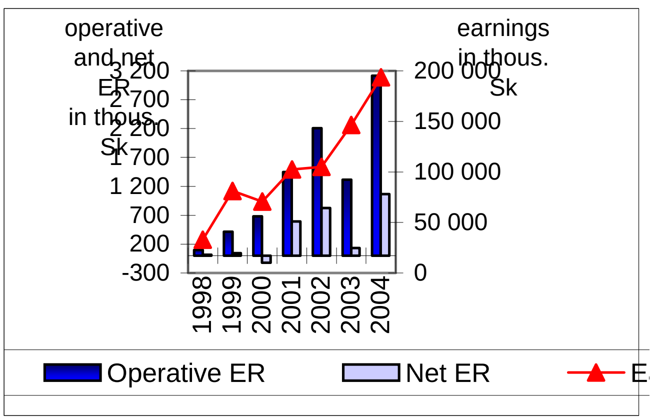
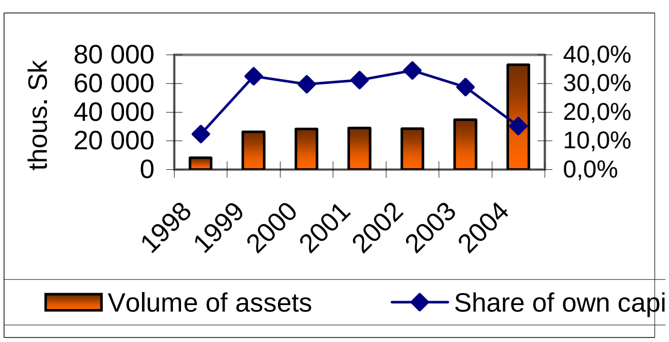
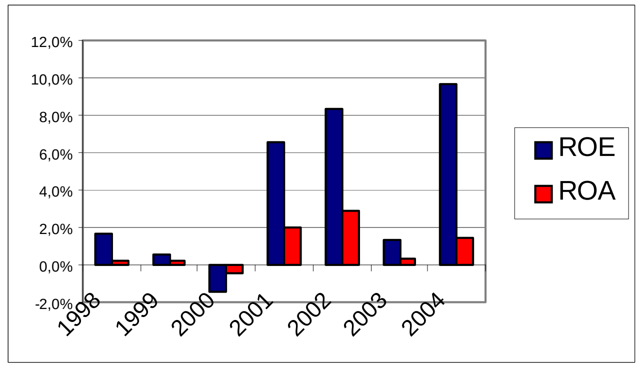



Chart 2: Reached positive effects of BALA, ltd. – volume of assets, share of own capital.




Source: [6]

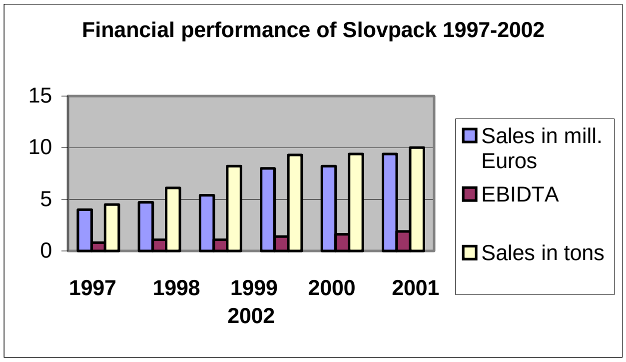
Chart 3: Reached positive effects of BALA, ltd. – ROE, ROA.




## 2.2 Slovpack

Slovpack was founded in 1994 as a specialised manufacturer of plastic packaging for clients in the Slovakian food and industrial construction sectors. By 1998, although ranked number three in the local market, the company was under a joint venture ownership structure that handicapped effective decision-making and impeded development. Thus, to Raiffeisen Ost Invest Slovpack was an attractive investment proposition, with a management team that had extensive experience. Slovnaft, a 50% owner of the company, was searching for a reliable joint venture partner to develop Slovpack. Buying out Slovnaft's outgoing joint venture partner for 1.1 mill. Euros, Raiffreisen Ost Invest set about developing a five-year business plan and a new development strategy. The strategy saw the company invest in new moulding machinery and diversify its product offering while at the same time boost product quality. Reiffeisen Ost Invest ensured that production was tied directly to client orders rather than to forecast demand. By 2002, Slovpack's sales had grown from 4 mil. Euros to 10 mill. Euros and productivity increasing by 30%. Slovpack grew to be the leader of the Slovakia market, and since 2002 also an exporting company to Germany, the Netherlands, Austria, the Czech Republic and Poland. In 2002, Raiffreisen Ost Invest exited in a management buyout transaction and realized 3.3 times its invested capital with an IRR of 32%.

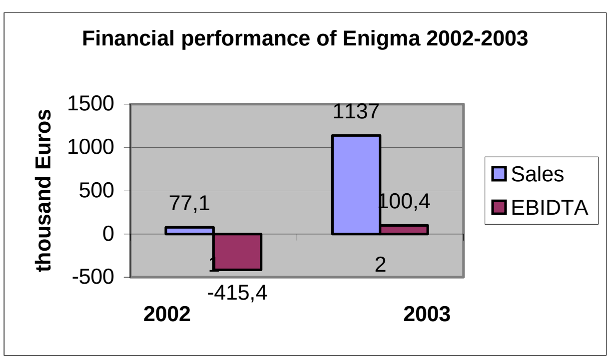
Chart 4: Financial performance of Slovpack 1997-2002.




### 2.3 Enigma

Enigma developed a working prototype of a secure mobile payment system. With this process successfully completed, funding was needed to bring the system closer to commercialisation. For Euroventures, Enigma's principal attraction lay in its founder's successful track record and potential of a secure payment system targeted at rapidly developing mobile telephony services. The subsequent deal saw Euroventures commit 1 mill. Euros for a 45% stake in the business. Fast Ventures invested 400 000 Euros ten months later, valuing the company at a 40% premium to Euroventures' price. On exit in 2004, Euroventures achieved a cash multiple of 2.6 times and an IRR of 87%. Fas Euroventures exited at the same time, realizing a 2-times cash multiple and a 70% IRR.

Chart 5: Financial performance of Enigma 2002-2003



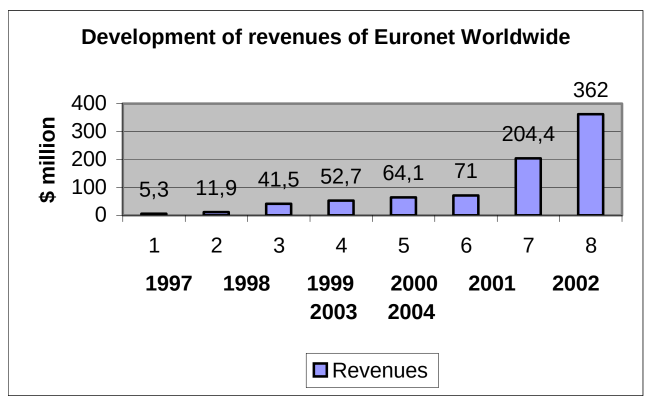

### 2.4 Euronet Worldwide

Euronet's progress, from start-up to international leader, initially depended on its ability to expand sales volume aggressively in key regional markets. Euroventures and the Hungarian-American Enterprise Fund (HAEF) each invested $1 mill. in 1994. Two years later, Innova Capital and Advent International invested a total of $6.8 mill. in the company to expand its offering into the Polish market. On full exit in 2000, Euroventures achieved an IRR of 125% and a total cash multiple of 11.3 times. In partial exits during the 1997 initial public offering and in subsequent public market sales, HAEF, Innova and Advent realized cash multiples of 7.8, 10.3 and 5.2 times on their respective divestments. Innova and HAEF retrain stakes in the company.

Euronet Worldwide, as Europe's first independent automated teller machine operator, knew it had a chance to capitalize on its first-mover advantage to become a dominant regional player, as local economies shifted from cash to plastic-based transactions and the region's consumers began using banking services on a mass scale. Soon, Euronet was exporting to Poland, Germany, Croatia and the Czech Republic.

Euronet revenues grew dramatically during the expansion years. Cash profitability was achieved by late 2002, and EBITDA of $48 mill. is forecast on revenues of $362 mill for 2004. Euronet Worldwide is now established as a global industry leader in secure electronic financial transaction solutions. It operates on one of the largest independent pan-European ATM networks, with more than 162 000 point-of-sale terminals across 68 000 retailers in Europe, Asia, and the USA.

Chart 6: Development of revenues of Euronet Worldwide.




## 3. Conclusion

Venture capital is not suitable for many entrepreneurs. Venture capitalists are very selective in deciding what to invest in; as a rule of thumb, a fund invests only in about one in four hundred opportunities presented to it. They are most interested in ventures with high growth potential, as only such opportunities are likely capable of providing the financial returns and successful exit event within the required timeframe that venture capitalists expect. Because of such expectations, most venture funding goes into companies in the fast-growing technology and life sciences or biotechnology fields. Because of these strict requirements, many entrepreneurs seek initial funding from angel investors **[2].**

If a company does have the qualities venture capitalists seek such as a solid business plan, a good management team, investment and passion from the founders, a good potential to exit the investment before the end of their funding cycle, and target minimum returns in excess of 40% per year, it becomes much easier to get venture capital.

The private equity industry in Central and Eastern Europe (CEE) is more than 15 years old. The first fund raisings and investments were completed in 1990. Although relatively young compared to the private equity industries of Western Europe and the USA, CEE private equity has developed considerably since its inception. Estimates suggest that during the past 15 years, more than 7 bn. Euros of funding has been raised for private equity funds dedicated to the CEE countries **[3].** From this, over 900 investments have been made in the region and more than 400 exits achieved. It is further estimated that of the funds raised to date, some 75% have been invested.

The conditions for private equity in CEE continue to develop in a positive way. Many former start-up companies have developed over the years to become more mature market players that continue to grow, in some cases internationally, and provide an ample pool of investment opportunities. Management teams have become significantly more experienced and repeat entrepreneurs are present on the market. The availability of experienced local managers has improved dramatically and is contributing to the growth of management buyin and management buyout transactions across the region. Managers with strong and tested track records are now behind new ventures. The region's companies are increasingly technologically advanced and have proved they can succeed against the best world-class competitors. Debt financing for private equity transactions is also increasingly available, contributing to a growth in the volume of larger deals and widening the scope of transactions being completed. Finally, industry investors, both foreign and domestic, have shown a keen interest in buying CEE companies that received private equity support..

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