

Analysis of Institutional Subjects of the Venture Capital Market in the Investment Environment of Foreign Countries

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Abstract:

In the conditions of modernization of the economy, there is a need for additional financial resources for the development of high-tech industries and innovative projects. This article examines the relationship between institutional entities of the venture capital market in foreign countries. The purpose of the research is to evaluate the possibilities of alternative means of venture financing of innovative projects.

Keywords: innovation, venture capital, venture fund, diversification, pension fund, insurance companies, infrastructure.

INTRODUCTION

The swift expansion of economic and social sectors, the comprehensive utilization of scientific and innovative potential through the full mobilization of scientific, intellectual, and financial resources, and the setting of priorities for ongoing scientific reform are crucial contemporary issues. These efforts also include the training of highly qualified personnel equipped with modern knowledge and independent thinking skills, and the elevation of scientific infrastructure modernization to new qualitative heights. These priorities align with the five key development areas identified in the 2017-2021 action strategy for the Republic of Uzbekistan, particularly emphasizing the "Year of Development of Science, Enlightenment and Digital Economy". In accordance with the Presidential

Decree No. PF-6097 issued on October 29, 2020, which approved the concept of science development up to 2030, measures have been taken to address these challenges.

As part of this initiative, the decree has mandated the creation of two venture funds in Uzbekistan in 2021, with an increase to ten by 2025, in collaboration with leading foreign investment firms. This article delves into the development of innovative entrepreneurship in the country and explores how the establishment of venture funds facilitates investment attraction.

Problem statement. The discourse on the innovative development of economies and the pivotal role of investment in innovative activities has been extensively explored by numerous distinguished scholars worldwide. Foremost among these are B. Lundvall, G. Mensch, M. Porter, S. Kortum, R. Solow, E. Toffler, M. Hurikawa, K. Freeman, Y. Schumpeter, and others, whose contributions have significantly shaped our understanding of economic innovation.

Additionally, scientists from CIS countries like A. Virolainen, E. Ignatushchenko, A. Popov, I. Melnikova, A. Nechaev, I. Rodionov, Yu. Ryumina, B. Lisin, T. Tumina, and R. Fathutdinov have conducted pivotal research focusing on the influence of various factors on economic innovation. Their studies have offered valuable insights into the complex mechanisms that drive the innovative processes within the economies of their respective countries.

In Uzbekistan, economists such as Kh.P. Abulkasimov, B.A. Begalov, A.V. Vakhobov, S.A. Voronin, M.Q. Pardaev, Z.T. Gaibnazarova, S.A. Giyasov, I.J. Jakhongirov, A.A. Kadyrov, M.A. Makhkamova, N.M. Makhmudov, N.K. Mukhitdinova, R.R. Nazarova, G.Kh. Razikova, T.S. Rasulov, F.B. Shakirova, and Sh. G. Yuldashev have also contributed to the body of knowledge regarding national economic innovation through their scholarly work.

Despite the rich body of existing research, there remains a critical need for comprehensive studies that specifically address the development of financing mechanisms for innovative entrepreneurship through venture funds. This area is crucial for enhancing the investment foundations essential for the sustained innovative development of the national economy. Therefore, a dedicated and specialized scientific inquiry into this subject is necessary to devise effective strategies and frameworks that can bolster the innovative capacities of the economy.

RESEARCH METHODOLOGY

It is known that the role of investments for experienced and large enterprises operating in the market for a long time is to ensure strategic development, while for small and new enterprises, investments are important not only for development, but also for survival in the competitive environment. This represents the specific characteristics of small business capital.

Small businesses have more flexibility and strategic flexibility than large businesses. Newly established small business entities may not be able to compete openly with companies that are already operating in the market, but they begin to take their place and position in the market during this period, so small businesses usually require less investment than large companies.

But it is also worth noting that small business is less stable than big business. For example, a mere delay in payment by customers for a certain period of time can have a negative impact on the operation of a small business. Therefore, having the required amount of investments on time ensures stability in business and creates the necessary conditions for growth.

When it comes to innovative business, attracting investment sources to finance it is not easy. Because there is a high risk of innovation-based, i.e., early stages of innovative business, there is a high risk of parting with the invested funds if the final results of the invested projects are not achieved after the implementation of the final results. We should also note that the results of

scientific research, especially in the field of science, are not guaranteed to generate income for a long time after funding.

ANALYSIS AND RESULTS

Professional financial intermediaries operate in the institutional venture capital market and attract financial resources from pension funds, banks, insurance companies and other financial institutions as investments in their businesses. Venture funds managed by experienced venture investors are established for these purposes.

Usually, venture funds in foreign countries are formed in the form of limited liability companies operating for a limited period (not more than ten years). Such a partnership is not considered a legal entity (this exempts it from double taxation, as well as significantly simplifies the registration procedure and other organizational processes). It would be appropriate if the same principle is applied in the establishment of venture funds with the participation of the state in Uzbekistan.

Leading (main) partner as a venture fund management company (VC), which organizes a venture fund and makes investment decisions. Typically, successful venture capital firms manage several venture capital funds in a row at the same time. General partners invest in the company by owning a share of the authorized capital. In many cases, the general partners establish subsidiaries that act as back-office companies and work with certain venture funds.

Limited partners are usually institutional investors such as pension funds, insurance companies, and banks. At the same time, other organizations (corporations) and individuals who have not established their own venture funds as funds under the board of sponsors and OTM can participate as partners.

In recent years, in European countries, the participation of agencies authorized to distribute budget funds by the state for the purpose of stimulating the innovative activities of the country or individual regions and sectors as limited partners is increasingly ensured.

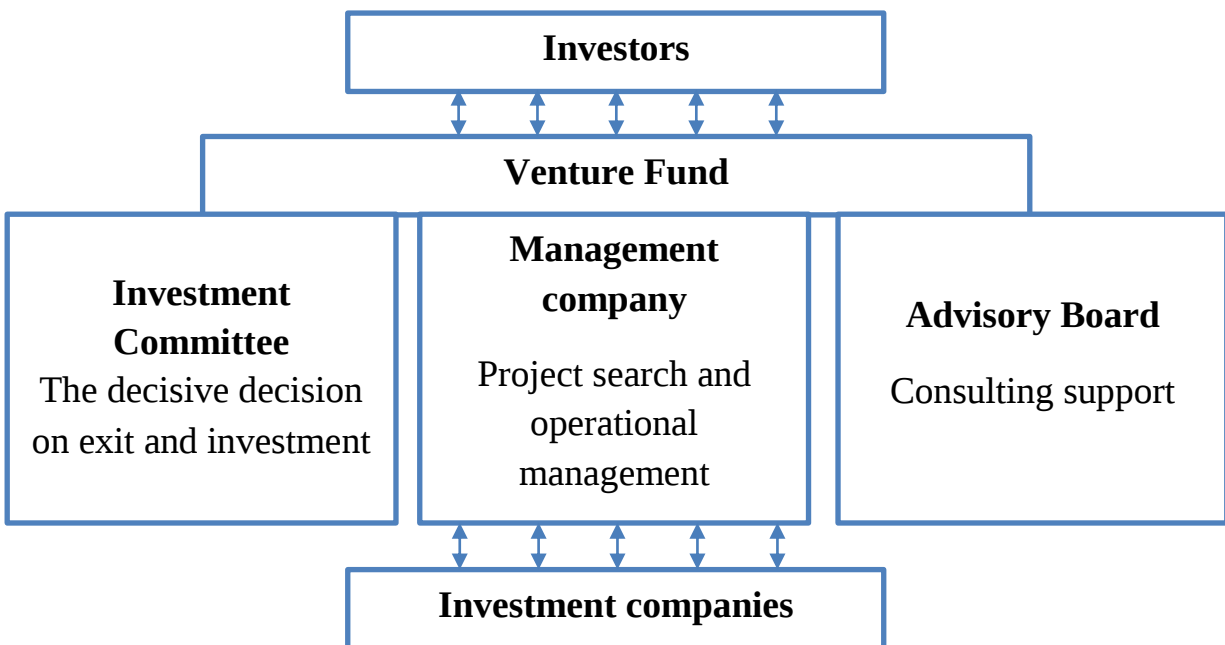


Figure 1. Scheme of operation of the venture fund

The advantage of a limited liability partnership (LLC) over other organizational and legal forms is its accuracy in paying taxes - taxes are paid once, that is, only when the partners receive income, that is, the LLC itself is not taxed as a legal entity.

It is also important to adapt to the organizational conditions, which allows all conditions for managing the fund to be determined by contract, as it is known that the conditions of the contract may change depending on the wishes of the partners. This allows the parties (investors and venture capitalists) to legally determine the rules of management in order to achieve the maximum profit calculated as the common final goal of the "exit" from the project, so that they are interested in the fund's achievement of income. Also, such agreements allow each participant to be protected from the wrong or unexpected actions of the other party.

Sometimes, in order to monitor the activities of the management company, investors may create a fund's investment committee. In this case, it is mandatory for the management company to take into account the decisions of the investment committee. Also, the investment committee will have to approve all the main decisions, such as the selection of investment objects, the amount of allocated funds, the time and order of "exit", and the distribution of profits. The relations and powers between the investment committee and the management company are confirmed by the agreement of the parties and specified in relevant documents.

An advisory board of experts consisting of representatives of various branches and fields can be established at the venture fund, which advises on issues or problems of interest to investors, experts and members of the fund. The presence of experienced and well-known people in the venture business on the advisory board will significantly increase the reputation of this venture capital fund.

When establishing a fund (terminating membership), LLCs undertake to contribute an agreed amount of financial resources to the fund within a specified period (confirmed by the general partner in agreement with the schedule investors) or at the request of the general partner. This commitment is called commitment. When the general partner needs funds for the next round of financing within the company's portfolio, he sends a commitment payment request to the investors. In this, the following issues will be resolved:

- the fund will have no problem attracting free funds;
- investors' funds are not frozen for several years;
- the general partner ensures a high return on investment.

Usually, the general partner also invests in the venture fund, but its size will not be significantly large - that is, it will be less than one percent of the total investment.

After the list of investors is clear, an investment memorandum is drawn up, in which the organization of the fund and its operation procedure, the rights and obligations of the parties, and the dispute resolution mechanism are clearly defined. Although the investment memorandum is not considered to be a legally binding document, once all parties have agreed to it, it is no longer acceptable to deviate from the agreement. An investment memorandum is often considered a confidential document.

After the investment memorandum is drawn up, the stage of signing legal documents on the rights and obligations of the parties begins. Completing this stage is known as closing the fund.

Closing a fund is the end of the fundraising phase, not the liquidation of the venture fund. Closing only opens the process of investment activity of the fund.

After all the funds of the fund have been invested, the management company usually creates an additional fund to continue investing in venture companies in its portfolio or to look for new, potentially profitable projects. Usually, the general partner creates a new fund every 3-5 years for the existing LLC and to attract new partners. (Figure 2).

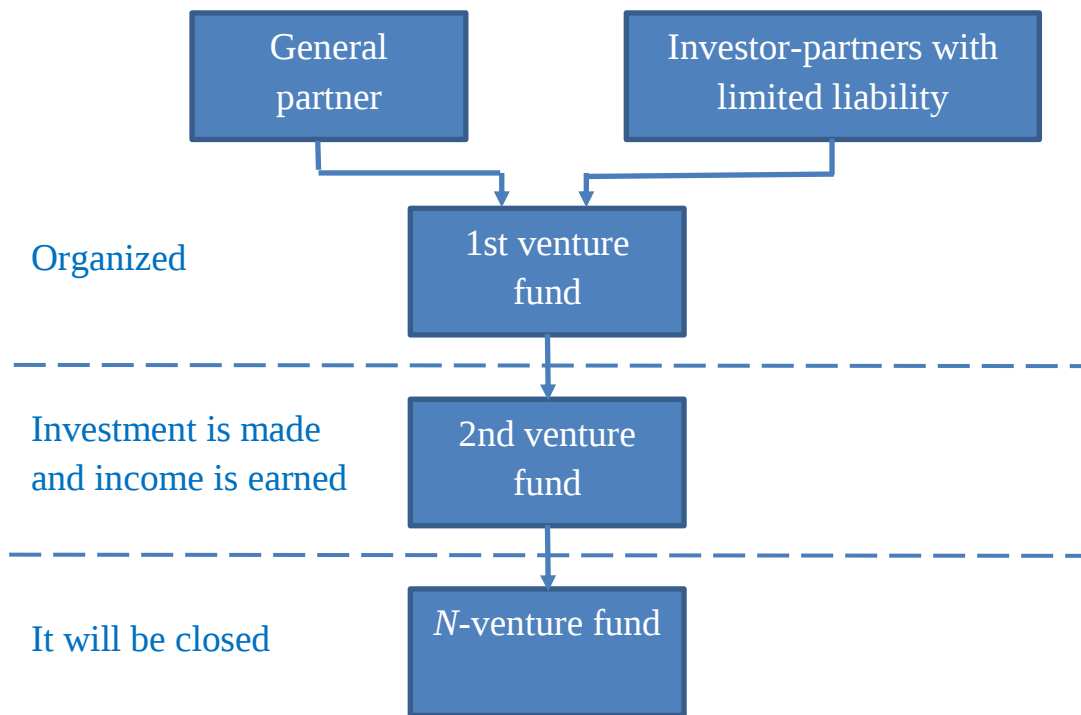


Figure 2. Stages of organization of venture funds.

A study of the activities of European venture funds showed that limited partners take a careful approach when choosing venture capital firms and take into account the following criteria:

- the amount of resources previously managed by the venture capital firm and the profitability of venture funds;
- the position of the venture capital firm in the ratings compiled by specialized agencies and organizations over a certain period of time (NVCA - US National Venture Capital Association, EVCA -European Venture Capital Association, Venture Economy Database, etc.);
- the reputation of the venture capital firm among entrepreneurs who have used their services or among business circles in general;
- professional qualifications of venture capital firm employees;
- conditions for establishing the fund (venture capital firm awards, fund's term of operation, investment schedule, expected profit);
- Investment portfolio diversification strategy.

If the investment in a particular project is successful, the venture capital firm will sell the share in the company's authorized capital at an opportune time in order to ensure the return on investment of the limited partners (in successful projects, this return is usually much higher than the average market indicators). After that, if the period of operation of the fund has not yet ended and all the funds have not been directed to investment, then new investment objects will be sought.

The general partner receives contributions from the limited partners in return for the management of the funds of the fund for its current activities. In addition, the venture capital firm is rewarded in the form of a share of the fund's profits based on its performance after the end of its activities. Figure 3 shows the distribution scheme of cash flows in venture investing. In this scheme, we can see that venture investors can act as financial intermediaries between institutional investors and businesses in need of financing.

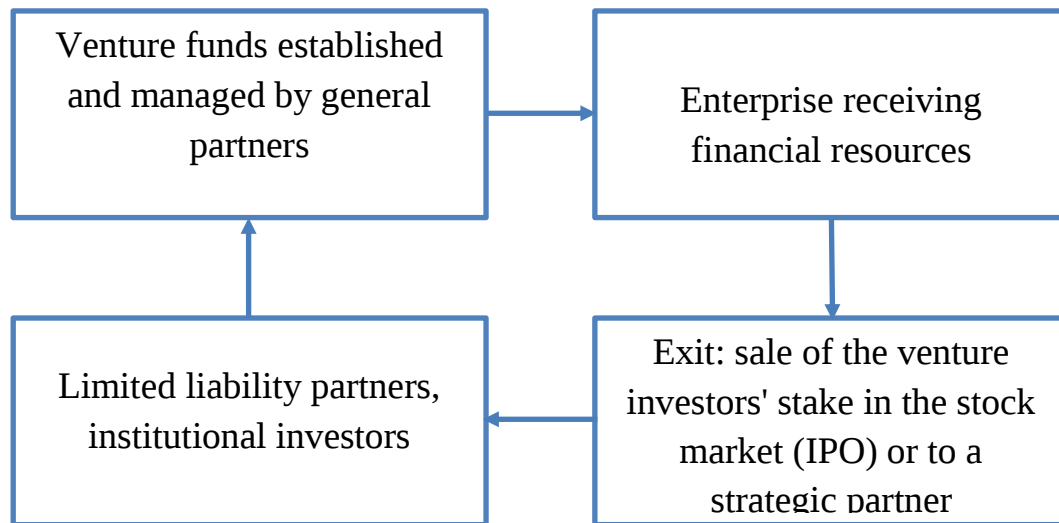


Figure 3. Financial flow in venture investing

Business angels, often referred to as venture investors, share similarities with venture capitalists in their investment activities. However, unlike venture capital firms that utilize institutional investors' funds, business angels invest their own personal funds. These investors can be categorized into two main groups based on different criteria.

The first category consists of individual investors who typically invest their personal assets and investment funds in businesses run by friends or relatives. They may also invest in highly promising projects recommended by advisors, although they make their investment decisions independently.

The second category includes entrepreneurs or groups associated with a specific economic sector. Since their investment decisions can benefit their own business ventures, these investors may opt for smaller investments with potentially lower returns compared to traditional venture capitalists. They tend to focus more on the early stages of innovative companies, helping them navigate through the critical "valley of death" phase. This type of group investment activity is illustrated in Figure 4.

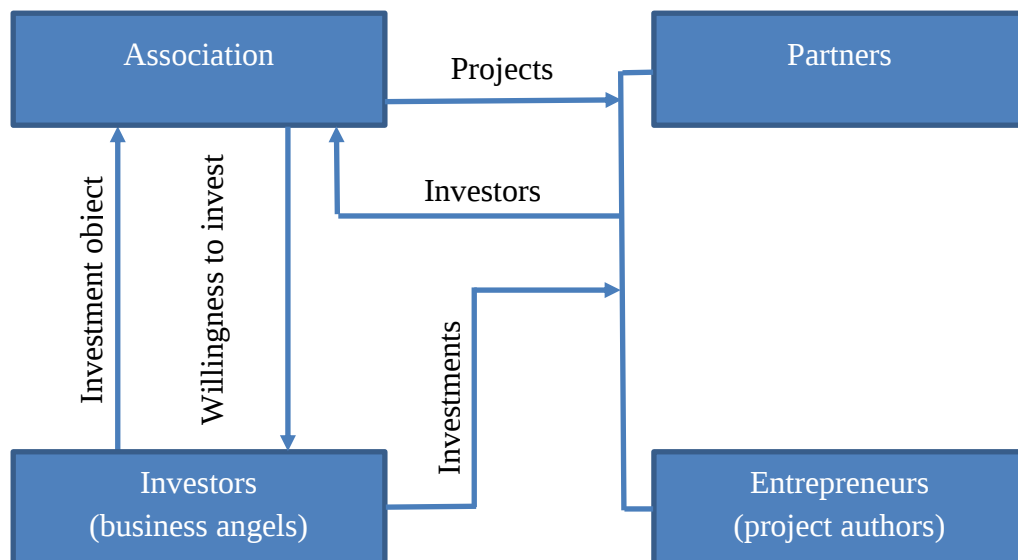


Figure 4. Relationships between business angels and entrepreneurs.

Although business angels usually do not publicly show their activities, according to some estimates, the size of such investments is not less than the size of official venture capital.

Another feature of venture capital investments is that they can only be invested in private companies.

These may also be closed companies that do not have the opportunity to sell their shares on stock exchanges or alternative platforms. That is why, in order to reduce the risks associated with uncertainty, venture investors invest in areas where they have experience and know well.

The closedness of the invested companies, on the one hand, provides a competitive advantage for venture investors, because they have insider information, and on the other hand, they reduce the risk of higher-yielding investments.

CONCLUSION

At present, the number of qualified personnel who are designed to attract venture investments and prepare companies to accept investments, understand the nature of innovation companies, venture investments is very limited. This is due to the lack of comprehensive training programs for venture financing specialists.

State and non-state educational institutions that train managers in all aspects of business education are unable to provide training of highly qualified specialists in the field of venture financing.

In this regard, we believe that the formation of a specialized educational system and the development of methodological support in the field of venture financing is an urgent issue. This can be done in the following ways:

- Organization of a special course of lectures on venture financing at higher educational institutions for students studying such specialties as "Finance and Credit", "Innovation Management";
- creation of a special professional system of training specialists in venture financing.

In addition, an organizational-economic mechanism that ensures the introduction of private venture capital into the economy in order to positively change the current situation in the industry in order to develop venture financing and eliminate the main problems in the establishment of venture funds in our country, and also has an effective effect by activating the innovative activity and entrepreneurial environment in the scientific and technical sphere. it is necessary to create.

Also, currently, potential participants in the venture financing process do not have enough information in this area. In particular, venture funds face some difficulties in searching for investment objects, production managers do not know or do not understand enough the rules and features of venture financing. Therefore, for the effective development of the venture industry, it is important to form a single information base that includes information related to this field.

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