

Chapter 12

University–Industry Collaboration With a Focus on Venture Capital Investments: A Conceptual Model and Empirical Evidence

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ABSTRACT

Today, many countries are searching for financing alternatives which may contribute to the development of an economy. Funds provided by venture capitals may be considered as a vital funding source especially for start-ups. In particular, venture capital investments may enhance the available financing alternatives used to finance innovative business ideas. Policies supporting the capital market development may also boost innovative business ideas since the developed capital markets may attract higher amounts of venture capital investments. Hence, it seems possible that policies supporting innovative business ideas may contribute to this goal by supporting the development of the capital markets. This chapter aims to explain business models, financing alternatives, and exit strategies; give information about venture capital investments in Europe; propose a conceptual model for an improved university-industry collaboration via capital market development; and finally, empirically investigate the causal association between venture capital investments and capital market development.

INTRODUCTION

Venture capital (VC) investment is one of the most crucial financing alternatives for entrepreneurs in developed and developing economies. It also stands out as an investment instrument for economic units having surplus funds. Although venture capital investment is one of the outstanding vital financing sources in meeting the financing needs of entrepreneurs, it is also vital for the development of the

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national economy and financial system. Accordingly, venture capital investments may contribute to the development of an economy by improving financial system efficiency.

The latest statistics by the association, which is the Europe's Private Equity and Venture Capital (Invest Europe) indicate that total investment reached €94 billion and 4,696 firms are backed by venture capital (VC, henceforth) investments in 2019 ("Investeurope Research," 2020). VC investment is a particular type of investment financed by VC corporations that raise funds for high-risk and high growth companies (Black & Gilson, 1998, pp. 245). VC is also defined as fund management, which transfers raised funds from corporate or wealthy individuals to new ventures with high growth potential (Da Rin et al., 2011, pp.3-4).

VC firms invest in startup firms that focus on innovative products and services (CVCA, 2020). According to British Private Equity & Venture Capital Association (BVCA) VC is a specific type of financing technique for startup firms focusing on information and communication technology (ICT), life sciences or FinTech (BVCA, 2020). National Venture Capital Association–United States (NVCA), states that VC investments provide capital for risky but high growth firms that are also innovative. According to this definition, VC is a long term (5 to 8 years or longer) investment fits especially for the firms' lack of access to traditional financing such as bank loan and has a long term potential to convert innovative ideas into products and services that may threaten current products or services (NVCA, 2020). Middle East Venture Capital Association (MEVCA) defines VC as a long term (4 to 7 years) financial and non-financial (human and technological capital), high risk-high return investment (MEVCA, 2020).

In this manner, VC investors generally require higher return rates due to the higher risk they face in their investments. These investors generally face a considerable amount of risks, especially in their early-stage investments. Due to the need of higher amount of investments to late-stage firms, large-scale VC firms tend to invest in late-stage companies, whereas small-scaled VC firms tend to invest in early-stage firms. Different from large-scale firms, small-scaled firms need non-financial assistance more than financial aid. In this manner, it is thought that investment in early stage firms bear the higher business risk (Elango, et. al, 1995, pp. 159-160). The fact that newly established companies are risky bears upon investors and financial institutions providing loans such as banks.

Banks are unwilling to extend credit to these firms in general due to their risky nature since these firms generally bear high business risk. In other words, carry management risk (Keuschnigg & Nielsen, 2002, pp. 176). Lack of assets to provide collateral and negative cash flows are the main reasons why banks cannot cover the financing deficit of these newly established enterprises (Mason, 2020, pp. 156). Since these recently established firms are accepted to be quite risky due to the high failure rates, banks hesitate to provide funds to these startups due to the possibility of high credit risk (Dossani & Kenney, 2002, pp. 229). At this point, VC investments contribute to the growth of companies and the success of their business models by meeting the financing deficit of these recently established firms (Mason, 2020, pp. 156). Firms with high risk and high return potential are at the target point of VC investments. VC firms take risks by investing in those companies that do not opt for alternative financing alternatives (Gompers, 1994, pp. 3). Financing alternatives for these firms may also differ. While some of these firms have access to bank loans, some other firms incredibly high-tech startups may receive private equity capital (Honjoa & Nakamura, 2020, pp. 2). However, there is a false perception that VC firms invest only in technology firms (Gompers, 1994, pp. 3). Hence, it can be concluded that VC firms also try to diversify their portfolio and manage to maximize their profit.

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