

Chapter 9

Firm Growth: Access to Venture Capital Finance

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ABSTRACT

Venture capital (VC) is an alternative means of access to finance for innovative SMEs to sustain their innovation, growth, and survival. Although VC firms are well established in the UK and USA, they are not well-known worldwide and many SMEs are unaware of their potential. This is a review of research literature on VC, its conceptualization, and synthesis over four decades. VC is gaining increased and varied significance worldwide as a way for innovative SMEs to access funds. Globalization has provided entrepreneurs the opportunity to seek VC globally as reputable VC firms are able to fund innovative projects across countries and continents. As the legal and regulatory regime improve, VC finance opportunities increase with impact on the demand and supply of VC. Innovative SMEs are encouraged to take advantage of globalization and competition among VC firms in their search for VC. Recently, VC firms have become more risk averse regardless of their traditional competence in screening and monitoring.

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INTRODUCTION

Access to finance is important for small and medium-sized enterprises (SMEs) to start-up, innovate, grow and survive (Faria & Barbosa, 2014; Hasan et al., 2018; Jackson et al., 2012; Megginson, 2004). SMEs use different methods of raising funds for their businesses (Saridakis et al., 2008). Venture capital (VC) is an ‘alternative’ (Denis, 2004, p. 301) or ‘substitute’ (Maier & Walker, 1987, p. 207) method of raising finance for business ventures because VC funding can be used instead of debt finance. According to Maier and Walker (1987, p. 207), VC is a ‘substitute, but not a perfect substitute’ for funding entrepreneurial ventures following the different approach to access VC funding and debt finance. VC or private equity is one way that innovative SMEs use to raise money for their start-up and growth (Hasan et al., 2018; Meglio et al., 2017; Cumming et al., 2016; Cumming & MacIntosh, 2003; Jackson et al., 2012). Utterback and Abernathy (1975) described innovation in firms in terms of their innovative capacity, competitive strategy and production resources. However, in the business environment, there is no clear definition of best innovation because there is no universal standard of measurement for innovation from one business environment to another (Downs Jr & Mohr, 1976). Therefore, the reliance of VC firms (VCF) on innovation in their entrepreneurial funding decision varies across the VC industry; and they employ their funding criteria in making investment decisions. VCF often target their funding towards innovative SMEs as they have the potential for high growth and job creation (OECD, 2002; Smallbone et al., 1995). New growth SMEs are most likely to pursue external funding and they are more susceptible to rejections (Riding et al., 2012).

Although VC is useful for raising finance for business ventures, they are not widely available worldwide (Cumming & MacIntosh, 2003; Megginson, 2004). For example, Pistor et al. (2000) disclosed the legal and regulatory bottlenecks in transitional economies which are having negative effect on finance contracts. On the other hand, Megginson (2004) discussed the value of a strong legal and regulatory framework to protect the VC investment environment and participants alike. The level of the quality of the legal and regulatory environment can lead to the success or failure of VCF investments (Tykvová, 2018). The financial crisis of 2007 caused a reduction in the availability of VC in Israel (Avnimelech & Harel, 2012), the UK (BIS, 2012; Fraser, 2008) and other parts of the world. For example, there was a 31% decrease in VC for UK SMEs in 2010 (BIS, 2012). VCF in the UK, USA, Netherlands and France identified strategic involvement as their key role in their investment (Meglio et al., 2017; Sapienza et al., 1996). In the USA, VCF and their investments tend to be concentrated within some geographical areas (Chen et al., 2010). According to Revest and Sapio (2012), UK VCF helped the European VCF to catch up with their USA counterparts in their funding provisions. The USA and

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