Venture Capital Financing of Enterprises in Croatia

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Abstract

The aim of this paper is to explore the financing of small businesses in the early stages of their development given that the method and even the possibility of funding in seed, startup and early expansion stage are crucial for the realization of entrepreneurial ideas. Given the level of risk in these phases of the development of small businesses, entrepreneurs are faced with a small number of financing options that involve mainly their own resources and formal and informal venture capital (VC) funds. If it is assumed that development stems from new and innovative products, which are often just launched by startups and SMEs, then this method of financing is an important engine for the development of each country. The conclusions have been drawn on the basis of data collected through the survey of startup market in Croatia, through personal interviews with business angels and companies that have received money from the VC funds, as well as on the basis of their internal financial reports. In Croatia, the venture capital market is still underdeveloped with the small number of projects financed by venture capital funds as evidence, mostly because of low levels of capital, slow systems, poor ecosystem for entrepreneurship development, lack of successful and professional people who become investors and lack of real VC funds that will continue to invest in further stages after the initial minor business angel's funding. The projects, in their early seed or startup stage can only rely on the business angels as part of the informal venture capital market, while the formal one is mainly directed towards the less risky investments or public capital investments for reconstruction and development of some already present companies on the market.

Keywords: Financing, Venture capital, Venture capital fund, Business angels, Startup, Croatia.

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1. Introduction

Strengthening of small businesses imposes itself as a strategic objective of each country in view of powerful impact of entrepreneurship on employment, growth in gross domestic product (GDP), export revenues, and strengthening of competitiveness.

The importance of small and medium enterprises (SMEs) is supported by the data for 2012 about the role of SMEs in the Croatian economy: SMEs are the largest

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employers in Croatia (covering 65.5% of employment in 2011, and continuously growing), and contribute significantly to the GDP (51%) and exports (43.04%). Also, in 2012 there is an increase in the number of small businesses by 6.8%, compared to a continuous decline in the year before. In Croatia, for a number of years, research indicates obstacles to the development of entrepreneurship: administrative barriers (long and expensive procedures for establishment and liquidation of companies), the inefficiency of the judiciary, lengthy procedures of ownership registration, weak focus on entrepreneurial education and underdeveloped informal Startup financing.

The subject of this paper is the financing of small businesses in the earliest stages of their development, the so-called seed and startup phase which are the founding stages of small businesses since the biggest problem for the businesses still represents the financial capital availability.

The paper is structured as follows. Section 2 presents the role of startups in the economic development. Section 3 and 4 detail the formal and informal venture capital markets in Croatia, respectively. Section4 concludes.

2. Risk Capital in the Function of the Economic Development

Startup is a company with a brief history of the business, generally in the phase of development and market research. The advantage of a startup company that attracts potential investors is that it is more scalable than it is the case with the already established businesses concerning the higher growth potential with limited investment in capital, personnel and property, while the disadvantage of startup is its high statistical failure because of the associated risk (Šokić, 2009). The process of business entry and exit as well as post-entry firm growth enhances productivity, and drive economic growth. New enterprises exert competitive pressure on incumbents and improve resource allocation by forcing less efficient firms out of the market, which is especially important during a post-recession phase, as business creation can help renew productivity growth and job creation. New Startups can exploit knowledge that is not used by existing companies and draw on existing knowledge to enter new or established markets. New OECD evidence indicates that the most net job creation originates from young and fast-growing firms. Those firms have represented about 20% of non-financial business sector employment over the last decade and have generated nearly half of all new jobs. It is the fact that most Startups exit within 5 years, but those that survive grow very fast on average and contribute more than proportionally to employment and productivity growth.[2]

Small and medium sized enterprises (SME) are the backbone of all economies and the key source of economic growth, job creation and innovation especially in developing

[2] OECD (2014). "OECD Science, Technology and Industry Outlook. Financing innovative entrepreneurship".

countries. In that regard, many governments offer different types of loans, guarantees and other supporting measures to facilitate these companies' access to capital. The recent crisis only confirmed that bank credit is not a reliable source of financing, especially during periods of systemic stress. Moreover, the regulatory measures taken after the crisis, such as strengthened rules on capital requirements, create additional challenges on the financing of SMEs through bank loans. Consequently, the need for diversified funding sources for SMEs is growing.[3]

An EVCA study finds that private equity involvement in portfolio companies increases the efficiency of innovation efforts. Private equity-backed companies are more focused in their innovation efforts and deploy better management of innovation processes than their peers. In addition to the improved productivity that arises from higher levels of innovation, private equity contributes to creating an enabling environment to enhance the levels of productivity in the economy as a whole. It does this by increasing the finance available for capital investments, supporting companies through periods of commercial or financial distress, and by increasing the operating performance of portfolio companies. Finally, improvements in productivity either through innovation or other productivity enhancing measures at individual company level translate directly into increased competitiveness at a macroeconomic level. Moreover, private equity has a direct impact on competitiveness through making funding available for risky but potentially lucrative new business opportunities.[4]

In its core, venture capital connects surplus funds in the capital market (investors) with the companies and/or projects of high economic potential that do not have direct access to (institutional) investors through regulated markets (stock exchanges), in a situation where entrepreneurs/companies cannot provide the necessary funds for business through the banks, either by open-end investment funds or pension funds. When entrepreneur sells an interest to a VC fund, the venture capitalist receives both a residual interest in the firm's value, usually in the form of convertible preferred stock or debt and significant control rights, both explicit (e.g. the right to remove the CEO) and implicit (e.g. the right to decide whether the firm can continue in business through staged funding). In return, the company and the entrepreneur receive capital plus nonfinancial contributions including information, monitoring and enhanced credibility with third parties. In addition, the entrepreneur receives an implicit incentive contract denominated in control (Black and Gilson, 1998; Caselli and Caselli, 2003).

In many scientific researches the key insight is that human capital is an important driver of the activities performed by venture capitalists. The most important human

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[3] ICSA Emerging Markets Committee (2013). "Financing of SMEs through Capital Markets in Emerging Market Countries".

[4] Frontier Economics Europe (2013). "Exploring the impact of private equity on economic growth in Europe. A report prepared for the European Private Equity and Venture Capital Association (EVCA)".

capital factor is prior business experience, which is consistently positive and statistically significant for all activism variables. Having business experience increases the probability of an investor being active between 21% and 46%. Venture experience has almost no effect, suggesting that job-specific learning is not a major determinant of the across-firms variation. A prior business experience is an important predictor of an active investment style. Organizational structure also matters, especially whether a venture capital firm is structured as an independent entity. Also there is a positive relationship between investor activism and the success of portfolio companies, a finding which highlights the economic importance of human capital for financial intermediation (Black and Gilson, 1998).

The main characteristic of a venture capital fund is that it invests equity as an institutional investor at a specific time (medium to long-term period which is usually three to seven years) and then expect a return of about seven to ten times (VC) or two to three times (Private equity, PE). Funds are always founded on a specific period, usually 10 years, in which the fund must invest all assets, divest those assets, and return the assets enlarged by the profit to the investors (Makek et al., 2011).

The initial stages of development are very high risk, so the bank capital in the form of loans is unavailable. In the last three decades, the solution to this problem was first found by the Americans and then followed by Europeans. The United States (US) has a much more fully developed venture capital market than Europe and the main reasons are size and substance. The US has a larger number of funds and the funds themselves are larger relative to each country's economy. Substantively, the US funds are more heavily invested in early-stage ventures and high-technology industries, while in Europe VC provides later-stage financing in lower-technology industries. Differential performance between the US and Europe in industries where VC plays a significant role in the US suggests that Europe has not yet developed a functional substitute for VC (Black and Gilson, 1998). Since venture capital plays a crucial role for the creation of innovative startups in a continent where capital markets are particularly unsupportive of non-established businesses, the public concern for fostering the supply of funds to industry appears justified. However, studies for the Europe suggest the European venture capital delivers more than pure financing (Bottazzi et al., 2008).

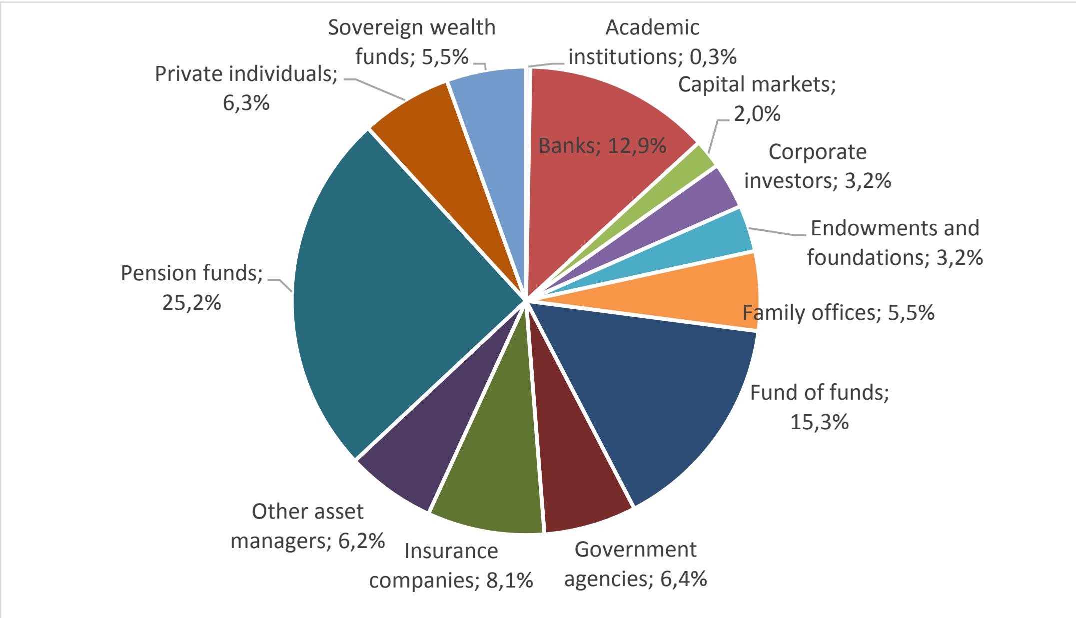
The most prominent growth is noted in PE and VC funds in the U.S., where companies such as Digital Equipment Corporation, Apple, Federal Express, Compaq and Intel have achieved a market capitalization measured by billions of dollars. The basic task of venture capital is to finance a new and fast-growing company, to invest in the equity of the company, to assist in the development of new products and services, to add value to company through active participation in the management of the company, to take a high risk investment, but with a very high expectation of return on the investment and to have a vision of long-term investments.

In this paper, we accept the distinction between PE and VC to explain the situation on the venture capital market in Croatia. VC funds are venture capital funds that invest in companies at an early stage, i.e. the stage of early growth and development, while PE funds are funds in the broad sense that invest in the equity of other companies, regardless of the stage of growth/development of company they invest in and regardless of the type of financial operation that has served that purpose (Cvijanović et al., 2008).

Generally, companies can finance their growth in two ways: by borrowing or by increasing the share capital. In Croatia, a country where the financial market is still underdeveloped or so-called bank-oriented, the most common method of financing is taking loans from banks. However, at company's early stage, banks generally do not give loans because of the high risk and the inability to evaluate companies. Therefore, banks require high collateral that startups do not have. The only alternative for startups is the venture capital fund, the one that invests in seed and startup phase. That kind of VC does not exist in Croatia because of its usual investments in the development stage, which makes the funds in Croatia typical PE funds.

Figure 1 shows the share of individual investors in EU from 2007 to 2012 whereby the investors with the largest shares are respectively pension funds, banks, funds of funds, and insurance companies.

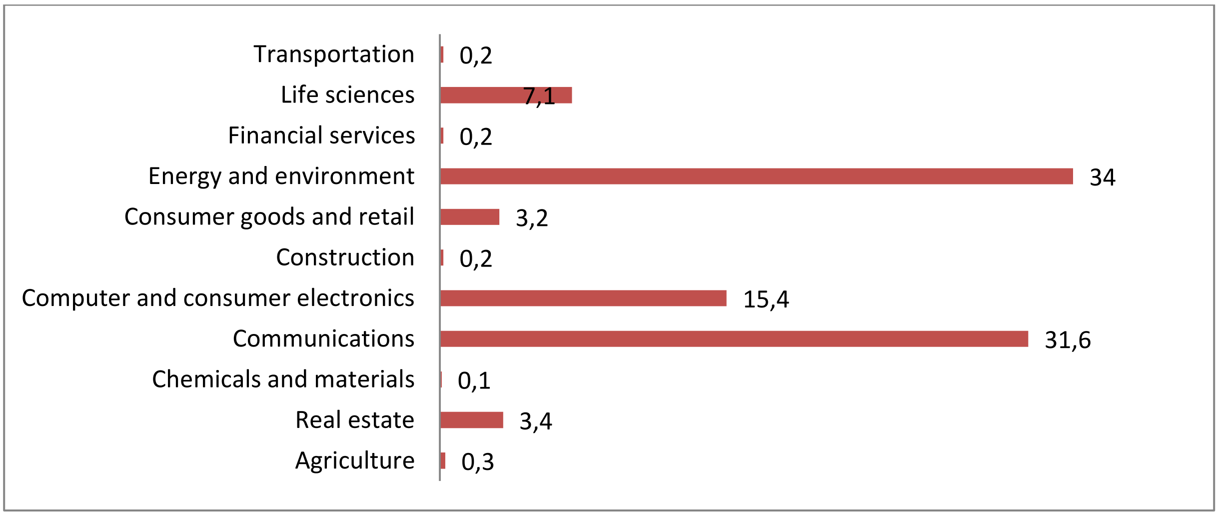
Figure 1. Main funding sources of venture capital in the European Union (EU) from 2007 to 2012



Source: Created by the authors according to EVCA: available at: http://evca.eu/facts/

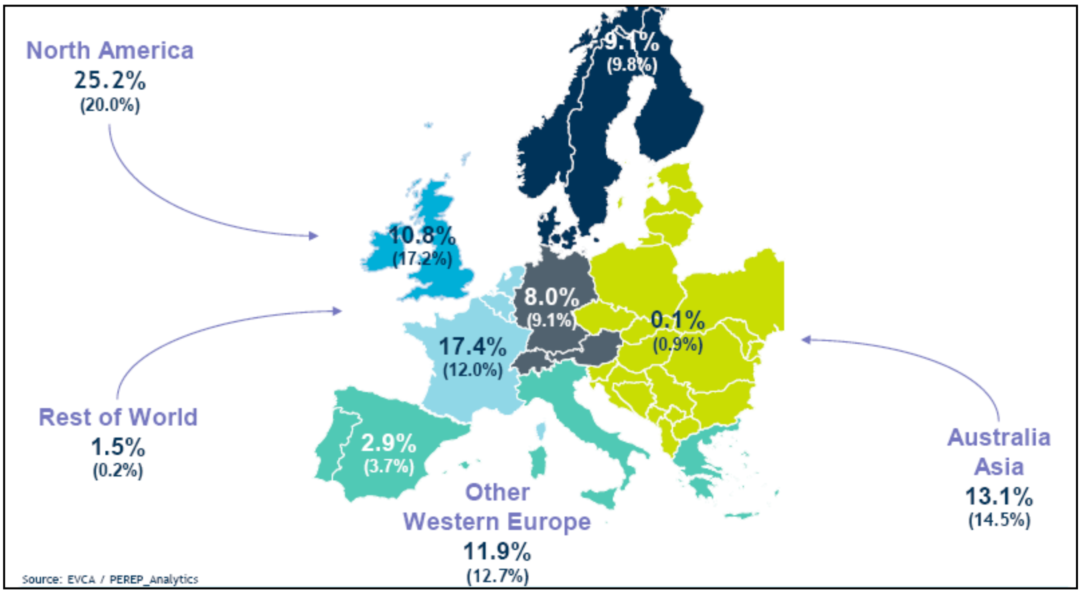
Figure 2 shows the VC investments by the industries in 2012 in Central and Eastern Europe. It is evident that the industries of energy and the environment, communications, and computer and consumer electronics are the leaders. In comparison, most US investors invest in IT projects (37.2%), projects in the field of health (19.9%) and telecommunications industry (13.6%).

Figure 2. Size of venture capital investment by industries in Central and Eastern Europe in 2012 in million €



Source: Created by the authors according to EVCA available at: http://www.evca.eu/publications/PBCEE12.pdf

Figure 3. Sources of venture capital inflow in 2012



Source: Activity Data on Fundraising, Investments and Divestments - Pan-European Private Equity and Venture Capital Activity, EVCA, 2012. Available at: http://www.evca.eu

Figure 3 shows the sources of venture capital inflow into Europe. Croatia belongs to the European region of lowest percentage of formal and informal venture capital (0.1% according to the EVCA or 0.9% according to the PEREP Analytics). In Western Europe and in the United Kingdom, the concentration of venture capital is the highest. Despite the fact that US investors prefer to invest within their own country[5], even 25.2% (20.00%) of the total venture capital flows into Europe from North America.

3. The Formal Venture Capital Market in Croatia

Formal venture capital market in Croatia represents the venture capital funds that are registered in Croatia as an open-end investment funds with a private offering under the management of investment companies. Since 2010, on the initiative of the Government, the Funds for Economic Co-operation (FGS) have been established. There are two private equity funds and five Funds for economic co-operation (FGS) today in Croatia. There are also five registered companies that manage a total of seven open-end investment funds with a private offering. Overview of registered companies that are managing mentioned funds in Croatia is given in the Table 1.

Table 1. Overview of registered companies for managing investment funds with a private offering by net asset on December 31, 2012

Nº	Name of the investment company	Net asset (EUR)	Venture capital fund under the management of the investment company
1.	ALTERNATIVE PRIVATE EQUITY D.O.O.	12738121	ALTERNATIVE PRIVATE EQUITY FGS
2.	HONESTAS PRIVATE EQUITY PARTNERI D.O.O.	2942	HONESTAS FGS
3.	NEXUS PRIVATE EQUITY PARTNERI D.O.O.	16729885	ALPHA, NEXUS FGS
4.	PROSPERUS INVEST D.O.O.	3977543	PROSPERUS FGS
5.	QUAESTUS PRIVATE EQUITY D.O.O.	21.031.870	QUAESTUS PRIVATE EQUITY KAPITAL I, QUAESTUS PRIVATE EQUITY KAPITAL II
TOTAL:		**54480361**	

Source: Croatian Financial Services Supervisory Agency (HANFA). Available at: http://www.hanfa.hr/index.php?LANG=HR&AKCIJA=1005&FN=1

Funds for Economic Co-operation (FGS)[6] are a project on the initiative of the government launched in January 2010 with the aim of reducing the negative effects of

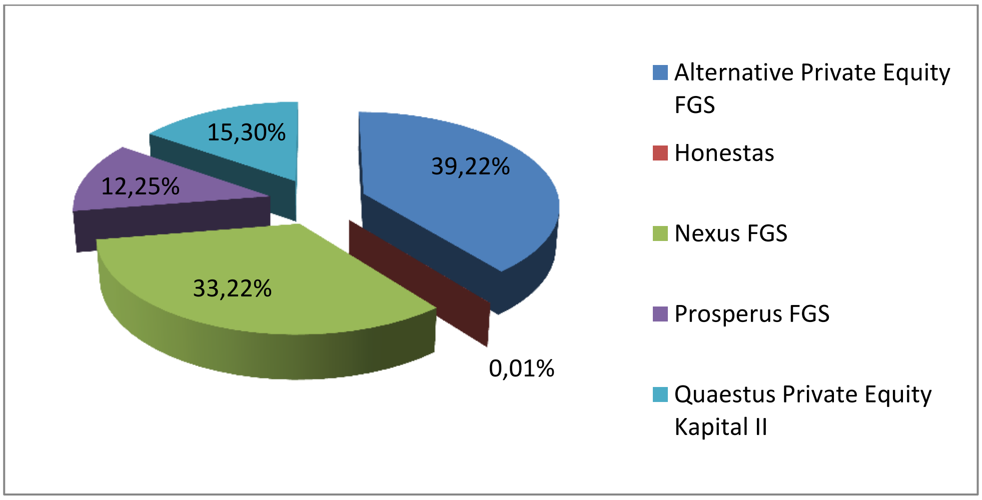
[5] Startup Genome (2012). "Startup Ecosystem Report".
[6] The Economic Program of the Republic of Croatia, 2013.

the economic crisis. FGSs are open-end funds with private offerings that were established under the Law on Investment Funds. Their goal is to encourage economic development, to preserve the present jobs, and to create new ones. The Croatian government in a particular fund accounts for 25% to 50% of the amount that is committed to the private sector. In 2013 Croatia participated with HRK 345 million of budgetary resources.

Figure 4 shows the shares of certain Funds for Economic Co-operation in relation to the total assets of FGSs. The largest share of the net assets on December 31,2012 was recorded by Alternative Private Equity (EUR 12738121)[7], followed by Quaestus Private Equity Capital II with the net assets of EUR 10787498. The lowest net assets were recorded by the fund Honestas (EUR 2942).

According to net assets, the importance of venture capital funds in an environment of all types of investment funds is small because the share of net assets of venture capital funds in relation to the total assets of all types of investment funds is considerably low, as shown in Graph 4. Given the importance of venture capital in any financial system because it provides capital for startups that do not have sufficient resources and cannot conclude optimal financial arrangements with other financial intermediaries, such data is devastating. It is noticeable that the share has increased in the 2010 as a consequence of FGSs, which further means that venture capital funds with no FGSs have very little significance in the total assets of all investment funds.

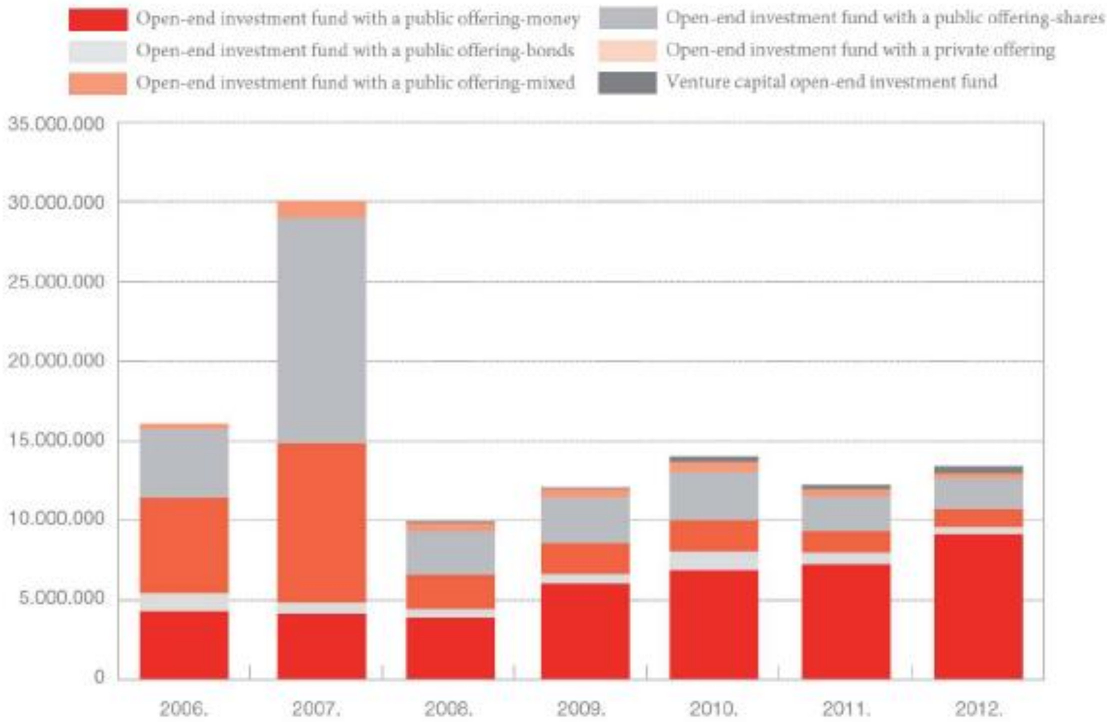
Figure 4. Net assets share of each Fund for Economic Co-operation on December 31, 2012



Source: Created by the author according to CroatianFinancial Services Supervisory Agency. Available at: http://www.hanfa.hr/HR/nav/106/statistika.html

Available at: http://ec.europa.eu/europe2020/pdf/nd/ep2013_croatia_hr.pdf
[7] Croatian Financial Services Supervisory Agency. "Revised data for investment funds on 12/31/2012".

Figure 5. Net assets of all open-end funds from 2006 to 2012 in Croatia (in HRK)



Source: HANFA-Annual Report 2012

The biggest problem of this form of venture capital investment, with the country as participant, is precisely the fact that the state pays the extremely high fee to the companies for managing the funds. It is a problem, especially if there are no investments, the benefits will still be paid so the money that was intended to revive the economy by investing in projects ultimately ends in profits of management companies. Also, it is considered that synergies of public-private investment should be much more exploited. A small number of investments so far have brought FGSs in the context of inefficient forms of venture capital investment in Croatia.

FGSs are mostly oriented on investment with the objective of recapitalization or acquisition of existing companies in the need of capital to expand their business, to restructure and improve the business, with the aim of merging smaller companies to create a larger and more efficient ones, with the aim of forming strategic partners to enable participating in transactions with larger companies or in order to participate in the privatization. For example, in June 2013, Quaestus Private Equity has invested in the company called Spačva Wood Industries Inc., while in April 2012 Nexus has invested in the largest floor boards' factory in Croatia called Požgaj. Despite that, both companies still have financial difficulties. Therefore, this kind of investment is not intended for initial and early stages of business, or for small businesses, so startup companies and small businesses cannot rely on this form of venture capital in search for an alternative form of financing.

Various public-private venture capital funds[8] exist also in Europe, but with a different organization as well as the intended use of resources, which can serve as a comparison or the suggestion of possible changes and introduction of such funds in Croatia. The average size of the public-private funds in Europe amounts to €27.2million, although the majority (70%) of these funds has a budget of €10million or less. An average investment per project is approximately €0.57 million. An example is the German Bayern Kapital, its branch Cluster fonds Startup! with a total fund of €20 million intended for startups in the seed or early stage in the form of low-interest loans or investments (silent partnership) under the condition of a minimum of 50% of private capital.

Figure 6 shows venture capital investments in Europe for a period 2007-2013. Venture capital investments slowed sharply at the height of the financial crisis in Europe. Despite tentative signs of recovery in 2013, total VC investments remain approximately half of their pre-crisis peak. Seed and startup stage financing held-up better than later-stage financing. Seed and startup stage financing in 2013 was approximately 30% below its pre-crisis peak compared to about 70% for later-stage.

A total of €66m in venture capital financing was invested in 154 companies located in the CEE region in 2013. It marked a 35% drop in venture capital invested and it was the first fall in five years. As a result, the CEE region's share of the European venture market fell back to 1.9% from 3.2% in 2012. But, while investment value fell down, the number of companies receiving venture capital funding increased significantly by 23% (or 29 in number). In other words, more CEE companies received venture capital funding in 2013 than any other year since 2007, in part reflecting the impact of ongoing support from venture funds started with government backing.

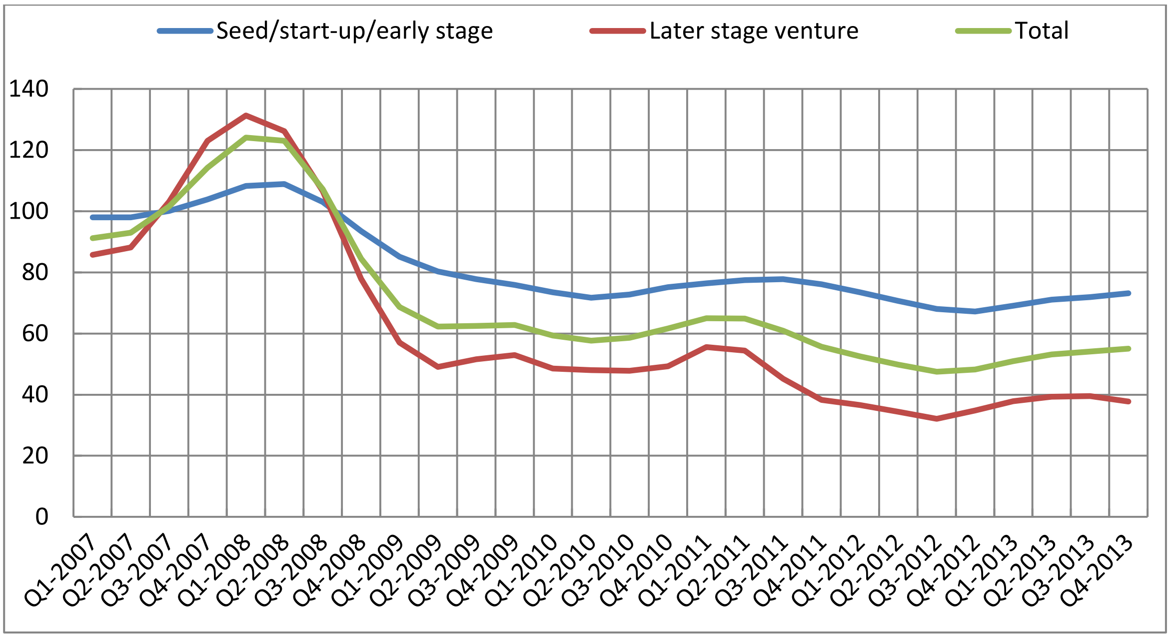
Breaking the data down further, the fall in investment value stems entirely from a contraction in startup stage funding to €32m from €70m in 2012. Despite this development, it remains the largest part of the total venture capital market in CEE, comprising 49% of total venture investments in 2013. The amount of capital deployed in 2013 as seed investments increased by over 30% to €4.2m.

The results of the study into the CEE venture capital market in 2013 show that the proportion of early-stage funding (seed capital and startup capital) was 55% of total venture investment in 2013, compared with 73% in 2012. That puts the region on a part with Europe as a whole, where early-stage forms of investment accounted for 59% of the market. By number of companies, the figures are completely in line with the rest of

[8] EBAN. "Compendium of co-investment for business angels and early stage funds in Europe", 2013.

Europe; early stage investments accounted for 73% of venture-backed businesses both in the CEE region and across the continent.

Figure 6. VC investments in Europe (Trend-cycle Average 2007=100)



Source: Entrepreneurship at a Glance 2014

Table 2. Venture capital investments (in millions EUR, 2013)

Czech Republic	296	Austria	6937	Russian Federation*	31968
Slovenia	424	Norway	7596	Korea	51042
Greece	516	Denmark	8608	United Kingdom	59468
Luxembourg	564	Belgium	9545	Israel	71888
Estonia	659	Spain	10842	France	72469
Poland	1667	Ireland	11684	Germany	74928
New Zealand*	1744	Finland	13731	Japan*	103179
Hungary	1842	Australia	20316	Canada (2011)	112978
Portugal	4048	Netherlands	20644	United States	2358631
Italy	6482	Switzerland	20934		
South Africa*	6533	Sweden	24680		

Source: EVCA. Central and Eastern Europe Statistics, 2013.
*The statistical data for 2012.

Hungary remained the CEE market leader for venture investment by value for the third year in a row in 2013. However, the amount of capital deployed fell markedly year-on-year from €66m to €18m, impacting the results for the CEE region as a whole. As a result, Hungary only narrowly beat Poland, which was the second largest market with

€16m invested in 2013 compared with €9m in 2012. These countries were followed by the three Baltic countries, which jointly registered €12m of venture investments in 2013, a similar level to 2012. Together, the five countries above accounted for 68% of all venture capital investments in the CEE region in 2013. It should be noted that excluding Hungary, the remainder of the CEE region saw a 38% rise in venture investing on 2012 levels.[9]

Croatian entrepreneurs still do not understand the importance of innovative SMEs and their potential for further growth. Many of them still have fear of entrepreneurship and do not accept advises of the international experts. Only minority will try to seek international customers which indicate a need for development of international competitiveness and corresponds to the results of IEF where Croatia is rated as a country with relatively high barriers to foreign investment. Concerning investment freedom, foreigners may invest in nearly every sector of the economy, but the problem of complex bureaucracy, very slow legal system, and subsidies to state-owned enterprises remain. Regarding property rights, many observers view the judicial system as most affected by corruption. The court system is inefficient, and business disputes drag on courts for years. The government is working on judicial reform, but much remains to be done. Unenviable situation of Croatia sends the wrong message to the foreign and local investors that are interested in investing capital in it. Therefore, Croatia still belongs to the group of European countries where tax and legal environment is inconvenient for venture capital investments. Also, this situation is likely to continue since Croatian entrepreneurs are not sufficiently educated to recognize potentials of venture capital financing and most of the entrepreneurs believe that this kind of financing is not a necessity fearing of potential investors influence on their business policies (Milovanović et al., 2008).

In addition, other studies provide empirical support for the notion that legal traits indeed matter when it comes to financial market development. It was observed that the British common law system is positively associated with a flourishing venture capital market. Consistent with the line of argument in the political and adaptability channels, it was concluded that an independent judiciary and a flexible, dynamic legal system are important contributors to a thriving venture capital market. Not surprisingly, relative to GDP, venture capital markets tend to be larger in countries with better developed stock markets and in countries whose legal systems are effective in enforcing contracts. Finally, it was identified that a possible substitution effect between government subsidies and venture capitalist funding tend to be less developed in countries whose governments act themselves as fund providers (Punkthuanthong et al., 2006).

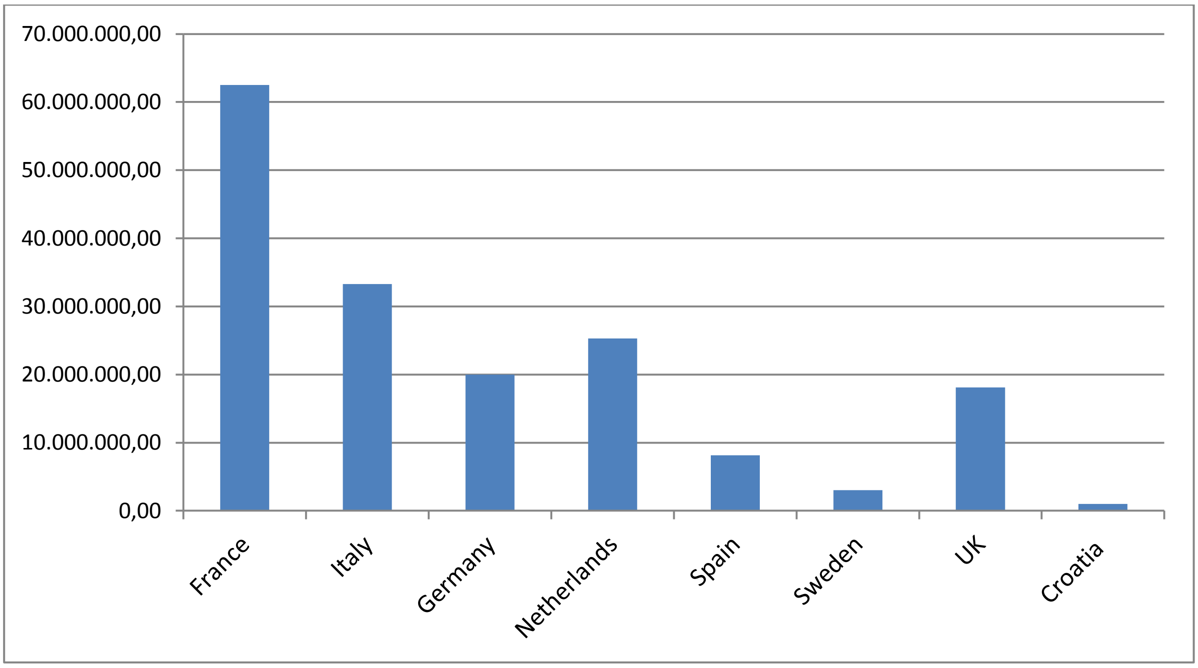
[9] European Private Equity & Venture Capital Association (EVCA), PEREP Analytics (2014). Central and Eastern Europe Statistics 2013.

4. Informal Venture Capital Market in Croatia

CRANE (Croatian Business Angels Network) is the Croatian network of business angels, i.e. private investors that are interested in investing into companies that produce something or develop innovations in their early or seed stages.[10] Business angels make up Croatia's informal venture capital market and make use of the smart financing through which they offer their funds, their own *know-how*, i.e. knowledge of a certain industry, general business and technical knowledge and *networking* – their business contacts. By doing so, they increase the odds for success in commercializing the project because the goal is to sell the project which then results in making a profit. So far they have made 13 investments with a total sum of €1050000[11]. In 2010 and 2012 CRANE invested approximately €80700 per project, most of which were IT industry projects.

Figure 7 shows total investments made by business angels in a selection of EU countries in 2010. Note that the informal venture capital market is largest in France with over €62.5 million, followed by the Italian one with half the amount. Considerable funding is noted only in the Netherlands and Great Britain, while Croatian business angels invested €155000 into only two projects that same year.

Figure 7. Total investments by business angels in a selection of EU countries in 2010 (in EUR)

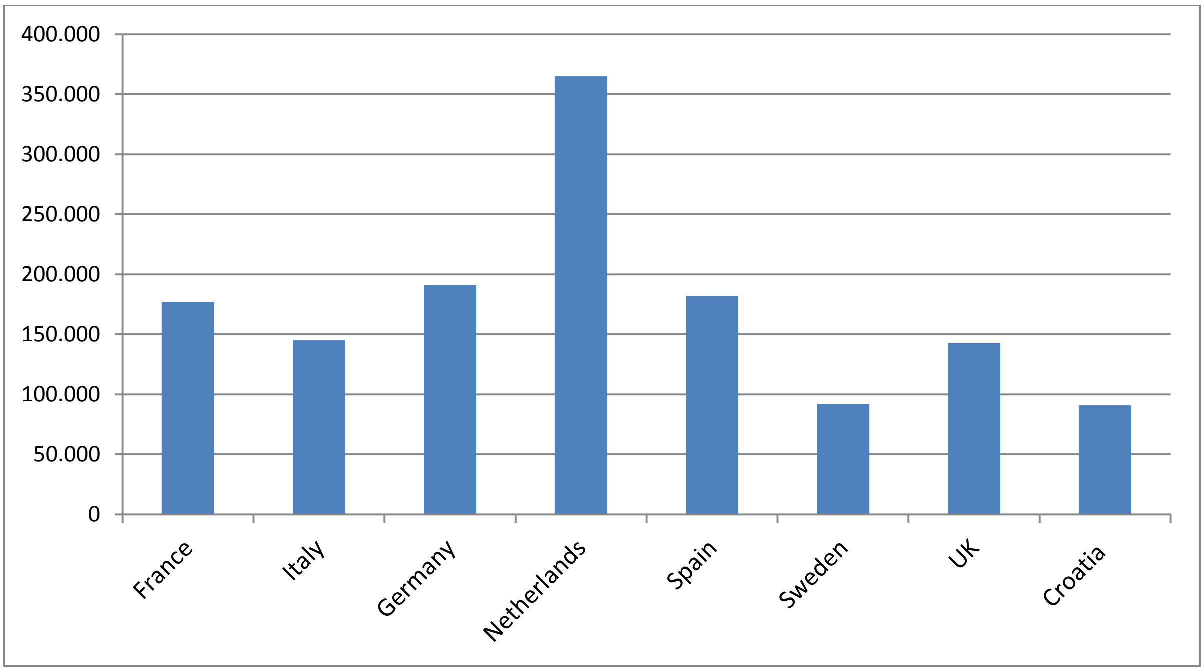


Source: Created by the authors according to:

http://ec.europa.eu/enterprise/policies/finance/data/enterprise-finance-index/access-to-finance-indicators/business-angels/index_en.htm

[10] Internal data: CRANE
[11] According to http://www.crane.hr/static/users/888/uploads/crane-basic-cro.pdf

Figure 8. Average investments by business angels in a selection of EU countries in 2010 (in EUR)



Source: Created by the authors according to:

http://ec.europa.eu/enterprise/policies/finance/data/enterprise-finance-index/access-to-finance-indicators/business-angels/index_en.htm

Figure 8 shows an average amount invested per project in a selection of EU countries, and it is evident that the Netherlands' business angels are the most generous, with up to €360000 per project. However, in Croatia the investments range from €25000 to €250000, which makes an average of €80770 per project by the end of 2012, but in 2010 this average was somewhat lower: €77500.

4.1 Croatian Informal Venture Capital Market Research Based on Interviews with Business Angels.

The research to determine the opinions of four business angels, all active investors in the Croatian market, was conducted through a series of interviews. The investors Mihovil Barančić, Saša Cvetojević, Hrvoje Prpić and Tomislav Šekerija were the ones interviewed. The purpose of these talks was to identify internal and external factors that have influence on investors, and consequently, processes of deciding on investing into projects, and to find out their opinions on the investment climate in Croatia (see Table A1 in Appendix).

The interviewees have become investors, because they wanted to diversify investment risks due to their belief that there is no point in saving the money they own in a bank, but it is crucial to keep investing it, and also because of amusement and the desire to pass on their experience to those who will have it. So far they are all at a loss, partly related to some poor decisions, partly because they have not yet achieved an exit as it is still too early for the investment returns. They believe that only one in ten or even twenty projects that they invested in, succeeds. Precisely that one project must capitalize at least as much profit to cover the losses of the other projects. In most cases, their investments are syndicated in order to share the risk and expertise, but one of the investors prefers to invest individually because he believes there are not enough expert investors in Croatia that could follow through on a project.

When choosing a project they all focus on the team, because their investment takes place at a very early stage when it is hard to foresee the other factors and initial estimates change considerably over time. They are mostly discouraged by unbalanced and unprepared teams that have not conducted a thorough market research or that have unrealistic business plans, as well as having to invest into team members' salaries. On a monthly basis, they receive thirty to forty business plans for review, which they then rate and evaluate. On most occasions they invest into IT (but not exclusively), either because of their personal preferences, or because of a relatively low venture into investment as well as a much greater dependency of such projects on the teams, rather than on expensive technologies. The value of startup, and by that the share they demand for the amount invested is mostly estimated through negotiations. Even though, there are methods, such as net present value and cash flow estimations, they believe that it is too early to make projections at the stage of the project when they invest and so they generally rely on their instincts. Precisely for that reason, by categorizing the presented factors (team, market potential, amount of the initial investment, return profit and business plan) which influence their decision to invest, that they have come to the conclusion that the business plan is the least important, and is preceded by the team and the market potential.

It is their opinion that there are sufficient ideas in Croatia, but only a small number of independent entrepreneurs that can successfully carry out a project even with external investments. They also think that in Croatia the entire process is still very slow and that only the foundations for such form of entrepreneurship have been laid down. In comparison with the investors from the US or West European countries, they conclude that the only advantage that investors have in Croatia is less competition, while the disadvantages are numerous: low funding capital, slow-working system, poor entrepreneurship development climate, lack of bankruptcy laws which make American startups unafraid to fail, lack of successful and expert investors and lack of real VC funds that will continue to invest in projects at later stages. Finally, they predict a more favorable investment climate in Croatia in the future, and, despite the belief that founding a VC fund in Croatia is still too risky, they think there should exist such a fund at least on a regional level, so that each stage of project development can be funded.

5. Conclusion

In order for an economy to grow and develop, constant changes and adaptations according to global trends and ever more choosy consumers are necessary, because on the global market new products and technologies are the solution for competitiveness. Innovative products are often launched by startups and SMEs which lack the means for initial stages of product development, and in those cases the only way of funding are venture capital as important development initiators in any economy.

Croatian venture capital market can be divided into two as formal and informal, where the formal one includes both venture capital consisting of private funds only, and the FGSs with a share of public capital. In Croatia there are five registered companies that manage a total of seven open-end investment funds with a private offering, five of which are FGSs. Since the FGSs are mainly focused on recapitalization and development of large enterprises, especially during the economic crisis, and the rest of the risk capital funds are typical private equity, and not venture capital funds that invest in the early and seed stages of company development, it can be concluded that Croatian innovators have a hard time raising funds. On the other hand, Croatian informal venture capital market is currently made up of 14 business angels, members of the CRANE association. They invest only smaller amounts of funds, but are, unlike other venture capital funds in Croatia, more accessible to startups and early stage small enterprises.

For projects in seed stage there are several programs, incentives and incubators in Croatia which are set up to endorse them in an number of ways. This creates the foundations to establish future successful companies/enterprises that will participate in generating growth of the entire economy. However, after that initial stage, there is a need for venture capital funds which will maintain the process and support further growth and development of those enterprises by capital injections. Since Croatian market is relatively small to set up a full-fledged VC fund, among the interviewed investors there are ones with an interest in establishing such funds, but with an operating range that extends over the entire region.

Croatia belongs to the region of Europe which takes up the smallest share in the total amount of the European venture capital, only 0.1%, and in addition, that kind of capital is an almost negligible portion of the total assets of all investment funds. Considering that venture capital financing model could become a diving force of economic growth, as it was in the US and Western Europe after World War II, these figures are incredibly disappointing.

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Appendix

Table A1. Questionnaire and answers of the interviewed business angels

	Hrvoje Prpić	Saša Cvetojević	Tomislav Šekerija	Mihovil Barančić
Specify couple of reasons why did you become an investor?	Due to boredom. The desire for something new.	I wanted to incorporate personal knowledge and experience with work and possible profits in the future.	Diversification. I didn't want to put all my eggs in one basket.	In order to work, have fun and help others.
As one of the investors, have you ultimately gained or lost?	No exits yet, the most of projects still have no market value. Currently at a loss.	Currently at a loss because of no exits and therefore I can't make a good evaluation.	At the loss in external projects, beyond the basic industry. The core business is still profitable.	Currently at a loss partly because of a bad decision and partly because of the period of generating a profit which is yet to come.
What is the ratio of success and failure in funding projects with venture capital?	1:10	1:10	1:30	1-2:10
Do you invest more as an individual or jointly with other business angels?	Mostly syndicated, especially when there are opportunities.	50:50, but it turned out better when there was more of us.	Syndicated, but only because at that time there were more investors interested in these projects, but I wouldn't mind to invest individually.	As an individual. Apart from a few individuals in Croatia, I wouldn't invest with others. The reason is that all of us have to learn a lot.
What is crucial when making a decision on funding a particular project?	Team.	Team.	Person, team.	Team.
What is the main reason for rejecting	Team, poorly analyzed market, too competitive	Team.	The ignorance. For example, I want a salary £10.000 after	Unrealistic business plan and unrealistic evaluation.

the projects?	market.		a month, not considering that at this point the individual reduces working capital.	
As an investor, in how many projects are you participating in?	6	6	2	5
What is a monthly average of projects you get for a review for possible future investment?	Approx. 15	Approx. 30	20-30 projects.	Approx. 20
In which industries do you invest the most and why?	IT, because the ratio of the investment and the return are the largest so a risk is reduced.	IT, because it is easiest to start (relatively low input), scale and make a return on investment, but I also have investments in labor-intense industries and trade.	IT, primarily because it is my profession and I can contribute the most.	IT because you can easily step up –it mostly depends on the people who are in the project, and not so much on external factors.
What is the largest amount that you have invested?	1000000 £	50000 €	30000 €	70000 $
What is your involvement in the projects, besides the financial support?	I try to reduce it as possible, but it depends on the project. In average 3-4 hours per week.	It is great, if I can contribute.	It was large one and there was need for more, but then an entrepreneur would feel pressure.	Not a strong one. I engage myself when setting up a business model, especially in organization and finance.
What is an average return and when do you expect that return?	Return in 10 years, 30-40 times	Minimum 10 times in order to consider project a profitable one.	The return in 5-6 years is ok.	10-30 times, but it should be prepared that there won't be returns.
What is the highest return that you have achieved so far and to which	There are no returns yet, because it has not passed 10 years since any project.	-	Only core business-construction.	-

industry belongs the project?				
How do you estimate the value of the startup and, therefore, a share that you take when funding?	I think that every startup in its beginning is worth about 10000 euros, and I like to invest at the very beginning. It is generally difficult to evaluate startups.	The stage in which we are investing is too early to do special analysis. Mainly rely on instinct.	Cash flow method, negotiation.	Negotiation. The idea is that the investor receives at least 10% from the project due to pure mathematics. The present value methods are showing up in later stages, when company starts to generate income.
Join the numbers from 1 (the most important) to 5 (the least important) according to importance of the following factors when deciding on funding **TEAM – MARKET POTENTIAL – AMOUNT OF INITIAL INVESTMENT –RETURN ON INVESTMENT – BUSINESS PLAN**	1. team 2. amount of initial investment 3. market potential 4. return on investment business plan	1. team 2. market potential 3. amount of initial investment 4. return on investment 5. business plan	1. return on investment 2. team 3. market potential 4. amount of initial investment 5. business plan	1. team 2. market potential 3. amount of initial investment 4. return on investment 5. business plan
Dou you think that in Croatia there are not enough ideas and good entrepreneurs / teams?	Yes.	There are some good ideas and slightly fewer entrepreneurs, but the problem is rather in the entire startup environment that is only at its beginnings and has to be developed.	I think there are ideas and a lot of initiatives, but they are scattered. It is necessary to sum up everything in one place.	There are not enough startups, but initiatives, ideas and teams are increasingly arising. It should be at least 10 startups per year on 4 million people.
Compare yourself in the role of investors with investors from the US market.	Number of projects and the quality of those in America is an advantage. In America, it is much easier both to investors and startups.	The advantage is only the absence of competition, and everything else is a disadvantage. For example, lower levels of capital, lack of real VC funds that will continue investments and so	The capital flow is higher in the United States, environment around the entire startup system is stronger in the US (e.g. Bankruptcy law, incubators, Silicon Valley, the government	It is incomparable. The market is large and there are successful people-managers or entrepreneurs. Here, the main problem is the lazy chain - startups are slow, the investment

		on.	provides incentives for startups and investors).	process is slow and, there are no VCs who will accompany
Do you think that the Croatian market has perspective for venture capital funding?	I do not. It would be good if there is a VC in Croatia, but I do not believe that it will be opened soon because the market is too small and uncertain.	I think at least one large or two smaller VC funds are necessary that will not put funds in a bank, but in startups instead. The aim is to gather excess capital which could then be used to develop the right ideas.	Yes.	I believe that measures should be taken on the regional market. Croatian market is not big enough, and VC funds have shown considerable shortcomings in the whole model.