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RISK MANAGEMENT IN THE ACTIVITIES OF A VENTURE COMPANY

GESTÃO DO RISCO NAS ACTIVIDADES DE UMA EMPRESA DE RISCO

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ABSTRACT

Background: The world experience of leading companies shows that the effective development of a company, in particular a venture company, and the efficiency of its activities cannot be increased without a proper strategy as a set of measures aimed at achieving the goal set.

Objective: The article presents the results of studying and developing a venture company strategy.

Results: The main stages of organizing the activities of a venture company are determined, possible strategic alternatives and the problems of venture business are identified, and ways to solve them are proposed.

Conclusion: To make adequate decisions, it is necessary to comprehensively assess the situation and make a reliable forecast of further events. This article is relevant since the activity of any enterprise, especially venture capital, is accompanied by risks. Consequently, it is required to develop and apply an activity strategy within the competence of various departments.

Keywords: Venture company; Business; Innovations; Services; Risks.

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RESUMO

Antecedentes: A experiência mundial de empresas líderes mostra que o desenvolvimento eficaz de uma empresa, em particular de uma empresa de risco, e a eficiência das suas atividades não pode ser aumentada sem uma estratégia adequada como um conjunto de medidas destinadas a atingir o objetivo estabelecido.

Objetivo: O artigo apresenta os resultados do estudo e desenvolvimento de uma estratégia de empresa de risco.

Resultados: As principais fases da organização das atividades de uma empresa de risco são determinadas, possíveis alternativas estratégicas e os problemas do negócio de risco são identificados, e são propostas formas de os resolver.

Conclusão: Para tomar decisões adequadas, é necessário avaliar exaustivamente a situação e fazer uma previsão fiável de outros eventos. Este artigo é relevante, uma vez que a atividade de qualquer empresa, especialmente de capital de risco, é acompanhada de riscos. Consequentemente, é necessário desenvolver e aplicar uma estratégia de atividade no âmbito da competência de vários departamentos.

Palavras-chave: Empresa de risco; Negócios; Inovações; Serviços; Riscos.

1 INTRODUCTION

Entrepreneurship is closely connected with risks. The greatest risks are related to investing in venture capital since economic activity in venture investment brings either large profits or large losses. This is where risk management comes in handy.

At the present stage of its structural development, the Russian economy needs to develop alternative mechanisms for financing innovation activities. The study of Russian and world experience proves that the development of the venture capital market is the main factor in launching innovation processes. The formation and development of venture capital in Russia requires the substantiation of certain theoretical, methodological, and practical aspects, in particular, to determine the role and advantages of venture financing, clarify the specifics of venture financing risk management, and reveal typical strategies for such management.

Venture business, approaches to its financing, and certain aspects of risk minimization are addressed by many Russian and foreign scholars. The above-mentioned

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topics are covered by E.N. Barikaev, S.G. Buyanskii, V.N. Vyatkin, A. Damodaran, M.V. Danilina, R.Kh. Ismagilov, N.V. Kapustina, P.P. Kovalev, V.V. Bankovskii, M. Krui, I.V. Larionova, S.Yu. Ugnich, A.V. Fedorova, E.P. Shatalova, etc.

The high dynamics of economic transformations necessitate further scientific research on venture financing risk management to revive innovation processes in the domestic economy. Recent studies and publications on professional activity in Russia have shown that this field of activity cannot exist only due to its own funds. For its development, it is necessary to attract funds, i.e. there is a need for investment. Therefore, this issue remains relevant for any industry. Due to the attraction of funds, the economy of both a small enterprise and the country as a whole is gaining significant momentum. Many publications and studies dwell specifically on the issue of investing in entrepreneurial activity and the related risks.

2 RESULTS AND DISCUSSION

2.1 THE ROLE OF RISK MANAGERS IN VENTURE INVESTMENT

At the innovative stage of development of the Russian economy, venture financing is the most promising form of interaction between business entities. Its main difference is the distribution of common risks between a venture investor and an entrepreneur. An effective venture business combines scientific and technical knowledge. Currently, the development of almost every industry or entrepreneurial activity in Russia requires investment. This issue especially concerns the development and implementation of innovation projects.

An effective venture business combines scientific and technical knowledge, finance, and management. According to scientific estimates, one dollar of venture capital investment for the registration of invention patents is almost 10 times more effective than one dollar invested by a large industrial company (Pokrovskii, 2017, p. 24).

Small businesses that are little known and non-public at the initial stages of their development cannot raise funds through the stock market. Bank lending is also out of

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question due to the lack of money-back guarantees and high project risks increasing their costs.

Thus, venture capital companies cannot pay interest on debt obligations as there are losses at the initial stage and they have to attract external equity capital. There is a need to develop venture financing as the basis for the development of the innovation economy. Innovation activity and investment, especially venture investment, cannot exist without risk. However, risks can be managed and reduced to a minimum. To this end, there are specialists in risk management, i.e. risk managers.

Innovation activity is among the main components of scientific and technological progress and economic growth. The current economic competition for leadership in world markets is associated exclusively with innovation. Most economically developed countries build their long-term growth strategy primarily based on an innovative development path.

Venture investment is one of the most important mechanisms that ensure innovation processes and ensure resources for their development. It is a special system of investing in new projects. Unlike traditional investments, the necessary funds can be provided for a promising idea without guarantees in the form of the existing property, savings, or other assets of the entrepreneur. The only collateral is a certain amount of shares in the already existing or newly created company.

2.2 INNOVATION ACTIVITIES AND VENTURE INVESTING RISK MANAGEMENT

A venture company (firm) is an enterprise whose product is innovations that are directly related to various risks: in the field of marketing, production organization, scientific research, etc. A venture firm serves as the initial stage in the development of a product since it is engaged in the selection and development of a scientific or technical idea, its approbation, and the creation of samples for their subsequent transfer to the production (industrial) stage. Most often, the company ceases its functioning and existence when the work on its product is complete. Venture companies realize only a small part of incoming projects. Since 35-45% of the projects accepted for development turn out to be unprofitable, a significant part of the companies become bankrupt (Dreshchinskii, 2016; Morrow et al., 2007; Nikulina & Troshina, 2018).

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Among professional investors, there is a growing interest in venture capital investments. Scholars view them almost as salvation from all problems and the possibility of obtaining long-awaited funding. Small high-tech businesses turn to venture funds to get a professional assistant who can give an impetus to innovative entrepreneurship.

In Russia, the process of forming a venture financing mechanism is slow and unsystematic. Today there is a lack of necessary organizations and centers that act as elements of this structure; a network has not been formed that would create the prerequisites for ensuring the functioning of the innovation life cycle. Without such a network, any industry effort to innovate would be local.

Russia should actively promote the development of venture business since the benefits that society receives from venture capital support programs are not limited to the income of venture investors.

Venture investments are:

– To contribute to new leading scientific and technical developments to create competitive high-tech products and technologies;
– To create new jobs, reduce unemployment, and increase the level of well-being in society, which is of strategic importance for the long-term growth of the national economy.

In the process of venture investment, its stakeholders obtain the following advantages (Rodionov, 2010; Ugnich & Ugnich, 2009):

a) The growth of companies through significant financial support;
b) Long-term investment in venture projects;
c) During the implementation of the project, venture capitalists do not require interest on the invested capital and its full reimbursement;
d) Venture projects produce the highest return on invested funds;
e) Venture capitalists become business partners of the company and contribute not only financial resources but also their experience and business connections, as well as ensure the legal and consulting support of the enterprise.
f) Venture financing fulfills a crucial function, i.e. commercializes R&D and promotes new ideas;
g) Venture capital creates conditions for the introduction of new developments, improving the technical and technological level of production;
h) Various sources of venture capital and many ways of investing in venture projects allow small high-tech companies to raise the necessary funds at any stage.

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Factors contributing to the development of venture business are as follows:

– Scientific and educational base, powerful research sectors, and scientific schools;
– The development of financial institutions and markets in the insurance and pension sectors; the stock market;
– Political and macroeconomic stability, sustainable economic growth;
– Stable demand of the state and private sector for research and development; the availability of free capital (Russian Venture Capital Association, 2017; Rybachek, 2009).

Most of these conditions are present in Russia but the venture capital business is still developing, although its formation started in 1992.

The system of venture investment should solve the following tasks:

– To attract a significant amount of private capital to the scientific and technical sphere which exceeds the amount of public investment by 100 times;
– To build an effective system for using intellectual property and other intellectual deliverables in economic circulation;
– To modernize the Russian industry through the creation of new industries based on high technologies;
– To provide conditions for the rational use of fixed assets from the enterprises that lost their competitiveness;
– To mobilize a significant amount of funds from the population for the development of the scientific and technical sphere;
– To reduce unemployment and solve urgent socio-economic problems;
– To attract targeted foreign investment into the development of the technological sphere (Damodaran, 2017; Popov & Kasyanov, 2013).

A full-fledged venture capital industry is developing in Russia. Large banks play a significant role in venture capital financing. For such enterprises, risks are vital and might lead to negative results in the future.

Risk management is the art of mitigating risks in an uncertain economic situation, based on risk prediction and risk reduction techniques.

There are principles in risk management that are presented in Figure 1. On their basis, a risk decision is made and methods for choosing a solution for investment projects are selected.

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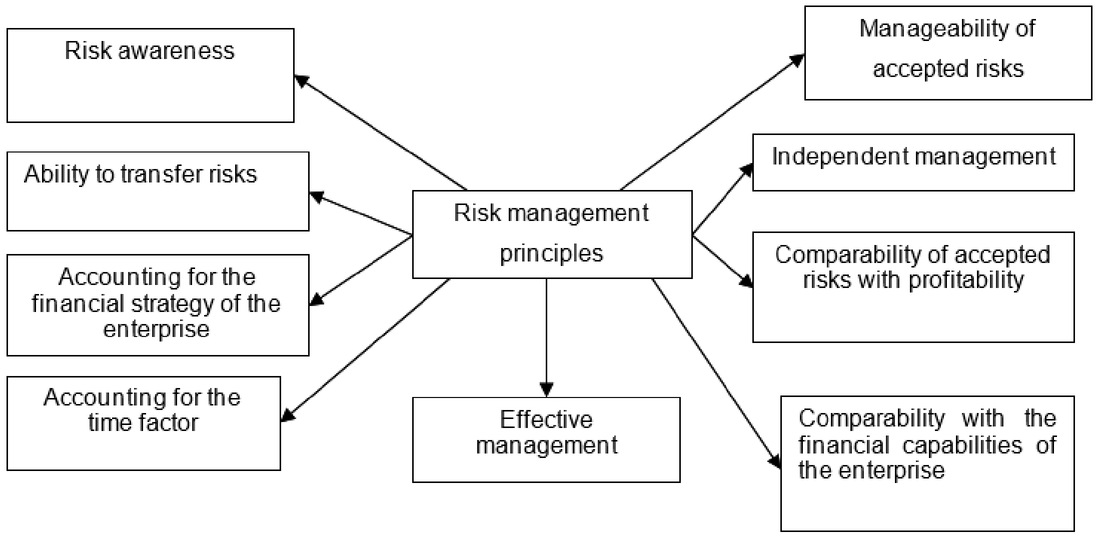

Figure 1. Principles to make risk decisions

The sphere of risk management includes about 100 risk types. The most common include investment, credit, market, operational, insurance, legal, transport, exchange, personnel uncertainties, and risks of losing one's business reputation. The services of risk managers are in demand in various business areas, in particular insurance, investment, and banking sectors.

At the present stage of Russia's development, the risk manager is a new but quite promising profession. The risk manager looks for all kinds of risks in the activities of companies and assesses the degree of their danger to the company and the expected amount of damage. Based on this information, the risk manager develops recommendations that should help the company reduce the negative consequences of such risks (Kiseleva & Simonovich, 2016b, p. 24). The risk manager is one of the most needed specialists in any company, especially in venture capital firms with the maximum risks of getting a negative result.

Before making any risky decision, the risk manager should:

– Determine the maximum possible amount of damage;
– Compare it with the amount of invested capital;
– Compare it with own financial resources;
– Determine whether the loss of this capital will lead to bankruptcy (Kiseleva & Simonovich, 2013, p. 55).

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Given the instability of the economy, companies that implement investment policies have to deal with uncertainty and connected risks. In small firms, risk assessment is usually carried out by management, but large companies often require a professional, i.e. a risk management specialist.

Risk managers follow their own rules shown in Figure 2 (Porter, 2005, p. 24).

Since risk management is a new profession, it can be taught only in leading financial and economic universities. Therefore, risk managers are often people with other academic degrees, for example, economic or technical. This is explained by the high demands on this profession (Agarunov & Burnashev, 2013; Apollonov, 2011; Boiko, 2018).

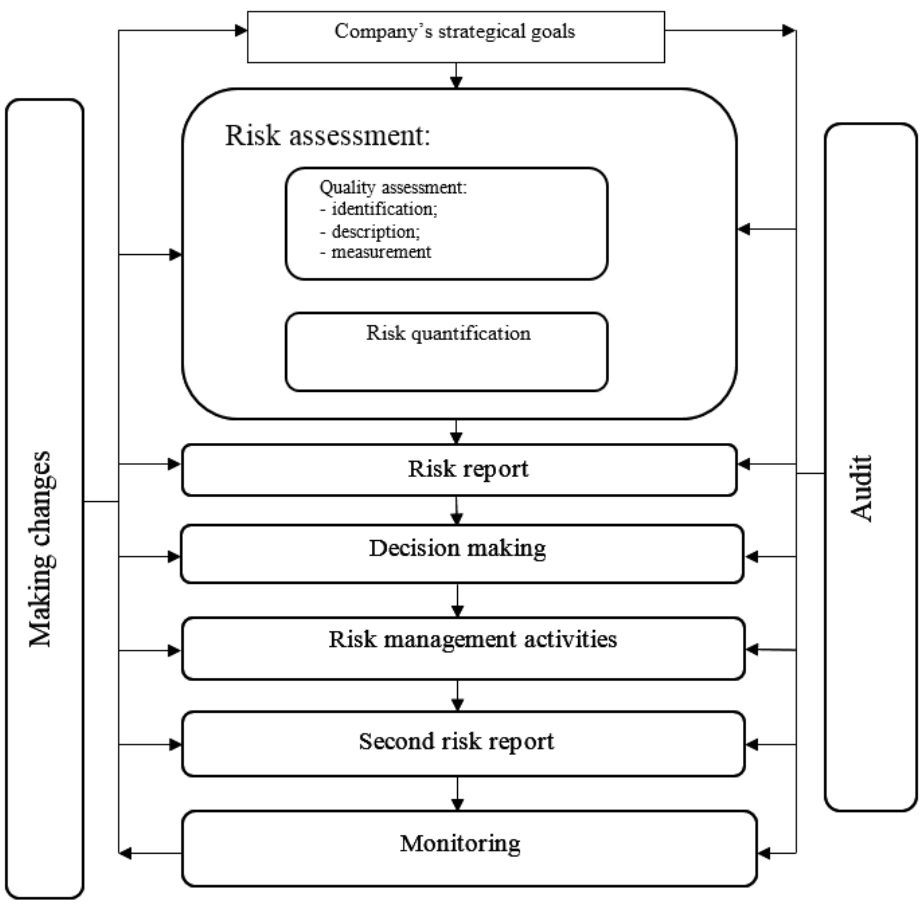

Figure 2. Basic rules of the risk manager

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The risk manager must understand not only risk management but also economics (micro and macro), banking, the securities market, and accounting. In addition, they need knowledge in the field of law, international financial reporting standards, higher mathematics, and mathematical modeling. The risk manager must be an experienced PC user, have analytical skills, and be ready to work in a fairly intensive mode (Kiseleva & Simonovich, 2016a, p. 26). As a rule, one of the requirements for risk managers is experience in related areas: the risk assessment of corporate clients (2+ years) or work as a credit analyst for corporate clients (3+ years).

Entrepreneurial activity, venture investments, and risks are interdependent categories. There is practically no guarantee that a particular economic decision will have a successful outcome. The task of risk managers in managing investment projects is to minimize such risks (Business.Rin.ru, n.d.; Foss, 2007; Teece et al., 2003).

At the present stage of development, more attention is paid to specialists. Every year the demand for such experts is increasing. This trend indicates a steady interest in risk managers. This is evidenced by the fact that, according to relevant studies, the salary of risk managers has increased by 20% over the past year.

The salary of risk managers in 2021 (in Europe) is as follows:

– Foreign exchange risk manager – $195,000;
– Risk manager – $105,000;
– Operational risk manager – $90,000-$175,000;
– Credit risk manager – $95,000-$180,000 (Larionova, 2017, p. 69).

A risk manager is a specialist who has not only professional skills but also the personality traits and individual psychological characteristics presented in Table 1 (Kapustina, 2018, p. 24).

Table 1. The main personality traits of the risk manager, including common and individual psychological features

Common features	Individual psychological features
Good organizational skills	Hand-eye coordination
Developed social skills	Environmental perception accuracy
Flexibility in conflicts	Short-term and long-term memory
Ability to defend one's point of view and convince people, in particular, customers	Stability and focus
Internal discipline, which is the basis of external discipline	Flexible analytical thinking

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Ability to search, analyze and systematize information, navigate the industry, make individual and group decisions	Volitional regulation of mental processes
Awareness of the company's specifics and market situation in this field	

At present, the mechanism of venture financing is developing in Russia. A full-fledged venture capital industry is under formation as an opportunity to receive long-awaited funding. However, the process is also connected with big risks and can be managed by a risk management specialist. Therefore, this profession is new but sought-after, and the role of risk management in investing grows more important.

3 CONCLUSION

Thus, the paper studies the development of various approaches to the risk management of venture financing, explores the role of risk managers in controlling venture investments, and considers innovation, venture investment, and risk management.

The risk manager is a prestigious and promising profession that will become one of the most highly paid and competitive in the future, as the demand for these specialists will increase many times over.

The paper considers venture business as a special form of the innovation process and determines both positive and negative aspects of venture financing from the viewpoint of a venture investor. It also covers the main theoretical approaches to understanding the essence of venture financing.

Venture financing through venture funds is justified since the accumulation of capital allows one to invest not in one but several projects with probable inferiority. In the end, risks are distributed due to the high number of projects in different industries, regions, and stages of implementation. With a high level of riskiness, this approach allows funds to make a profit even if a certain amount of investment is not returned at all.

Investing in fast-growing industries is the main indicator for investing in venture capital (venture capital is not invested in stagnant industries because they are not able to provide excess profits). For an investor, the goal of venture financing is income in the form of the difference between the purchase price and the sale price of the company's shares

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(not in the form of dividends). It can be implemented under the condition of a developed stock market with an operating market mechanism for setting the price of shares.

In the process of venture financing, the main incentive for investing capital is only the financial result (profit). A significant impact on the managerial decision about the possibility of venture investment is made by the assessment of possible risks. The investor's profit in venture business directly depends on the probability of their occurrence.

Venture risks can be viewed as the probability of losses that occur when capital is invested in the development of innovative technologies, equipment, goods, services, or managerial innovations that do not justify the expected market demand or do not have the expected economic effect. When financing venture projects, there is always a significant risk. This necessitates the definition of a risk management strategy for venture financing with due regard to their subsequent elimination or minimization. In various sectors of the economy, similar risk-reduction mechanisms are used. By combining popular risk mitigation measures, several types of venture capital risk management strategies can be identified.

Thus, venture business is a specific type of activity that, on the one hand, is at high risk and, on the other hand, it has a chance to make super profits in case of success. There is a need for effective risk management of venture capital financing. Currently, science has developed principles for protecting enterprises from venture risks. However, the high risks of venture business increase the relevance of their reduction with the help of the insurance mechanism and, consequently, the study of insurance protection as a risk management strategy for venture business.

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