THE ROLE OF VENTURE CAPITAL IN URBAN AND REGIONAL DEVELOPMENT: THE CASE OF OSTIM

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ABSTRACT

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Venture capital (VC) has been accepted to play an important role in encouraging of entrepreneurship, maintaining technological improvement and, urban and regional development in the country besides providing financial support for small and medium size enterprises (SMEs) with high growth potential.

This thesis analyzes the reasons of the limited venture capital investments in Turkey and the measures that should be taken in order to increase both the effectiveness of VC in maintaining urban and regional development and VC investments to SMEs. Furthermore, VC is emphasized to be an important model that can be efficient in solving the financing, management and technical problems of SMEs with high growth potential.

In order to analyze the problems, a field research was conducted. Research consists of two parts. In the first part, the questionnaire was conducted with 100 SMEs in Ankara that are active in OSTIM so as to reveal the general characteristics of SMEs and the funds they use to solve their financial problems in start-up and expansion stages. SMEs are generally family run firms that have limited capital and whose owner is also the manager in the firm. Equity capital is the most important source that is used in the start-up and expansion stages by the firms.

The rate of usage of subsidies like investment and export incentives and technology development support, credit guarantee fund and venture capital by these firms is low. Lack of knowledge, insufficiency of qualified staff and bureaucratic barriers are the most significant reasons of this situation.

In the second part, interviews with venture capitalists or managers of 3 important VC firms that are active in Turkey come up. These interviews aimed to reveal the goal of VC firms, evaluation process of the applications and VC firms' expectations from SMEs. VC firms face difficulties with the projects with no growth potential. Moreover, applicant firms do not have adequate staff and supplies in order to prepare the financial information for the application process, and this happens to be a crucial problem.

According to the results of the field research, some suggestions are tried to be put forward in terms of the achievement of a more effective use of VC system in Turkey. In this regard, firstly, efficiency of subsidies-particularly institutions that provide R&D supports- should be increased. Secondly, Credit Guarantee Fund should be strengthened in order to provide more entrepreneurs with guarantee support. And finally, establishment of a center that is to provide consultancy for applicant firms in their project development and application periods is suggested.

Keywords: Small and Medium Sized Enterprises (SMEs), venture capital, regional development.

ÖZ

KENTSEL VE BÖLGESEL KALKINMADA GİRİŞİM SERMAYESİNİN ROLÜ: OSTİM ÖRNEĞİ

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Girişim sermayesi, büyüme potansiyeli olan küçük ve orta ölçekli işletmelere (KOBİ) finansal destek sağlamanın yanısıra, ülkelerde girişimciliğin desteklenmesi, teknolojik ilerlemenin sağlanması ve kentsel ve bölgesel kalkınmanın sağlanmasına da önemli katkıda bulunmaktadır.

Bu çalışma, ülkemizde girişim sermayesi yatırımlarının sınırlı olmasının nedenlerini araştırmakta ve hem KOBİ'lerin finansal sorunlarının çözülmesinde hem de ülkede kentsel ve bölgesel kalkınmanın sağlanmasında girişim sermayesinin etkinliğinin artırılması için alınması gereken önlemleri belirlemeye çalışmaktadır. Diğer yandan girişim sermayesinin, yüksek büyüme potansiyeline sahip KOBİ'lerin karşılaştıkları yönetim ve teknik sorunların çözümünde etkin bir model olduğu vurgulanmaktadır.

Bu amaçla yapılan saha çalışması iki kısımdan oluşmaktadır. İlk kısımda, Ankara'da OSTIM Sanayi Bölgesi'nde faaliyet gösteren 100 KOBİ ile anket çalışması yapılmıştır. KOBİ'lerin genel yapısı, kuruluş ve büyüme dönemlerinde finansal sorunlarını çözmek için hangi finansman kaynaklarını kullandıkları, devlet yardımları, girişim sermayesi ve kredi garanti fonu hakkında bilgi seviyeleri

irdelenmiştir. KOBİ'ler çoğunlukla kısıtlı sermayeli, işletme sahibinin aynı zamanda işletmede yönetici olduğu aile işletmesi özelliğindedirler.
İşletmelerin kuruluş ve büyüme dönemlerinde kullandıkları en önemli kaynak öz kaynaktır. Bu işletmelerin yatırım ve ihracat teşvikleri ve teknoloji geliştirme destekleri gibi devlet yardımlarını, kredi garanti fonunu ve girişim sermayesini kullanma oranı düşüktür. Bunun en önemli sebepleri arasında bilgi yetersizliği, nitelikli eleman yetersizliği, bürokratik engeller sayılabilir.

İkinci kısımda, Türkiye'de faaliyet gösteren üç önemli girişim sermayesi şirketinin yatırım uzmanı yada yöneticisiyle ikili görüşmeler yer almıştır. Girişim sermayesi firmalarının amacı, proje değerlendirme süreci ve KOBİ'lerden beklentileri belirlenmiştir. Girişim sermayesi firmaları, kendilerine önerilen projelerin büyüme potansiyelinin olmamasından sıkıntı duymaktadır. Ayrıca, işletmelerin girişim sermayesine başvuru esnasında sunması gereken finansal bilgileri hazırlayacak yeterli teknik donanıma sahip olmamaları önemli bir sorun olarak tespit edilmiştir.

Bu çalışma sonucu elde edilen verilere dayanılarak, Türkiye'deki KOBİ'lerin girişim sermayesi sistemini daha etkin kullanmaları için alınması gereken öneriler ortaya konulmuştur. Bu kapsamda öncelikle devlet yardımlarının -özellikle araştırma ve geliştirme destekleri sağlayan kuruluşların- etkinliğinin artırılması gerekmektedir. İkinci olarak, Kredi Garanti Fonu'nun daha fazla yatırımcıya teminat desteği vermesi için güçlendirilmesi gereklidir. Son olarak da, girişim sermayesine başvurmak isteyen işletmelerin proje geliştirme ve girişim sermayesine başvurma dönemlerinde danışmanlık sağlayacak bir merkezin kurulması önerilmiştir.

Anahtar Kelimeler: Küçük ve Orta Büyüklükte İşletme (KOBİ), girişim sermayesi, bölgesel kalkınma.

To my family

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To my mother, thanks for your encouragement and being with me whenever I need. To my father, thanks for your continued and unfailing support and faith in me. To my sister and her family, thanks for your invaluable love and your friendly smile. You are loved deeply...

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ABBREVIATIONS

SMEs: Small and Medium Size Enterprises

VC: Venture Capital

KGF: Credit Guarantee Fund

EU: European Union

KOSGEB: Public Organization for Promotion of SMEs

MEKSA: Foundation for the promotion of Vocational Training Small Industry

IGEME: Export Promotion Centre

TUBITAK: Scientific and Technical Research Institution of Turkey

TTGV: Technology Development Foundation of Turkey

HM: Undersecretariat of Treasury

DTM: Undersecretariat of the Prime Ministry for Foreign Trade

TESK: Confederation of Tradesmen &Craftsmen

TOBB: Union of Chambers of commerce &Industry

TOSYOV: Foundation of Small and Medium Business

CHAPTER I

INTRODUCTION

1970s crises happened to be an important turning point in development theories and regional development policies. After 1970s, state intervention policies became impossible to be continued with, and endogenous growth approach affected development theories. In this approach, regions are considered important size for development and SMEs are described as the engines of regional development. Also it is emphasized that innovation is vitally crucial and entrepreneurs are supposed to be innovative agents (Amin, 1998). In order to maintain regional development it is important to encourage entrepreneurs and maintain their sustainability. In the incentive system which has systematically been implemented since 1913, direct support provided for entrepreneurs by government is of great significance. However, globalization and development of new information technologies and the importance attached to research and development (R&D) has increased cause businesses to face with world-wide competition. The incentive system has gone through several changes in the world. Today the entrepreneurs have been supported through certain incentives and carefully designed policies such as training, and research and development support policies by public or semi-public agencies. Furthermore, this change also has brought about a new system in the market. In this new system, on the other hand, some of the needs of entrepreneurs may be provided by private sector organizations as a result of market transactions. Those organizations undertake the investment risks and when supported with public policies, they become major factors in maintaining regional development. Concerning this, venture capital occurs as a model that finances SMEs with high growth potential and their investment risk in market conditions (Pınarcıoğlu and Işık, 2004).

Venture capital (VC) also provides investors with the realization of their innovative ideas. In this way, VC acts as an encouragement to generate novel and improved products, services and processes, which are essential for corporate economic growth, and technological development. Through this, VC also becomes one of the most significant drivers of creating innovative small and medium enterprises (SMEs).

SMEs have been considered to be one of the principal driving forces in reducing unemployment, and in maintaining regional economic development and socio economic stability especially in less developed countries (Storey, 1982; Keeble and Wever, 1986; Nijkamp, 1986; Maillat, 1988). By their nature, SMEs have the potential to support innovation and economic activity. Through their small and flexible structures, and their quick adoption to changing market conditions, they maintain the innovation and the economic activity. It is obvious that SMEs should be innovative to be successful in the diffusion of innovations, and economic and technological development.

High technology, product innovation, and process innovation are the most important factors that strengthen the innovativeness of SMEs. Rate of return to R&D is an indicator of efficient innovative activity. However, insufficient capital, lack of management ability and high cost of R&D obstruct most of the SMEs to invest in research and development activities. These are the most important deficiencies that reduce the innovativeness and competitiveness of SMEs. However, practical experience and empirical evidence have shown that the SMEs face many difficulties to access finance. While some entrepreneurs have used bank loans or other sources of debt financing, SMEs in start-up and expansion stages can not benefit from these sources of financing. The reason for this is that these companies lacked substantial assets; are at high risk owing to and uncertain prospects.

Due to the fact that substantial amount of SMEs have been facing with financial problems, they should be supported with appropriate financial measures, training, management and incentives on R&D to maintain their functions and to strengthen their innovativeness.

Venture capital is considered to be the most appropriate form of financing for SMEs in high growth potential sectors. Venture capital invetsments are long term investments and in addition to financing, they provide management, and technical supports to SMEs. In this sense, VC investments are distinct from other financing methods. Venture capital is vital for SMEs' future growth as it creates more value and increases their competitiveness (and innovativeness) in national and international markets. For these reasons, in present day, it is widely accepted that VC model is an important catalyst in improvement of technology and regional development.

Considering the developed countries such as the USA and England it can be noted that venture capital has a significant role in encouraging technological development. In those countries, essential public supports and encouraging legislative amendments have been used to increase the number and efficiency of venture capital companies. It is no way a coincidence that the countries which successfully apply venture capital model today are technologically developed countries. Therefore, in order to have technological development, developing countries should also focus on VC model as in the case of developed ones.

In developing countries, government's effort put to enhance growth, expand job creation and diversify the economy by supporting SMEs. SMEs need access to short and long-term funding at reasonable rates, knowledge about market opportunities, and advisory assistance. They typically suffer from weak entrepreneurial skills as well as deficiencies in accounting, production management, and business planning. As SMEs grow, they increasingly need to venture capital. By their infrastructure, VC firms provide financing to SMEs as well as management and technical supports. Thus, public incentives and legislative amendments play a significant role in creating conditions in which VC can

flourish. These include SME-oriented training, consultancy and R&D supports etc. and encouraging legislative amendments to invest in VC.

In Turkey, various supporting instruments (tax exemptions, incentives, training and R&D supports etc.) have been used to stimulate SMEs in order to prevent uneven regional development, increase employment and maintain socio-economic development. Moreover, modifications in public policy and legislative amendments have been implemented in order to sustain venture capital.

The first time that venture capital has been formally discussed in Turkey is through the venture capital legislation prepared in 1993. The first venture capital firm has been established in 1996, and later, another VC firm has been established in 2000. The number of venture capital companies has been increasing gradually in the last 5 years; however venture capital investments have still been quite limited.

The study aims to understand why investments of venture capital firms in Turkey are limited in volume and number. Moreover, it is intended to determine critical suggestions to provide SMEs to use VC system more effectively.

Moreover, the study will attempt to answer the following questions:

- What are the financial sources of SMEs in start-up stage, future investments in Turkey?
- What is the distribution of the sources of funds used by SMEs when they have financial problems?
- Do the SMEs use supports such as incentives and technological developments?
- Is there sufficient information about supports, credit guarantee fund and VC whether they are available and accessible for SMEs?
- What are the attractive characteristics of SMEs for venture capital firms?

In this thesis, in addition to the questionnaire survey and interview, a literature survey on venture capital and SMEs' financing problems is carried out for acquiring information.

The thesis is composed of six chapters. Chapter 1 is introduction.
Chapter 2 attempts to give an overview of the increasing role of entrepreneurship in urban and regional development and role of SMEs in maintaining regional development and innovation. It is also evaluated critically the role of venture capital in regional development.
Chapter 3 includes the detailed information about venture capital model both in the World and in Turkish literature. In this chapter, funds of venture capital, investment phases, exit strategies, and the advantages versus disadvantages of venture capital model and the factors that are essential to improve VC are explained.

Chapter 4 explains financial problems of SMEs, the amount of interest in Research and Development (R&D), the usage of high technology and incentives provided to encourage technological innovation in SMEs. Furthermore in this chapter, the emergence and applications of venture capital in Turkey will be examined.

Chapter 5 presents the empirical analysis, which consists of two parts.
Part I is based on the SME survey in OSTIM Industrial Zone in Ankara, the capital city of Turkey. OSTIM is considered to be a representative sample region for SMEs in terms of their economic and technological capabilities in Ankara. The questionnaire conducted with 100 SMEs located in OSTIM. The study aims to reveal the general characteristics and financing problems of SMEs, the distribution of funds that are used in start-up and expansion stages of firms and the level of awareness with regard to venture capital financing method.

Part II is based on face to face interviews with the investment specialists of Is Venture Capital Investment Trust in Istanbul, Esas Holding J.S.C. in Istanbul and with the general manager of Vakif Girisim Venture Capital Co. in Ankara, which are 3 important venture capital firms in Turkey. This part of the study aims to reveal the structure of the investment strategy of the VC firms, their expectations from the entrepreneurs, and the reasons of rejection of SMEs' applications. These two analyses are the basic tools to bring the major problems of both SMEs and VC sector into light.

Chapter 6 is the conclusion and summarizes the study as a whole. This chapter includes the definition of the major problems, and in the light of these problems, policy options are suggested to increase the investments of venture capital firms in Turkey.

CHAPTER II

THE INCREASING ROLE OF ENTREPRENEURSHIP IN URBAN AND REGIONAL DEVELOPMENT

During the globalization, increasing competitiveness and rapidly changing economic conditions for regions and urban problems have affected economic development policy. Furthermore, private sector has become more important in economic development as increase in competitive power of enterprises is relevant with sustainable development of regions.

Before 1970s, income redistribution and welfare policies constituted the conceptual base of economic development. In this approach, economic growth is maintained with exogenous resources, government interventions and infrastructure investments by the state's regional economic policies. Furthermore, the problem of interregional growth disparities is tried to be solved by investments made by the state.

1970s crises happened to be an important turning point in development theories, regional development policies. The development theories towarded to abate price distortions, privatize public firms, encourage private foreign investments and increase global competitiveness in the 1970s. After 1970s with the effect of liberalization, state intervention policies could not be continued and regional development models were affected by endogenous growth approach. In endogenous approach, regions are defined as meaningful level for development and human capital, research and development, and small enterprises are supposed as crucial determinant of sustained regional growth (Amin, 1998).

Increasing role of innovativeness in the regional development proved a subject of discussion in recent decades. In endogenous approach because technology and innovativeness become regionally generated issue, encouragement of entrepreneurs, increase in the SMEs that use technology and produce new products and techniques plays an important role in the regional development (Harrison and Mason, 2002). In addition, diminishing the interregional development disparities were not tried to be solved by direct interventions of government but by the approach of supporting entrepreneurs and development of innovative SMEs.

2.1. The Importance of Entrepreneurship in Innovativeness

In the 1990s innovation has a deep impact on productivity as well as a source of endogenous growth and regional development. Schumpeter; one of the scientists who first realized the role of technological innovation and entrepreneurs in economic growth, claimed that the inadequacy of innovations in a country's economy, affects the investments in that country negatively. In "*The theory of Economic Development"*, he described the motor of the development as the innovation itself. According to him, the economic growth is a process of "creative destruction". Therefore progress or improvement creates a new product but destroys the old one (Bygrave and Timmosns, 1992). Moreover, he claimed that innovation and innovative activity should be viewed as an entrepreneurial process. Schumpeter, describes entrepreneur as an innovator who carries out new combinations of economic development, which are new goods, a new method of production, new markets, new sources of raw material, or a new organizational form (Jennings, 1994).

According to Schumpeter, because entrepreneurship includes being innovative, entrepreneurship is not valid indefinitely. Entrepreneurship is called so as long as he does innovative activities. In other words, entrepreneurship is a way of understanding and behavior. Regarding this description, every owner or professional manager is not an entrepreneur but every innovator owner or professional manager is an entrepreneurs. Entrepreneurs use opportunities and make innovations; therefore they do not have to be new firm establishers only.

Within this perspective, entrepreneurship has played a great role in regional development as a result of introducing new technologies, innovations of all kinds and new products, developing new resources, improving business organization and management; and bringing together the land, labour, capital and management in an dynamic enterprise to make innovations succeed in urban or regions (Higgins and Savoie, 1995).

2.2. SMEs in Maintaining Regional Development and Innovation

Since the 1970s, SMEs whose role was defined as the employment generation and due to flexible structure low capital accumulation in the regional studies prove main agents of economic growth and development. In recent development models, learning capacity and knowledge creation have been more important than employment generation in terms of capabilities of SMEs. Moreover, according to the recent empirical studies, small firms have been the engines of technological change and innovative activities (Camagni and Capello, 1998). Scherer (1991) indicated that new innovations were more likely to be introduced by small firms than larger firms because they commited to existing practices and products less than larger enterprises, and they played an important role in the diffusion of innovations and technological change at local and regional levels based on his researches. It is also emphasized the dynamic contribution of small firms in knowledge creation. Creation of knowledge and foundation of R&D units have been important for the regional innovativeness and development. The R&D expenditure is highly on large firms and they are expected to drive the technological progress (Scherer, 1991). For small firms improvement of the innovative capacity relies on R&D activities that could be exploited by small and medium sized firms effectively in the region (Camagni and Capello, 1998).

It could be concluded that the new role of SMEs in development models is their innovative capacity. It has already been discussed that in the development models, innovation capacity of SMEs highly depends on R&D expenditure. This shift toward innovative SMEs makes capital sources more important for funding in start-up stages, R&D expenditures and management actions affecting the innovation process. Compared with larger firms SMEs have limited sources particularly with

respect to finance and management sources. Limited sources can influence a firm's ability to search for new developments undertaken by R&D. On the other hand, the majority of SMEs are owner-manager firms (Asheim et.al, 2003). The combination of ownership and management can affect management behaviour, attitudes to risk, and the extend of external financing. Furthermore, new small innovative firms have difficulty in accessing finance due to high uncertainity which is a special feature of innovative new small firms. Therefore, encouragement of innovative SMEs has been discussed in order to maintain economic development (Storey, 1982; Aydalot et al., 1986; Keeble and Wever, 1986, Nijkamp, 1986, Maillat, 1988).

Today, some precautions are taken by the state for the encouragement and protection of entrepreneurship. On the basis of government interventions that provide SMEs with support it is aimed at decreasing the disadvantages of small firms in the market and increasing the performance and competitive power of small firms. Development of strategies directed at encouraging entrepreneurs, providing entrepreneurship training, seminars and courses and consultancy services for the entrepreneurs in the start-up stages, and helping the entrepreneurs reach various capital financing sources as venture capital are among those supports.

Many entrepreneurs do not have sufficient funds to finance their innovative projects, therefore entrepreneurs face the problem of where to find necessary capital. (Gompers, 1994). As a result of these distinctive characteristics, SMEs are in need of support such as the need of a firm's management to draw on sources from outside the firm to supply information, advice, training, finance or other assistance or innovative assistance, such as obtaining basic market information to advice about new product development. However, support needs should be addressed through public policy. In this respect, the aim should be to focus public sources according to the needs of the economy at the regional (or national) level. Some of these needs may be responded by public or semi-public agencies (for instance assistance might be delivered by a private sector organization but be partly funded by the state). The support provided by government may not always be a direct support but it can be through certain incentives and carefully designed policies. These supports may include tax incentives, provision of technological

know-how, support for technology development. Some of these needs may be provided by private sector organizations as a result of market transactions (Asheim et.al, 2003). Those organizations undertake the risks and when supported with public policies, they prove instruments in the economic development. Concerning this, venture capital occurs as a model that finances SMEs with high growth potential and risk in market conditions (Pınarcıoğlu and Işık, 2004).

2.3. The Role of Venture Capital in Regional Development

There are three functions in the venture capital financing model. They are; venture capital firms, venture capitalists and small enterprises or entrepreneurs those are invested in. Venture capital firms provide small firms that require financing and fund owners together so they are both intermediary of investment and financing provider. VC has a crucial role in regional development since it directs the sources to research and development activities in available investments (Aypek, 1998).

Venture capital is absolutely an equity capital. It is a type of investment that makes it possible for the institutional investors, individual investors and sectors with high growth potential to make investment. Venture capital investments are generally technology based and long term investments. There are 2 types of risk. First is the application risk that is caused by the difficulties in the phase of transformation of technology into production. The other risk is the time risk that occurs because investment is long term. Both risks are not independent on each other. It is very risky that time period is high in technology investments. Technology may change very quickly and when an innovation is produced, another innovation might be produced and makes the former old and this may cause a loss for the investors.

Venture capital firms take high risks for the high rate of return. According to a research made in the USA, venture capitalists invest in firms which, they believe, have a potential of making at least 50 million dollars profit in 3 years. However they take into consideration that those firms should be developing technology within themselves instead of buying new technology. It also is important for the venture capitalists that sectors, which firms that are to be invested in are active in,

are attractive for today and the future and that those firms are able to compete in their sectors (Aypek, 1998).

Firms meet their financial needs from their equity capital and if their equity capital is insufficient, then they use sources out of the firm. However, it is too difficult for the SMEs to provide credits when the firm's guarantees are not enough or the subject of the firm is risky. It is impossible for the small firm to obtain sources from the capital markets. Even if it seems possible for them to borrow from the banks, because they are focused on big firms, they can not benefit sufficiently from the finance opportunities of the banks. Equity capital that is required in the establishment stage of small firms is usually obtained individually. Therefore, the source necessary for the work proves inadequate most of the time. It can also be observed that individuals may only have ideas but they may not find the required source in order to realize their ideas.

Venture capital is a source of financing that helps new entrepreneurs and small firms that have equity capital scarcity and can not benefit from foreign sources to continue to be active and shares their high risks, targets high revenues. Funds of individual and institutional investors that consider venture capital as a way of financing are accumulated in venture capital firms.

Venture capital is considered to be the most appropriate form of financing for innovative SMEs in high growth potential sectors. Venture capital exerts a powerful effect on innovation. Venture-backed firms grow more quickly and create far more value than no venture-backed firms. According to venture capital researchers Paul Gompers and Josh Lerner (2001b, p. 83) "venture capital clearly serves as an important source for economic development, wealth and job creation, and innovation."

Innovation is one of the main criterions of venture capital investments since venture capital investments look for high profits which can be achieved by technology intensive small firms. Innovation has a deep impact on the economic structure, urban and regional development. Technological innovations depend on R&D which needs expensive investments. The venture capital firms supply the support and finance to the SMEs for their R&D activities. The existence of well

developed venture capital system in regions significantly encourages the technological innovation and economic development in those regions. New generation of regional development policies have appeared worldwide, the most common ones being technology development supports for small enterprises, and venture capital (Florida and Kenney, 1988).

CHAPTER III

ECONOMIC, FINANCIAL AND INSTITUTIONAL ASPECTS OF VENTURE CAPITAL

In this chapter, in order to understand venture capital financing model, sources of venture capital, venture capital investments characteristics, process of venture capital investment, phases of VC for financing SMEs, the function of venture capital and advantages and disadvantages of this model both VC firms and SMEs are analyzed.

3.1. The Characteristics of Venture Capital Investments

Every investment with a potential of high return is not an interest of venture capital. At this point, it is revealed that venture capital investments have special characteristics apart from expectation of high return. The most significant factors of VC can be summarized as follows (Tuncel, 1996):

3.1.1. Small and Medium Enterprises with High Growth Potential

Investment project should include new technologies that show development potential and the production of goods, and should be intended for innovative, high-tech SMEs.

The goal in venture capital investments is to invest in SMEs that have rapid growth potential. It is possible to be a shareholder in small firms with capital investments. When the firm rapidly grows, investor can make great profits. Aim of venture capital investment is to make high rate of profits and this is provided by small firms which grow rapidly. Particularly technology firms that are financed in early stages have the potential of providing great profits to their investor. Big firms can easily borrow from financial markets. Aim of venture capital investments is to participate in the growth of SMEs.

3.1.2. Long Term Investment

Venture capital investments are long term investments. Exit from the investment takes usually three to six years, depending on the development stage of the company in which it is invested.

It is 7 to 10 years that technological innovation happens and is presented to the market. Venture capital companies cannot earn revenue during this period so this period adds new financing costs to the venture capital company. Thus, venture capital investments require strong liquid until the firm that is invested in reaches to a certain level in size. Therefore, it is too difficult to exit from the venture capital investment in the short run.

3.1.3. Technological Innovation

The source of the revenue in VC is the increase in efficiency which technology provides. Development of technology necessitates the short or long term investments. VC provides technological innovation by financing technological developments with proving a regulative of the distribution of resources and increasing the efficiency.

3.1.4. Participating in Management

In order to minimize the risks besides providing financial support, venture capital firms intervene firm's management in which they invest in concepts of,

- Determining firm strategy
- Planning the financial structure of firm
- Resolving the market problems
- Control of cash flow

3.1.5. Participating in Capital

Venture capital investments are organized as limited partnerships, in which the capitalist becomes a partner of the firm he invests in. Venture capitalists have limited votes in management. Shares of the partners are determined as a result of a negotiation.

3.2. The Process of Venture Capital

The process of venture capital comprises the stages that are; constitution of the venture capital fund, making of the investment and exiting from the investment.

3.2.1. Constitution of the Venture Capital Fund

VC funds are formed by receiving the funds from pre-determined sources (e.g.; insurance companies, banks, other financial institutions etc...). There is no interest policy for these funds. Funds are gathered with the fund usage contract and in that contract the period of fund usage, operating the funds, the distribution of the profits are addressed (Aypek, 1998).

3.2.2. Making of the Venture Capital Investment

The relationship between the entrepreneur and the venture capital firm consists of a series of stages (Zaimoğlu, 2001).

- Evaluation of the projects,
- Negotiations,
- Contract,
- Monitoring,
- Exit.

The process of obtaining venture capital starts with;

Evaluation of the projects: Entrepreneur should first prepare the executive summary. Executive summary should introduce his business concept, he should explain why his business and products are unique, identify his market, demonstrate an exit plan (everyone would want to know how they will get their money back), and, most importantly, describe his management team and credentials. Strong Management - includes both an inside management team and qualified outside advisors.

If the venture capital firm approves his executive summary, he must be prepared to have a full business plan available. If the firm has to wait a month for it, interest may wane. Business plan shows what people do with money first. Business plan consists of following (www.palo-alto.com);

- Objectives,
- Company location and facilities,
- Company ownership,
- Competitive comparison,
- Market analyses,
- Pricing and sales strategy,
- Management Team,
- Financial plan (Projected cash flow, projected profit and loss)

Assessments: The outcome of the analyses is introduced for mutual negotiations. In the case the results are positive; the conditions to join to the project are determined by him.

Investment Contract: If the parties agree in the terms set by venture capital company, an investment contract, in which the rights and the liabilities are defined, is put into effect. Later, all the way to be followed must be parallel to this contract. While Venture Capital will be represented on the Board of Directors of the invested company and will seek to monitor and participate in any key decisions, it doesn't intend to play an active role in the day-to-day management of the company.

Exit: Venture capital company, leaves the investment when it reaches to the point where the company once projected it is maturity level for venture capital investment, in regard to the exit conditions written in investment contract.

A venture capitalist with funds to invest needs attract a large number of potential entrepreneurs. In USA, approximately 10,000 projects are examined in a year and 50% of them are eliminated in the first stage by venture capital firms. Only a small proportion of the proposals received, 1-2%, might reach completion. A rough guide to the stages at which proposals are rejected is shown below (Coyle, 2000).

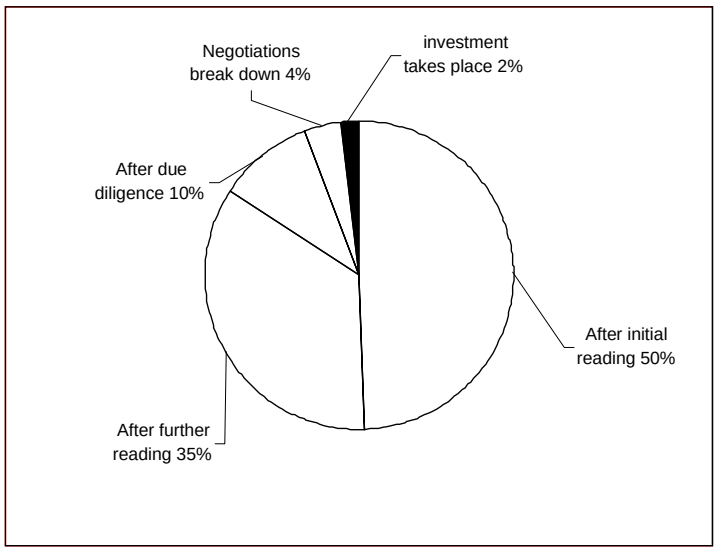


Figure 1: The Stages at Which Proposals are Rejected (%)

The reasons of many companies fail to be attractive targets for venture capital funding are insufficient management, lack of knowledge about preparing to business plans, projections, and assumptions, and failure to demonstrate compelling dynamics of business and non-responsiveness to VC requests (www.messerlikramer.com).

3.2.3. Liquidation of Investment

A venture capital company invests in SMEs with the expectation of a significant return of investment when it exits. The main risk faced by investors and venture capitalists is the risk of not getting their money back. Thus, a viable exit mechanism is extremely important to the development of a venture capital industry.

There are several common exit strategies:

- IPOs: IPO or initial public offering: An IPO is a company's first public stock offering, which takes place when a company goes public by registering its securities with the Securities and Exchange Commission.

According to the researches, 35% of the VC investments made in between 1970 and 1982 went public and 22% was purchased by a firm. 96% of the public offerings and 59% of the purchasing operations helped VC investors earn profits (Barry, 1990)

In the researches about venture capitalists it has been seen that the most preferred way of exiting from the investment is the firm's going public. The value of the investment generally rises as a result of the firm's going public. Stock sales that are to be done later on contribute to the increase in profits of VC companies (Sorabella, 2000).

- Mergers and acquisitions: In an era of large companies dominating industry landscapes, acquisition is often the targeted and most common exit strategy. Smaller companies have, in essence, become the research and development arm of larger companies who often look to buy them once their innovations can contribute to their own profitability.
- Redemption: Another alternative is that the company may be required to buy back a venture capital firm's stock at cost plus a certain premium. Often a venture capital firm will put a redemption clause (sometimes referred to as a "buy-back clause") in the investment terms which allow them to exit their investment in your company in the event that an IPO or acquisition does not happen within a designated time period.

3.3. Sources of Venture Capital

Venture capital is a kind of capital that is risky but looks for projects with high rate of return. Those projects prove new technological investments. Various funds are used in order to reduce the risk which new technological investments have in venture capital investment. Generally, these funds are organized as limited partnerships, with a venture capital firm serving as the general partner who receives a management fee and a percentage of the profits earned on any deal. The limited partners may include institutional investors such as insurance companies or pension funds, as well as corporations or wealthy individuals. Individual investors are generally interested in seed and start-up stage investments. Institutional

investors invest in more than one firm in order to decrease the risk they have (Aypek, 1998).

Main sources of financing of venture capital can be summarized as; individuals, insurance companies, banks, other financial institutions, pension funds, corporate investors and the government. Banks take the first place in maintaining venture capital while pension funds come second and, insurance companies and subsidies rank third (www.evca.com).

3.4. Phases of Venture Capital for Financing SMEs

Venture capital is defined as the most convenient form of financing to innovative SMEs; venture capital companies are not only interested in start-up investments but also in different investment phases defined in VC sector. It is important to examine the implementation stages of the investees' lifecycles.

The phases of VC investment are composed in 6 different phases for financing of SMEs (Akmut, 1990; Coyle, 2000; Zaimoğlu, 2001).

3.4.1. Seeding Phase

Seed capital is used to determine the financing of idea phase. Seed capital is provided in order to produce a new product or a service. In general, the seeding phase can be summarized as the financing of R&D activities.

In this phase entrepreneur has developed an idea, however has not done any technical planning for the idea to realize. In venture capitalist's point of view, this is the riskiest investment type because it is not certainly known whether the project could be applied.

This type of investment necessitates much patience. It is started 2-3 years before the start-up phase and it requires 10-12 years in average in order to be liquidated. It is highly possible that the project proves unsuccessful. Thus, professional venture capitalists rarely prefer this type of investment. According to the statistics 70% of the projects are rejected within the first year by venture capitalists.

3.4.2. Start-up Phase

Start-up phase defines the basis for the venture capital system. It is the phase in which firm gets active after R&D activities. Besides that, it is used for the financing of firms which have been active recently but could not make their products tradable. In this phase, risk is more than in the seeding phase. Business plan that is prepared about the idea of entrepreneur should be carefully examined. Data about the size of the market, growth of the firm and how the firm's management would be should be collected. In this phase venture capitalist helps entrepreneur for the success of the project with his knowledge and skills. Generally, financing of start-up capital investments takes 3 to 5 years.

3.4.3. Expansion Phase

In this phase companies bring their products to the market. The product does not have a great market share and a trademark image that would make it superior in the market. The firm, in this phase, has developed its prototype however needs funds for its production and marketing. There is high competition between the firm and its rivals, and because the profit firm earns is not enough to prove the superiority of its product, it needs additional financing. It is difficult for the firm to obtain funds apart from venture capital under the conditions it experiences because the guarantees are insufficient in order to borrow from the banking system and there is no opportunity for the firm to obtain funds from the capital market. In this phase, firm also have some managerial problems. Those problems can be overcome by the financial and managerial support of the venture capitalist.

3.4.4. Bridge Financing

Bridge financing is provided for the firms that promise to go public in between 6 months and 1 year. If the firm has a good structure for the supply of its stocks, this financing method is used in order to provide the financing it needs to continue its activities until it does public.

3.4.5. MBO/MBI and M&A Phase

This phase is normally provided to more mature companies. This phase comprises entrepreneurs or firms which have knowledge about the work but do not have sufficient financing and that want to purchase the firms which are to be sold with various reasons. It finances changes in the ownership of the investee, necessary to set the basis for further successful development. These are;

- Managers of the firm, (MBO-Management Buy-Out)
- Third party (LBO-Leveraged Buy-Out)
- Managers of another firm (MBI-Management Buy-In)
- Personnel of the firm (ESOP-Employee Stock Ownership Plan)

The most important property of this phase is that the buyers know the subject of the firm they purchase very well.

3.4.6. Turnaround Financing

A company that has been in decline because of various reasons might develop plans for halting the decline and staging a recovery. In the early stage of a recovery program, the original backers will have to provide the extra finance required. First of all, present management team should change. If the recovery appears successful, it will usually be sold to another firm in the same sector. Turnaround financing is comparatively rare.

Under the light of those explanations above, time periods and risk levels of VC financing are displayed in the table below (Zaimoğlu, 2001).

Table 1: Time Periods and Risk Level of VC Investments.

Type of Investment	Time (year)	Risk Level
Seeding Phase	7-10	Very High
Start-up Phase	5-10	Very High
Expansion Stage	3-7	High
Bridge Financing	1-3	Low
Buy-out / Buy-in	1-3	Low-High
Turnaround Financing	3-5	Medium-High

3.5. Institutions Invested in Venture Capital

USA is the country in which VC is most developed. Thus, USA is more than useful an example in examining the institutions that invested in VC. VC investment sources can be examined as (Tuncel, 2000):

- Private independent venture capital partnership,
- Business Development Companies,
- Research and development partnership,
- Corporate VC Subsidiaries,
- Small Business Investment Companies (SBIC),
- Specialty Funds,
- Incubators.

3.5.1. Private Independent Venture Capital Partnership

Tax advantages are the most important reasons of the establishment of VC limited partnerships in USA. VC partnerships consist of a main partner who directs the portfolio and limited partners. General partner is active in management whereas limited partners are passive. Time of investment is generally 5 to 7 years.

The greatest advantage of independent VC partnerships over VC institutions dependent on firms is that they are highly flexible. By their dynamic structures they can compensate their faults and losses in investments more quickly.

3.5.2. Business Development Companies (BDC)

BDCs constitute a mixed type of private VC funds and publicly owned investment firms. Those companies are more advantageous than private partnerships regarding taxation because revenues are not taxed in those companies until they are shared to partners.

They choose sectors with high development potential when they make investments. They are active in the company's management. They can not liquidate their investments until a specific time period. They have the opportunity of growth via going public.

3.5.3. Research and Development Partnership

R&D Partnerships grow fastest in the VC sector. The most important reason of this is that R&D expenditures are dropped out of tax and attractive with the innovations (inventions) that provide great profits. They are usually established as limited partnerships. They are exempt off tax since profit or loss is allocated to partners. It makes them advantageous with reasons such as to benefit from technology by increasing the R&D expenditures, to decrease debt or capital usage for R&D, etc. (Mercan, 201).

According to the economic analyses, it is seen that R&D activities provide benefits to the society more than to the firm. So it is recommended to support small scaled high-tech firms with subsidies. Concerning this, SBIR is the most important program that is put into effect in USA. SBIR provided funds amounted more than 7 billion $ to the small scaled high tech firms, in between 1983 and 1997. Amount of this fund was yearly 100 million $ in 1983 whereas it reached yearly 1.1 billion $ in 1997. Moreover, it has been observed that the firms supported under this program grew faster than their rivals (Lerner, 1999).

3.5.4. Corporate VC Subsidiaries

Corporate VC Subsidiaries are established to diversify the activities of the main firm and to keep up with new technologies in the main firm. They are specialized in VC. They usually choose to invest in firms that show maturity, and if the firm is being successful, they make the investment.

3.5.5. Small Business Investment Companies (SBIC)

SBIC are private financial institutions that provide VC for the small firms with growth potential. They also provide consultancy service to the firms they support financially. They can borrow almost 3 times of their capital (Kaur, 1991). Small Business Administration inspects these investment firms and gives low-interest credits to them.

3.5.6. Specialty Funds

Though main target of private funds is not making VC investment, in some situations they make VC investment. Their main aim is to invest in the re-structuring of firms and benefit from the capital profits afterwards. Constitution of

the fund in private independent fund firms is based on various sources and more than half of the funds are provided from intermediary institutions such as pension funds or insurance companies.

3.5.7. Incubators

Incubators aim at providing an environment for the entrepreneurs directed to technology to improve their technical creativity. They are mostly connected to universities. Apart from providing the entrepreneurs with offices, labs, consultancy, etc. they help them find credits and venture capitalists.

3.6. Advantages and Disadvantages of Venture Capital

Venture capital presents both advantages and disadvantages for concern to SMEs and can be summarize as follows (www.allbusiness.com):

Advantages of venture capital investments for the SMEs are;

• Less risky than bank loans (no collateral, no fixed financial obligations, dividends depend on profits).

• Better asset structure and possibility of accessing additional bank finance.

• Administrative and management support, including improvement of information systems and management procedures.

Disadvantages of venture capital investments for the SMEs are;

• The owner loses his management autonomy.

• New administrative and management methods imply significant changes, which might require training or recruitment of additional staff.

• External control required by the VCF might increase internal bureaucracy.

Advantages of venture capital firms are;

• Possibility of achieving high returns.

• Control of investment through participation in management and better access to information.

Disadvantages of venture capital firms are;

• High risk, exit not certain.

• In the case of SMEs, poor management and accounting procedures limit analysis of the enterprise and the investment potential and risk.

CHAPTER IV

THE EVOLUTION OF VENTURE CAPITAL PRACTICES

4.1. The Evolution of Venture Capital in the World

Venture capital was developed in the late 19th and early 20th centuries while wealthy people had been looking for ways to invest in high-return initiatives in the United States. In an essay written by Paul A. Gompers in 1994, quoted from David Lample's history of Route 128, venture capital region:

> *"The city's (New York) great fortunes, including those of the Vanderbilts, Whitneys, Morgans, and Rockefellers, were based on such ventures as railroads, steel, oil, and banking. Although not all investors were so well known, it was wealthy families such as these that bankrolled Boston's earliest high-tech entrepreneurs. When the young Scot Alexander Graham Bell needed money in 1874 to complete his early experiments on the telephone, for example, Boston attorney Gardiner Green Hubbard and salem leather merchant Thomas Sanders helped out, and later put up the capital to start the Bell Telephone Co. in Boston (Lample, 1989)."*

In 1946, General Georges Doriot, Harward Business School Professor with the help of Ralph E. Flanders, the President Of The Federal Reserve Bank Of Boston, with many academics and business leaders set up American Research and Development (ARD), which had been the first venture capital firm in the United States in Boston (Osama, 2002). The scope of ARD was to finance companies which seek commercial applications of wartime technologies (Callagan, Muegge, 2002). Therefore, Doriot and ARD's staff helped companies increase their chances of success in market by providing them with industry expertise and management experience.

By the end of 1947, ARD had invested in six startups and two existing firms with negative cash flows and lack of profitability, liquidity and capital gains. However, by 1951, 10 companies of ARD firms turned profitable (Osama, 2002). Apart from the institutional characteristic that is gained by ARD, officially not an important single step has been taken until 1958. However, in the same year, the Federal government decided to support small firm actively and studies have been done about the financing of small firms. As a result of those studies, it was determined that short term funds and firm capital requirements of small firms were met by trade banks and "Small Business Administration" (SBA), however their demands for long term funds and equity capital were not met. Thus, "Small Business Investment Act" (SBIA) has been put into effect and with this legislation "Small Business Investment Company" (SBIC) that depends on SBA and aims at profit maximization has been established (Zaimoğlu, 2001).

The formal birth of the venture capital industry realized when the first of the Small Business Investment Companies (SBICs) was organized to encourage the development of venture capital for innovation, about 13 years after ARD's inception (Osama, 2002). The passage of SBIC Act of 1958 allowed the constitution of SBICs under Small Business Administration (SBA). It provided almost limitless federal money for the small companies to be initiated, and by mid 1960s over 700 SBICs were established (Osama, 2002). Because most of the SBICs managers and analysts had little industry expertise, professional information could not be povided for entrepreneurs. A great number of firms ended their activities because of lack of capital. And the number of small firms fell below 300 in the late 1960s (Zaimoğlu, 2001). SBICs had played an important role in the development of VC sector even though they could not be as successful as expected in the beginning. Although venture funds established under SBICs failed, they trained many venture capitalists and investment managers and helped venture lawyers, accountants, consultants critical to the venture capital industry to emerge (Osama, 2002).

The growth was rapid both in America, the origins of venture capital, and in UK. The UK have tried to form their own venture capital industries after the United States. This section explain with important legislative amendments and important

institutions and projects that were significant in the development of venture capital in the U.S. and UK.

4.1.1. United States of America

Venture capital had been a small industry until 1980s. In 1969, the newly established venture capital partnership raised a record $171 million. In 1980-82, for instance, venture capital commitments totaled more than $3.5 billion with a peak in 1987 at $17.8 billion (Osama, 2002).

Important legislative amendments:

The flow of venture capital was affected by the change of two important legislations. The first was The Tax Reform Act of 1978, which reduced the capital gains tax rate from 49.5% to 28 % in the US. The second was the change of "prudent man" role in the provision of ERISA which allowed pension funds to invest in venture capital in 1979 (Gompers ,1994).

Money flowing into venture capital industry increased impresively, by the fall in the capital gains tax during in 1980. However, decrease in the capital gains tax rate had a little effect on the flow of money into venture capital. A further capital gains tax reduction in 1981 resulted in the growth of total venture capital fund-raising from $961.4 million in 1980 to $5.1 billion in 1983. In 1986 with Tax Reform amount of money flowed into venture capital raised from $4.5 to $4.9 billion. If the investments in venture capital were affected by capital gains tax rate, amount of money flowed into venture capital should have declined after the 1986 tax changes (Gompers ,1994).

Another important legislation in 1979 that influenced supply of venture capital was the change of "prudent man" role in the provision of ERISA which allowed pension funds to invest in venture capital. Before 1979 the Employee Retirement Income Security Act of 1974 had forbidden pension funds from investing in venture capital or high risk initiatives. However, by Department of Labour's decision pension managers were allowed to invest in small and risky companies, including venture capital (Gompers ,1994).

This change created enormous capital movement. At the end of 1980s pension funds controlled more than $3 trillion. However, because pension funds managers

considered VC as an easy way of profit without understanding the risk factors well, they made investments hastily. Almost half of VC funds were provided by pension funds, in other words VC was institutionalized and this had bad effects. According to the results of the investigations of some economists about this issue, money that was invested in VC and considered as short term investment effected the structure of VC worst. While these changes may have been important for growth of venture capital investment in that time, in the long term it was observed that the change of "prudent man" role benefited more compared to the reduction in the capital gains tax rate (Gompers ,1994).

According to the data of American Venture Capital Association NVCA, in 1999 venture capital investments totaled 35.3 billion $ while in the first half of 2000 VC investments totaled 37.5 billion $. In the second quarter of 2000 software sector ruled in terms of amount of transactions while semi-conductor and electronics sector ruled in terms of amount of investments. Although VC investments increased in the second quarter of 2000, total VC investment fell 6% of the previous period. This fall proves an important reason of why internet firms could not show the expected performance. While VC investments to internet firms decrease, sanitary and biotechnology sectors started to attract investors in the same period. VC investments to sanitary and biotechnological sectors increased 32% and amounted 1.6 billion $. Today, VC has an utmost importance in the leadership of America in computing and electronics sectors.

Table 2: The Development of Venture Capital Investments in USA between 1992 and 2002

Year	The Number of Firms	The Number of Invested in Firms	The Total Amount of Investments (million $)
1992	1108	1484	4163.0
1993	993	1269	4012.2
1994	1018	1284	4091.6
1995	1633	1986	7785.1
1996	2199	2754	12025.7
1997	2673	3336	16704.2
1998	3613	4345	22210.3
1999	4611	5824	56465.6
2000	6599	8405	108754.8
2001	4005	4932	42910.6
2002	1535	1645	12122.6

Source: NVCA, www.nvca.com. 2000

As it is also seen in Table 2, VC investments increased with acceleration until 2001 in America while in 2001 and 2002 they decreased because the incredibility of capital markets diminished the success of public offerings and possibilities.

4.1.2. EUROPE

Although VC sector occurred in Europe in 1950s, development of the sector started in 1980s and today activities of this sector continue with acceleration. In the establishment of many firms with European origins such as Baan, Barco, Business Objects, Denby Pottery, Filofax, Gemplus, Lernout and Hauspie, Natuzzi, Parker Pen, Salomon, Uniface and Zodiac, VC played a significant role.

Important institutions and projects that were significant in the development of VC in Europe are;

- Institution of 3Is (**I**nvestment **I**n **I**ndustries-1945): It was established, following the World War II, in order to create employment, provide technological production and innovation in industrial and trade sector.
- Loan Guarantee System (LGS-1981): Today government supports small firms with loans that amount maximum £75,000 by getting a guarantee of 70% of the loan.
- British Venture Capital Association (BVCA-1983): Ideas about VC are shared and demands are directed to the regulatory institutions of VC, standards for the VC applications are created and improved via regular meetings. The British Venture Capital Association was established in 1983 with 34 founding members and by the end of the decade its number of members had exceeded 120. Its current membership comprises 155 full members (BVCA 2002b).
- European Venture Capital Association (EVCA): Project that was prepared and put into effect in 1985 aims at encouraging the development of SMEs in Europe by creating international VC unions.
- Business Expansion System (BES): According to this system, investors who buy stocks of both old and newly established firms are exempt off income tax to a limit of £40,000 yearly.

Data below are important in order to understand the level of VC sector today in Europe (EVCA, 2000):

- Total amount of VC investments since the first half of 1980s exceeded 125 billion ECU.
- In 1999 for more than 11.000 investments 25.1 billion $ amount of source was transferred.
- 41% of the investments were used to finance the expansion.
- In 1999 technology investments increased 94% and reached to 26% of total investments.
- Start up capital investments made in 1999 increased 89% of the previous year.

- In the 1991-1995 period, supported with VC;
  - Sales of firms increased 35% in average and doubled the sales growth of the biggest 500 firms in Europe
  - Employment of firms increased 15% yearly but rose 2% in the biggest firms of Europe.
  - R&D expenditures of firms were around 8.6% of the sales whereas R&D expenditures of big firms were around 1.3%.
  - Exports of firms increased 30% in average yearly.

When VC sector is investigated in terms of technology and start up investments, the results below are deduced:

- There is an increase in start up investments made to high technology firms in Europe in recent years.
- Almost 26% of the total investments made by European venture capitalists realized in technology field.

Three fourth of the VC firms in the sector made their first investments after 1989. In other words, actual development of the sector happened in the 1990s. During the period, VC investments were realized as financing of growth-development at 39%, financing of purchases at 35% and financing of start-up stage at 26%.

One third of the firms invested in benefited from more than one VC investment. The reason of this is the growth of firms and their need for additional financing. 47% of the firms in start-up stages required additional capital and worked with more than one venture capitalist. This percentage is 34% in the expansion stage firms.

4.2. The Evolution of Venture Capital in Turkey

4.2.1. Importance and Problems of SMEs in Turkey

SMEs have an important role in maintaining both social and economic stability in Turkey. This can be shown by 3 main indicators (www.kobinet.org.tr):

-Number of businesses; 99.5% of the firms that are active in manufacturing industry are SMEs.

-Number of employees; 59.8% of the employees who work in manufacturing industry are employed by SMEs.

-Value added; 28.6% is the share of SMEs in the total value added.

Characteristics of SMEs whose importance is mentioned above are as follows: SMEs are generally admitted to be the primary source of economic growth. They have a vibrant entrepreneurial spirit, flexibility, adaptability and potential to rapidly react to new challenges and opportunities. SMEs have a crucial role in the creation of wealth and employment. SMEs also play a major role in technological development and innovativeness. SMEs are well-known to upgrade the level of human capital and skills with their flexibility and innovativeness. A strong SME sector may also bring more flexibility to the society and contribute to a better resource allocation, through high competition. New business development is a key factor for the success of regional development.

Besides, although SMEs are less affected by the economic fluctuations, they may face with problems sourced by the high inflation and frequent economic crises in the country. Main problems can be summarized as follows:

-Financing Problems: SMEs have difficulties in taking bank credits and they can have around 4% share of bank credits (Kobinet, 2004). The most important problem that SMEs experience when taking credits is the guarantee demand of banks. Banks do no accept the machines, equipment firms own as guarantee, and they demand for property as guarantee. However, entrepreneurs prefer to make their investments on their businesses and not on property. This attitude of banks leaves entrepreneurs with little choice. It can be stated that the banks' behavior causes the credit to be given to the property and not to the entrepreneurs with ideas.

KGF, whose importance is perceived in Turkey in recent years, fills this gap and proves a guarantor for the firms to assure credits. Therefore, with this application firms can assure the amount of credit which they demand from the banks.

In addition to this, they do not have financial discipline since they do not have finance experts. Therefore, most small firms are worried about growth process, keep their business in small size and can not utilize the opportunities effectively.

According to the studies about the problems of SMEs in manufacturing industry, interest rates, high and continuous inflation, economic instability prove the most important problems. As a result of a survey conducted by Istanbul Chamber of Industry; 50.8% of medium sized enterprises complain about the cost of credits and 41.4% complain about the increase in the need of business capital and not being able to meet this need (ISO, 2001).

-Bureaucratic Problems: Managers of SMEs face difficulties because of the majority and complexity of bureaucratic processes. They spend most of their time by being occupied with those processes since they do not have enough specialists and this affects the enterprises negatively.

-Problems of Harmonization with Conditions of Customs Union: It is inevitable that within the Customs Union process Turkish SMEs have difficulties. They are to compete with European SMEs which are superior in technology. SMEs in Turkey can not follow domestic and foreign technical and trade developments because they have scarce qualified staff and their technology level is low.

4.2.2. Supports Provided For SMEs in Turkey

Policy makers have recognized the importance of SMEs sector for economic growth and designed specific institutional frameworks and incentive structurers especially targeted towards SMEs and aiming their expansion with such as financing, training, consultancy, marketing, export and technology development supports.

4.2.2.1. Incentives Provided for SMEs in Turkey

In Turkey, the importance of small and medium sized enterprises for the economy was realized at the beginning of 1990's. In the mid 1990's, with the ratification of Association Council Decision No. 1/95, Customs Union with the European Union

has been established as of January 1st 1996. In order to help survival and competitiveness of the Turkish SMEs in the Customs Union, design of new support mechanisms seemed necessary at that time.

Currently, the investments of small and medium sized enterprises are supported with “Decree for State Aids in Investments of SMEs’” (published on the Official Gazette dated at 18.01.2001 and No: 24291). The Decree Concerning State Encouragements to Investments provides a base for “Aids Granted to Small and Medium Sized Enterprises’ (SMEs) Investments”.

In line with the development plans and annual programs, the related legislation aims to:

- Encourage the investments of SMEs,
- increase production and improve quality standards,
- supply the demands in relation to the product development,
- increase employment,
- bring about a level competition within the Customs Union

The investments of SMEs benefit from the following encouragement elements (www.hazine.gov.tr):

a. Exemption from Customs Duties: For the investment projects which are evaluated and found eligible by the Undersecretariat of Treasury, imports of the machinery and equipment to be used in the production process shall be subject to Customs Duty exemption. Once the exemption is listed on the "Certificate", the investor can import the machinery and equipment indicated on the approved list, namely the "Machinery and Equipment List" aiming only at the purposes of the investment in question, without paying any customs duties.

b. Value Added Tax Exemption for imported and domestically purchased machinery and equipment: Pursuant to the Law No:4369 and date: 22/7/1998, imports and domestic purchases of machinery and equipment within the scope of approved machinery and equipment lists attached to the investment encouragement certificate are exempted from the Value Added Tax.

c. Credit allocation from the Budget: Credit can be allocated in order to guide and encourage the investments aiming at regional development, research and

development (R&D) investments, environmental protection investments, investments in priority technology areas which are to be determined by Higher Science and Technology Board or Scientific and Technical Research Council, investments to be moved to provinces specified for regional development and investments to be moved to priority development regions and other organized zones from developed regions and manufacturing, agro-industry and mining investments to be realized in the priority development regions in compliance with the legislation on State Encouragements to Investments.

The limit for the investment credits aiming at regional development is 30% of the fixed investment cost and also shall not exceed 4.5 Trillion TL. For research and development investments, environmental protection investments, priority technology investments and investments to be moved to organized industrial zones, the limit for the credit is 50% of the fixed investment cost and shall not exceed 400 Billion TL.

The export incentives system and the legislation are implemented by Foreign Trade Undersecretary. The various support factors are provided entrepreneurs in order to increase export activities. Supporting instruments consist of tax exemption, tax refund, import exemption, and equivalent goods.

4.2.2.2. Technology Development Support

It is aimed that coordinated by KOSGEB universities and SMEs create a common platform for R&D together. Integration of brain power, scientific researches, usage of technology and infrastructure that universities represent with entrepreneurial, innovative and creative production power that SMEs represent provided SMEs with technological opportunities they require.

In this regard, TEKMER units have been established in many universities in big cities of Turkey. Various institutions have participated in providing financial and incentive supports and technological aid for SMEs within the framework of cooperation between KOSGEB and universities. Some of those institutions are TÜBİTAK, DTM, TTGV, etc…

Those supports are:

Place: Secretary services like location, facsimile, internet, copy, etc and opportunities like benefiting from the libraries of universities are provided for the innovative firms which target development of a new product or a new production method.

Supplies and Equipment: Equipment supports are provided for the enterprises that are in TEKMER for general and private purposes.

Consulting Services: University staff is benefited as consultants in the fields of financing, marketing, etc. for the success of the project.

Participating in International and Domestic Fairs: Rent of stand for the prototype manufacture of the firm which benefited from R&D iactivities in order to be exhibited and be commerced in international and domestic fairs.

International Exhibitions Visiting: Transportation and accommodation supports are provided for the personnel of a firm which benefited from R&D activities in order to visit international fairs to investigate the possibility of high technology and country's adaptation to it.

Supply of Software and Publications: Regarding R&D, for the requirement of international and domestic publications, softwares, etc. of the firm which benefited from R&D activities supports are provided.

Publication of R&D Results: When R&D results of the firm which benefited from R&D activities are published as books, documents, etc., supports are provided.

Promotion: When the firm which benefited from R&D activities completes its prototype manufacturing for the marketing of the product supports are provided for the catalogue, booklet, etc. expenses.

Employment: When the firm which benefited from R&D activities employ personnel who are trained in technical, marketing, export, management or financing fields, regarding the project, supports are provided.

Training: Concerning the project for domestic training program for the personnel working on the project in technical, marketing, export, management or financing fields, supports are provided within the framework of KOSGEB Eğitim Hizmetleri Yönetmeliği.

4.2.2.3. Credit Guarantee Fund

The main objective of the Credit Guarantee Fund (KGF) is creating additional bank credit financing for Small and Medium Size Enterprises (SME's), the financing which is not attainable for them because of the additional collateral requirements, and consequently increasing the credit usage in general, in the economy. In this system KGF acts as an intermediary organization and makes it possible for the SME'S with the inadequate collaterals to apply for bank credits, also increase the number of customers for the banks and minimize their risks (www. kgf.com.tr).

In order to realize this application Credit Guarantee Fund Operating and Research J.S.C in Turkey has been established with the partnership of TESK (Confederation of Tradesmen &Craftsmen), TOBB (Union of Chambers of commerce &Industry), MEKSA (Foundation for the Promotion of Vocational Training &Small Industry) and TOSYÖV (Foundation of Small and Medium Business) in 1991 and then KOSGEB and Halk Bank have joined this partnership. The establishment has started to provide credit security since 1994. Today, it assures guarantee for the credits that Halk Bank, Garanti Bank, Vakıflar Bank, Şekerbank, Yapı Kredi Bank and Tekstilbank give to the SMEs. The credit guarantee fund that KGF undertakes has been constituted by German Technical Cooperation Institution (GTZ-The Deutsche Gesellschaft für Technische Zusammenarbeit) and KOSGEB (Public Organization for Promotion of SMEs).

Today, KGF provides guarantees for the credits opened to the SME's by the following banks (2004 Annual Report, KGF):

- T. Halk Bank A.Ş.
- T.Garanti Bank A.Ş.
- Şekerbank T. A.Ş.
- T. Vakıflar Bank A.Ş.
- Yapı ve Kredi Bank A.Ş.
- Tekstil Bank A.Ş.
- Albaraka Türk Special Finance Coorperation

Based on the company status, KGF does not pay profit to its shareholders as dividend bur transfers any such amounth to the liability fund, as a result, KGF is exempt from corporation tax. With a further legal arrangement in 2003, KGF is also made exempt from VAT and stamp duty (2004 Annual Report, KGF). Guarantees are given for all kinds of credit needs of an enterprise and there is no limitation on the type of credits. It may be a long term investment credit, cash or non-cash credit in the form of letter of credit or a bank guarantee.Enterprise with less than 250 employees all over Turkey may apply for credit guarantees. Applications from all economic sectors; services and mining, alongside manufacturing industry are accepted. All tared and industry projects are being supported by KGF. All cases of project financing such as founding a new enterprise, improving current plant, providing raw material or guarantee letter may be financed by use of KGF guarantee. KGF guarantee is an important security in long term credits where high collateral is demanded. KGF accepts a maximum of 8 years of credit terms. Short-term credit guarantees are for 2 years with rotational use. The maximum amount of guarantee is about 400.000.-AVRO and maximum 80% of the credit id guaranteed by KGF. Credits exceeding 200.00.- AVRO can receive a maximum guarantee of 70% (www.kgf.com.tr).

Table 3: Granted Guarantees & Loan Amounts On a Yearly Basis

YEARS	2001	2002	2003	2004
NUMBER OF GUARANTEES GRANTED	54	93	172	253
AMOUNTH OF GUARANTEES (Thousand YTL)	2,200	5,200	14,100	28,200
AMOUNTH OF GUARANTEES (Thousand EURO)	2,600	3,400	8,400	15,800
AMOUNTH OF LOANS (Thousand YTL)	3,100	6,900	19,200	42,100
AMOUNTH OF LOANS (Thousand EURO)	3,600	4,500	11,400	23,600

There has been substantial increase in the guarantees granted in 2004 compared to the previous year, based on the recent years' successfully implemented economic programs and stability achieved in the economy, including an increase in the private sector investment in 2004. Banks increased interest and acceptance of the credit guarantee implementations has an impact on this achievement. According to KGF's 2004 annual report, by the end of 2004, the cumulative number of guarantees granted by KGF has reached to 1504 in number and 60.5 million YTL. in amount. KGF's guarantee risk, at the end of 2004 is 40,3 million YTL for 418 credits. Guarantee risk has been increased by 32% in terms of number of guarantees and 105% in terms of volume, compared to the 2004 figures (2004 Annual Report, KGF).

KGF granted its first guarantee on the 1st July 1994 and as of 30. 06. 2004 the stasistics of KGF are as follows:

- 803 firms have used KGF guarantees and the total amount of loans covered was Euro 78 million.
- The number of granted guarantees is 1396 in number and the total amount of guarantees is Euro 57 million.

- The outstanding guarantees are 401 in number and Euro 19.5 million in amount.

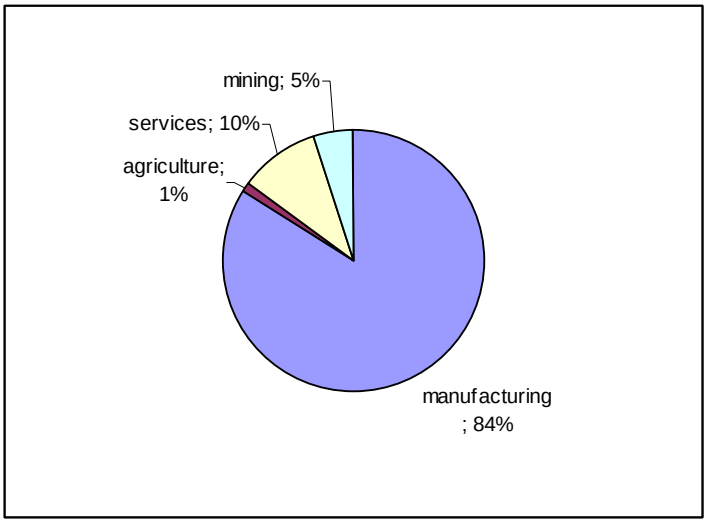


Figure 2: Sectoral Distribution of Guarantees

In 2004, 84% of KGF's guarantees were granted for manufacturing sector, 10% for services and 5% for mining sectors. 2004 a firm from agriculture has been granted a guarantee as the first time. Compared to the previous years' portions, there is a decrease in the percentage of guarantees received by the manufacturing sector.

For a successful result in guarantee application, the project should be feasible and have potential to make profits in the future. Together with this, the management ability and credibility of the partners are also considered with priority. In project financing, a certain portion of own capital is also (2004 Annual Report, KGF).

According to KGF's 2004 annual report, 216 guarantees were granted for existing firms in the amount of 24.646.000.-YTL. and 37 were used bu start-ups in the amounth of 3.548.000.-YTL. In 2004 credit guarantees were used mostly small companies, employing 10-49 employees. Credit guarantees were used by 113 small companies, by 97 micro companies and 43 medium size companies in 2004.

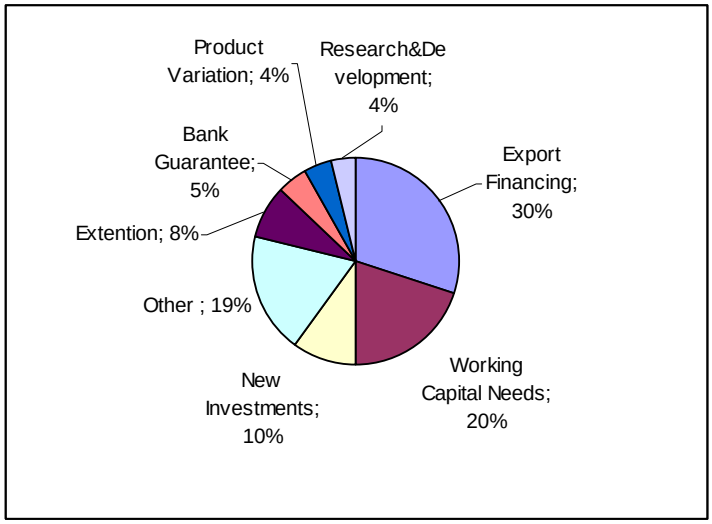


Figure 3: Financial Objectives

When guarantees are analyzed on the basis of financial objectives; export finance credits are on the first place with 30%, working capital needs on the second place with 20%, followed by complete new investments and extension investments with 10% and 8% respectively.

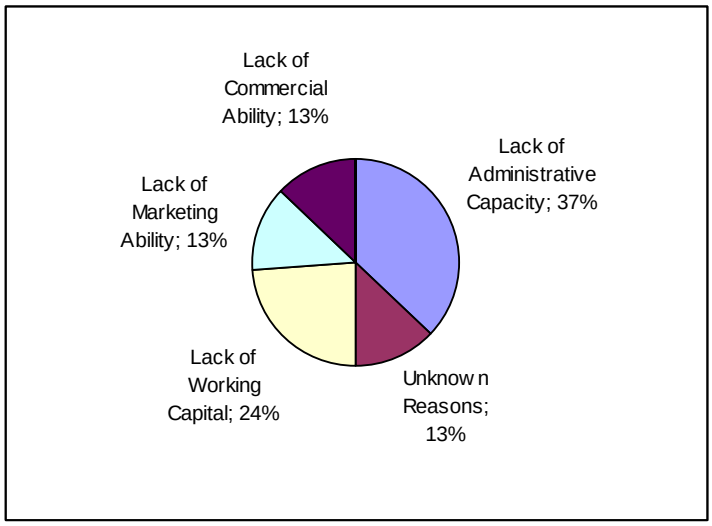


Figure 4: The Major Causes of Defaults

The major causes of defaults for companies that were not able to fulfill their payment obligations for the credits they used were lack of administrative capacity, working capital deficit and lack of commercial ability.

Dr. İrfan Yazman who is the President of the board in the message in the 2004 Annual Report, the credit guarantee funds in Europe, whether they belong to private or public sector, always received a very strong support from the governments. 50% of the KGF's risk under "State aids for small and medium size enterprise investments" scheme is shared by the Treasury under the same legislation. In 2004 KGF has been examined by the European Investment Funf (EIF), which is an agency of the European Union established to support the credit guarantee funds in the EU member states and the accession countries. EIF, recognizing KGF as an institution serving all over the country, with a potential for growth and with a dynamic structure, decided to support KGF with its counter-guarantee facilities. An agreement has been signed with EIF on 18th November 2004, according to which, EIF supports KGF operations with a counter-guarantee, up to 50%, which is an important support for KGF, since EIF is an institution with credit rating of AAA/Aaa in the international financial markets.

4.3. Development of Venture Capital in Turkey

Venture capital is taken into consideration since 1980 in Turkey. The first systematic action taken for venture capital was on January 5th, 1986. a circular was published by Employment Development Coordination Council, in order to support the small enterprises and entrepreneurs. This council established the Entrepreneur Support Agency (ESA), to form the basis of a venture capital system. The aim of ESA was to give support for small enterprises in the way of helping them in management, technical fields for their improvements.

The financial support for these enterprises was thought in the concept of venture capital. That is to encourage enterprises to work in new technological fields should be financially supported. In this way, new technologies and small enterprises would be supported because of they can not use bank credits efficiently.

In July 6th, 1993 a declaration was published in the name of Facts Related to The Venture Capital Partners. In 1998 only new technology projects took place in the

content of venture capital, while in 2000 partnerships with growth potential and source requirements were included as well.

In this section important institutions in the development of venture capital and venture capital firms and investments in Turkey are explained.

4.3.1. Important Institutions in the Development of Venture Capital

As it is emphasized mentioned in the previous chapter, venture capital is a long term investment and the venture capitalist should accept this fact. Thus, in the developing countries like Turkey, venture capital sector should be supported by government. It is also important that management and access to finance abilty of entrepreneurs should be improvement as well as their technological capacity. Important institutions in the development of venture capital in Turkey are (Aypek, 1998):

Agency of Supporting Enterprises (TDA)

The first important development is the establishment of an institution to increase employment by the state in order to provide support for SMEs (1988). One of the activities of this institution is establishment of TDA and venture capital system. TDA provides SMEs with the supports such as:

- Financial support
- Market research support
- Training support
- Qualified staff support
- Technical support

Economic instability in Turkey brought to an end of the efforts of TDA and venture capital in that period. However, with the development of venture capital being put in the state's program in 1992 the sector re-accelerated.

Technology Development Project

Within the framework of technology development project that is carried out by World Bank and Turkish Government, establishment of a venture capital firm in Turkey has been envisaged. Main goals of the envisaged venture capital firm are;

- Providing high rate of return for venture capitalists
- Providing capital for the firms which are in start up or expansion stages with high growth potential.
- Providing credits for the technology intensive projects of the firms
- Incresing the competitive power in fields of technology and export of SMEs in Turkey.

KOSGEB

According to definition of KOSGEB, while enterprises with 49 or less employees are regarded as small, enterprises which have employees between 50 and 149 are called medium sized enterprises.

KOSGEB is established in order to develop and support the mechanisms which would increase the SMEs' competitive capacity both in national and international markets, to disseminate appropriate information to SMEs, to provide new job opportunities in the market and technology oriented, high value added production fields, and to encourage enterpreneurship and to realize all of the above mentioned activities in accordance with the previously determined program targets and planned priorities (www.kosgeb.gov.tr).

Enterprise development centers, laboratories, technology development centers, etc. are established under KOSGEB in order to achieve its goals and activities. These centers play an important role in strengthening SMEs, increasing employment and qualified persons, R&D activities, etc.

Technology Development Foundation of Turkey (TTGV)

TTGV has an encouraging role in the establishment of venture capital and targets contributing to the constitution of venture capital fund towards high technology industry. Thus, seminars are organized in order to raise the awareness of entrepreneurs about venture capital.

4.3.2. Venture Capital Firms in Turkey and Investments

In 1993 some regulations were made in order to encourage VC and most banks of the period established VC partnerships to benefit from this opportunity. All but Vakıf Venture Capital were failed. Vakıf Venture Capital is the first VC company in Turkey which is established in 1996 with stated capital totaled 2 trillion TLs.

Vakif Girisim Venture Capital Co. has been established with a majority stake by a leading Vakıflar Bankası in 1996 as the first and the sole Venture Capital firm of Turkey until the third quarter of 2000. Company's paid up capital is 900 billion TL with a registered capital of 2 trillion TL . Its first investment is Teknoplazma A.Ş. and second investment is İnova Biotechnology A.Ş. Their third investment has been realized as a purchase of some stocks of Ortadoğu Software Services A.Ş. that is Turkey's first internet service provider (ISS) and that shows activity with TR.NET brand (www.vakifgirisim.com.tr).

Following this, having begun operational work in assessing investment projects in 2001 under of İşbank Group, Is Venture Capital, which paid-in capital is 22.5 Trillion TRL, has entered a relationship with enterprises that comprise 1.1% of the applicants so far. Assistant General Manager of Is Venture Capital, Murat Özgen, who draws attention that venture capital system is new in Turkey and not known enough adds; "*The system has not been adopted yet.*" (www.isgirisim.com.tr).

Together with the projects being usually domestic, Esas Holding is also open to any kinds of projects and does not look for any minimum or maximum investment criteria in the projects. Having invested into the pioneer and first mover companies during the first years of it's establishment Esas Holding today also develops and implements it is own project in prospective sectors (www.esas.com.tr).

In addition these, Burhan Karaçam Partnersip, Crea-World, and Superonline etc. are established in order to finance innovative projects of entrepreneurs. VC model is vital in Turkey. Existence of entrepreneurship and capital market in Turkey comprise the most two important factors of VC. The point is to joint these two factors with the help of required regulations. The most significant problem of Turkey in terms of VC regarding its existence and permanence in the country is economic and political instability. There are two reasons of why VC could not develop in Turkey: One of them is that investors are not interested in long term investment because of economic and political instability. The second and the last

reason is that subsidies could not be provided sufficiently. When the practices in Turkey are observed, it is clearly seen that subsidies have a vital role in the development of VC.

CHAPTER V

ANALYSIS OF VENTURE CAPITAL FINANCE AND SMEs

This thesis aims to reveal how SMEs could use VC system more effectively. VC system helps to solve financial problems at different investment stages of SMEs and to improve the technological capacity of them. However, strengthening of the effectiveness of VC system within SMEs in Turkey has various parameters such as financial situation of SMEs, innovativeness of projects and SMEs unawareness with regard to how the VC system works and advantages of this system as well.

In order to understand why investments of venture capital firms are limited in volume and in number in SMEs in Turkey, an analysis which covers the above-mentioned parameters was carried out. The analysis consists of two parts. The first part, namely Part I, is based on the SME survey with the participation of 100 SMEs located in OSTIM Industrial Zone in Ankara, the capital city of Turkey. The second part of the study, namely Part II, is based on face to face interviews with the investment specialists of Is Venture Capital Investment Trust in Istanbul, Esas Holding J.S.C. in Istanbul and with the general manager of Vakif Girisim Venture Capital Co. in Ankara, which are 3 important venture capital firms active in Turkey.

These two studies (Part I and Part II) are vitally important to bring the major problems of both SMEs and VC sector into light and then to suggest policy options to increase the investments of venture capital firms in Turkey.

5.1. PART I- OSTIM Industrial Zone Survey

5.1.1. The Data

Part I aims to explain the situation of SMEs in Turkey by focusing on their general characteristics, sources of funds in start-up and expansion stages of their firms, rate of participation in supporting programs, and the level of awareness with regard to venture capital financing method and KGF in particular.

While determining the sample in Part I, particular attention was paid to the necessity that the chosen sample is truly representing the SMEs character in Ankara, which is one of the most industrialized cities of Turkey. It is important to emphasize that OSTIM is considered to be a representative sample region for SMEs in terms of their economic and technological capabilities with the rate of 90 % fullness in Ankara, as well as being the biggest SME center in Turkey.

The questionnaire[1] is conducted with 100 SMEs which are chosen randomly. The analysis is carried out by using SPSS 11.0 software.
The enterprises are classified in 7 main sectors[2], which are manufacturing, services, electricity-gas, construction, agriculture, fishing and mining sectors.
As it is seen in Table 4; amongst all enterprises, 75% of them are active in the manufacturing sector whereas 20% of them are in the services sector.

Table 4: The Sectors of SMEs (%) (n=100)

Manufacturing	75
Services	20
Electricity-Gas	1
Construction	2
Mining	2
Agriculture	0
Fishing	0

[1] See Appendix A for the format of the questionnaire.
[2]Enterprises identified in The International Economic Activity Classification List are given in Appendix B (www.tubitak.org.tr).

The operating areas of these firms generally are;

-spare part manufacturing
-metal industry
-vehicle equipment manufacturing
-automobile services
-electronics and computing services.

While determining the size of the organization, the definition of KOSGEB is taken into consideration. In this definition while the enterprises with 49 or less employees are regarded as small, the enterprises which have employees between 50 and 149 are called medium sized enterprises. Amongst all enterprises surveyed, 82% of them are small and 18% of them are medium enterprises.

The questionnaire consists of 5 sections and 28 questions.
In the first section, in order to reveal the general characteristics of the SMEs, there are questions about the operating areas, start-up and current capital of the firm, the number of people employed in the firm, whether there is a financial department, whether the firm has had consultancy service, the level of production technology and how the entrepreneur decided to invest within the sector.

In the second section, distribution of sources of funds that are used by SMEs in the start-up period and when they have financial difficulties are explained.

In the third section, the relationship between the entrepreneurs and the institutions that support SMEs, the usage rate of incentives and other encouragements, and the reasons why firms do not use supports are examined, and their knowledge about venture capital and credit guarantee system is evaluated.

In the fourth section, it is revealed whether the investor plans to make a new investment in the next 2 years. And in this part, the new investment' sources of funds are investigated.

In the last section, the expectations of entrepreneurs about the integration with the EU are analyzed.

5.1.2. Results of OSTIM Industrial Zone Survey

Section 1: The General Characteristics of SMEs

Table 5: Distribution of Establishment and Current Capital of the Firms

Distribution of capital (thousand YTLs)	Establishment capital (%) (n=94)	Current capital (%) (n=96)
up to 5	58.5	3.1
5-25	19.2	17.7
25-100	13.8	35.4
100-250	4.3	23
250+	4.3	19.8

As it can be observed in Table 5, firms are generally established with a low capital. Amongst all firms, 58.5% of them are established with capital that is less than 5 thousand YTLs, but currently 35.4% of all firms have capital that is in between 25-100 thousand YTLs., which leads us to think that most of the firms add their profits to their capital and that there are firms which raised their capital in average from 5 to 20 fold, even 50 fold and more.

Table 6: Whether the Firm is Owner-Manager Firm (%) (n=99)

The owner of the firm is the manager in the firm	93.9
The owner of the firm is not the manager in the firm	6.1

Table 6 reflects the general structure of the SMEs, which is nearly in all the firms the owner-manager firms. Although this provides SMEs with advantages like making quick decisions, it causes firms to have narrow vision and a lack of professional management.

Table 7: Whether There is a Finance Department in the Firm (%) (n=100)

There is a finance department in the firm	36
There is not a finance department in the firm	64

As it is seen from Table 7, while 36% of the firms stated that they have a finance department, the rest of the firms stated that they do not have such department. However, during the interview with the entrepreneurs it is come out that some entrepreneurs get confused financial department with accounting department.

Table 8: Fields of Consultancy Services Firms Have (%) (n=129)

No consultancy services	34
Personnel management	2.3
Accounting	9.3
Research & Development	9.3
Marketing	10.8
Production	8.5
Public relations	2.3
Subsidies	4.6
CE, ISO	18.9

As it can be seen from Table 8, an important finding is that 34% all the entrepreneurs are not interested in receiving the consulting services. Consulting services are important to SMEs that needs professional support. During the survey, it is revealed that most of the enterprises need consultancy, but do not apply for the available services, because of consulting services are considered as additional costs by the enterprises which already have financial difficulties. However, it is difficult to maintain a stable growth without consultancy services in nowadays. It is also

seen from Table 8, 18.9% of the firms consider some standards like ISO[3] (International Organization for Standardization) and CE[4] (Communeautee Eurapannes), which lead us to think that and they consider technical standards important in their production and distribution. Moreover, the entrepreneurs became more aware of additional areas that are important for their development: marketing, accounting and research & development. Research & Development and marketing are very important issues in terms of SMEs' improvement of innovativeness and competitiveness in national and international markets.

Table 9: The Level of the Production Technology of the Firms (%) (n=82)

The firm uses the latest technology.	23.2
The technology the firm uses is more or less new.	58.5
The technology the firm uses is old.	13.4
The technology the firm uses is very old.	4.9

The data show that most of the firms really follow the technological advances. As it can be observed from Table 9, 81.7 % of the firms use latest or almost new technology, which leads us to think that entrepreneurs do not answer this questions objectively.

Table 10: Determining the Investment Subject (%) (n=98)

The entrepreneur made feasibility-market research	11.2
The entrepreneur has some other investments on the same subject	9.2
The entrepreneur assume the subject is profitable	11.2
Former work experience	44.9
The entrepreneur took over his father's firm, he maintains the same subject	23.5

[3] A worldwide federation of national standards bodies that develops international standards (www.iso.org).
[4] A mark that is affixed to a product to designate that it is in full compliance with all applicable European Union legal requirements.

As it can be observed from the Table 10, most of the investment subjects are the same as in the entrepreneur's former work experience. This causes an emerging of a great number of firms which have the same production subject. Therefore, costs of investment increase and SMEs can not grow. Furthermore, entrepreneurs maintain the same subject as their fathers. This reflects the general structure of SMEs. Some entrepreneurs determined on subjects that seem profitable and some made market research before determining their investment subjects. Entrepreneurs mostly prefer the ones they already know.

Section 2: Sources of Funds Financing SMEs in Start-Up Period and Financial Problems

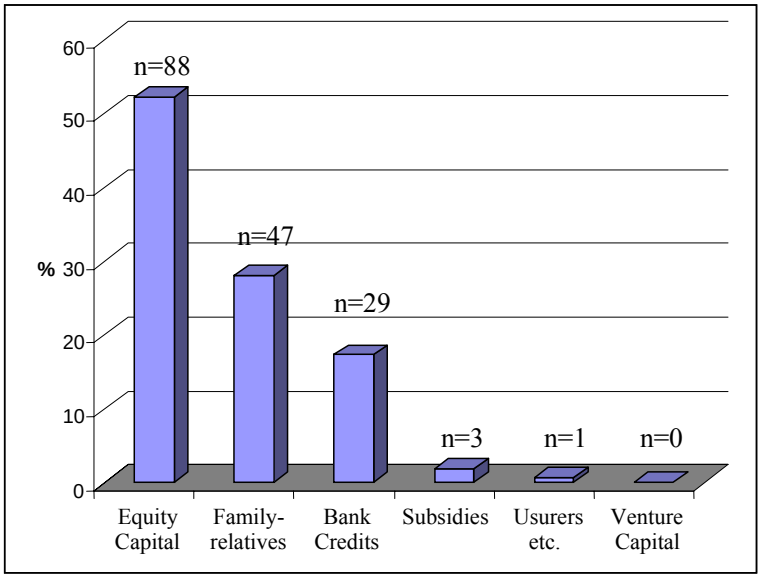


Figure 5: Distribution of Sources of the Firms Obtaining Capital in Start-Up Period (%) (n=168)

It can be observed from Figure 5 that there are three main sources of firms obtaining capital at start-up period. Equity capital is the main source of entrepreneurs at the establishment of their firms since many entrepreneurs can not make investment because of using other sources insufficiently. Family-relatives and bank credits are the other two sources of entrepreneurs. It is also seen from this

figure subsidies are used very little, and venture capital is not used at all. Detailed research about them is made in Part III.

Table 11: Financial Problems of Enterprises (%) (n=100)

No financial problem	34
Lack of capital	66

It is seen in Table 11, the most important financial problem of enterprises is the lack of capital. Amongst all enterprises, 34% of them do not have any financial problems, considering that, this value reflects both the number of entrepreneurs who do not have any financial problems and the number of entrepreneurs who are not interested in making new investments and growth.

Table 12: Reasons of the Lack of Capital of Firms (%) (n=189)

Can not take bank credits	19.3
Economic and political instability	13.5
Low profit rates	20
Unable to make payments on time	15.5
Instability of the foreign exchange rates	11.2

It can be observed in Table 12 that there are three main reasons which cause lack of capital. First, a great many of SMEs can not produce high value added products and as a result of this, they run with low profit rates which is considered as the main reason behind the lack of capital of the firms. The second reason is that due to the high interest rates and collaterals, firms can not use bank credits sufficiently, and as a result, they are left with no choice selling assets to find capital. The third reason is that a considerable number of firms can not make their payments on time. This situation affects the other firms negatively and, causes further negative consequences within the financial system i.e. firms will face with financial

difficulties in the market. As it is also seen from Table 10, the instability of the foreign exchange rates and the economic and political policies of the country are the other reasons behind the lack of capital of the firms.

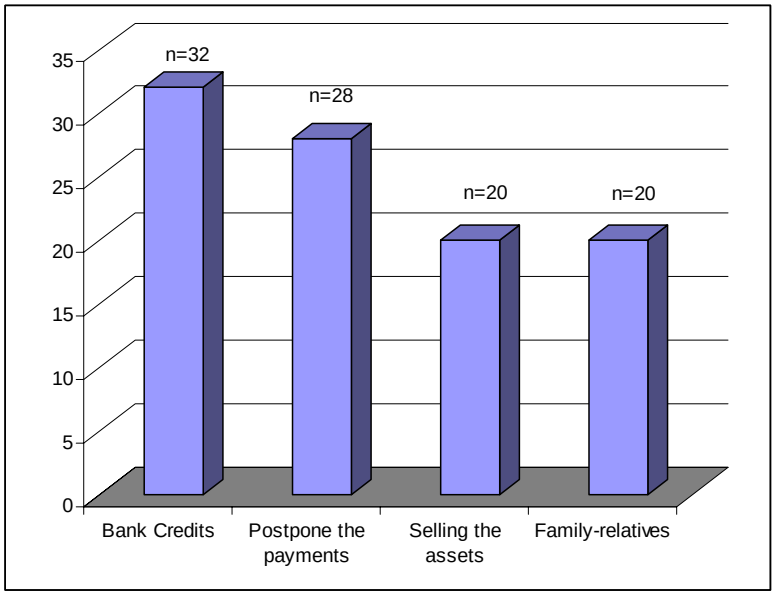


Figure 6: The Actions Used to Solve Financial Problems (%) (n=193)

As it is seen in Figure 6, there are four main actions using in order to resolve financial problems. First is to borrow from the bank (32%). The credits that SMEs take are usually short term and this ratio is not high enough for SMEs in the commercial life. Common factors that because SMEs avoid taking credits are the collateral system, high interest rates, and short pay back periods. The second used method by firms in order to resolve their financial problems is to postpone the payments (28%). This situation resulted in a reduction in cash flow in the market. The third and fourth methods which firms use to resolve their financial problems include borrowing from relatives/family (20%) and selling the assets (car, real estate etc.) (20%) and collecting cash.

Section 3: The Relationship of SMEs with the Support Providing Institutions

Table 13: Benefiting Supports (%) (n=100)

The investor does not get any support	53
The investor does get support	47

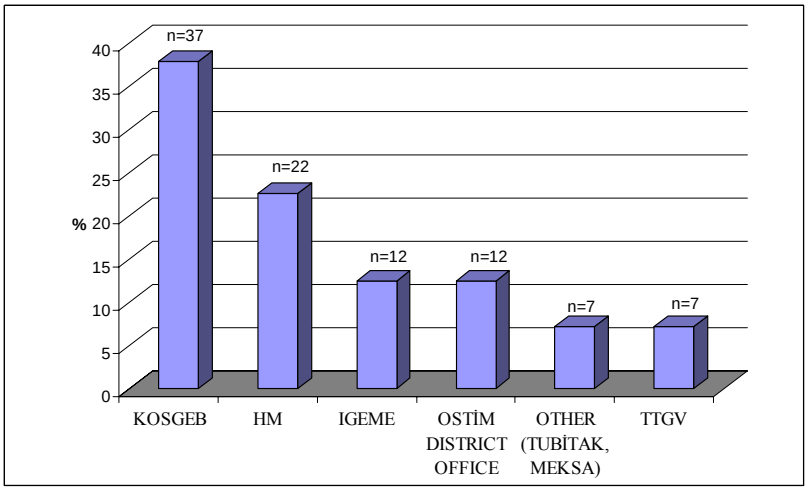


Figure 7: The Relations of SMEs with the Support Providing Institutions (%) (n=97)

As seen in Figure 7, firstly, KOSGEB is an institution that determines best the support SMEs need and that reaches most to SMEs. Secondly, HM provides credit allocation from the fund to firms via Halk Bank. It also provides tax exemptions, investment allowance, taxes duties, fees exemption, and Value Added Tax (VAT) support for the purchase of machinery and equipment. Thirdly, OSTIM Industrial District Office has been an office that reaches more easily than many corporations to SMEs because it is located in OSTIM region and in addition this the rate of benefiting from IGEME reveals that there are searches of support by firms in order to export.

The low ratio of other support providing institutions such as TTGV (7%), MEKSA (5%), and TUBİTAK (2%) shows the weakness of the relationship between these corporations and SMEs as well as R&D supports. As it can be seen in Table 13,

53% of all enterprises do not benefit from the support that corporations provide. The reasons of this considerably high value will be examined in details following tables.

Table 14: The Proportion of Benefiting From the Investment Incentives (%) (n=100)

The investor used investment incentives	22
The investor did not use investment incentives	78

Table 15: The Proportion of These 22 Firms' Usage of Encouragements (%) (n=22)

Customs tax exemption, Investment allowance, Taxes duties and fees exemption, Value Added Tax (VAT) support for the purchase of machinery and equipment.	100 %
Energy support	13.6 %
Credit allocation from the fund.	36 %

Table 16: The Reasons of Not Benefiting From Investment Incentives (%) (n=78)

Lack of information	43.8
Bureaucratic barriers	8.2
Lack of the staff to work on it	24.7
Subsidies are insufficient	23.3

The investment incentives system and the legislation are implemented by the HM. Depending on the Investment Incentive Certificate that is arranged by General Directorate of Incentive & Implementation entrepreneurs benefit from the various support factors. As it is seen in Table 14 amongst all enterprises %22 of them used investment incentives. And as it is seen from Table 15, %100 of these enterprises used "Taxes duties and fees exemption, Value Added Tax (VAT) support for the purchase of machinery and equipment, Customs tax exemption, Investment allowance", 36% used credit allocation from the fund. It is observed that tax

exemptions and credit allocation from the fund are important supports provided to SMEs by Treasury. It is revealed from Table 16, that the main reason of not benefiting from investment incentives is the lack of information about incentives. Other reasons are; lack of staff to work on it (prepare the documents of etc.) and subsidies are considered insufficient. And, during the interview with the enterprises, it is also revealed that entrepreneurs want the supports as cash. However, this is not preferred by government because of both the economic conditions of our country and the events experienced in the past.

Table 17: The Proportion of Benefiting From the Export Incentives (%) (n=99)

The investor has benefited	10.1
The investor has not benefited	89.9

Table 18: The Proportion of This 10 Firms' Usage of Encouragements (%) (n=10)

	Number of firms
Tax exemption, tax refund	80 %
Import exemption	20 %
Equivalent goods	30 %

Table 19: The Reasons of Not Benefiting From Export Incentives (%) (n=83)

Lack of information	34.9
The investor has some information about the incentives but he does not export	27.7
Bureaucratic barriers	15.7
Lack of staff to work on it	8.4
Subsidies are insufficient	13.3

The export incentives system and the legislation are implemented by DTM. As it can be seen in Table 17 amongst all enterprises, %10 of them benefited from export incentives. And, as it is seen from Table 18, %80 of these enterprises used "Tax exemption, tax refund" support. The low ratio of using incentives leads us to think that SMEs are not interested in export as well as they are not exporter firms or do not export directly. It revealed from Table 19, the main reason of not benefiting from export incentives is that lack of information about the incentives. Other main reason is SMEs are not exporter firms.

Table 20: Technology Development Supports (%) (n=110)

R&D	10
Market research	13.6
Supports provided for promoting and operating stores, offices in abroad.	0.9
Supports provided for participating to international fairs.	5.5
None	70

As it is seen in Table 20, 70% of the firms do not benefit from any of supports. Only a limited number of firms were provided R&D (10%) and market research (13.6%) supports. In addition to R&D and market research, participating to international fairs support is also necessary to know quality of products and technology used competitor firms. These aids are provided to firms by KOSGEB, IGEME, TUBİTAK and TTGV.

Table 21: The Reasons of Why Firms Do Not Benefit From the Supports (%) (n=156)

Lack of information	21.8
The entrepreneur do not need R&D	13.5
The entrepreneur do not need to take support	7
The entrepreneur need subsidies but the bureaucratic barriers create a handicap	27.6
Supports are insufficient	23.7
Applied but was rejected	6.4

From Table 21, it is observed that there are three main reasons which explain why entrepreneurs do not benefit from supports. First reason is bureaucratic barriers causes the entrepreneurs not to benefit from supports. Second reason is that entrepreneurs believe that the supports are insufficient. And the last one is lack of information about supports. As it can be seen from Table 21, 13.5% of the entrepreneurs stated that they do not need R&D supports, which shows that small and medium enterprises do not follow innovations such as product, process and technological innovations.

Table 22: The Information about the Credit Guarantee Fund (%) (n=100)

KGF provides guarantees	1
The entrepreneur has never heard of it.	53
The entrepreneur has heard of it but has never benefited.	46

As it is seen from the Table 22, amongst all enterprises 1% of them have provided credit guarantees. Although KGF has been established for SMEs to help enterprises to receive financing by means of bank credits; amongst all entrepreneurs 53% of

them have never heard and 46% of them have heard of KGF but have never used. As a result, KGF proves to be very unsuccessful.

Table 23: The Information about the Venture Capital (%) (n=99)

Entrepreneurs who have never heard of it.	45.5
Entrepreneurs who have applied but rejected	1.0
Entrepreneurs who have heard but never used, and considered about using it in the future.	22.2
Entrepreneurs who have heard but never used, and not considered about using it in the future.	31.3

As it is seen in Table 23, amongst all entrepreneurs, 45.5% of them have never heard of venture capital, while 31.3% of them are not interested in venture capital applying in the future. Only one firm applied but it was rejected. This draws attention to the lack of information about venture capital and small and medium enterprises are not yet ready for this sort of partnerships. As it is mentioned in the previous chapter, venture capitalists are interested in mostly enterprises with high growth potential, which leads us to think that SMEs have not high growth potential.

Section 4: Resource of Capital in a New Investment

Table 24: Plans About a New Investment within the Coming Two Years (%) (n=98)

Entrepreneurs who plans a new investment	47.9
Entrepreneurs who do not plan a new investment	52.1

As it is observed in Table 24, 47.9% of the enterprises do plan to make a new investment, at short term. The distribution of funds for a new investment is investigated in the following figure:

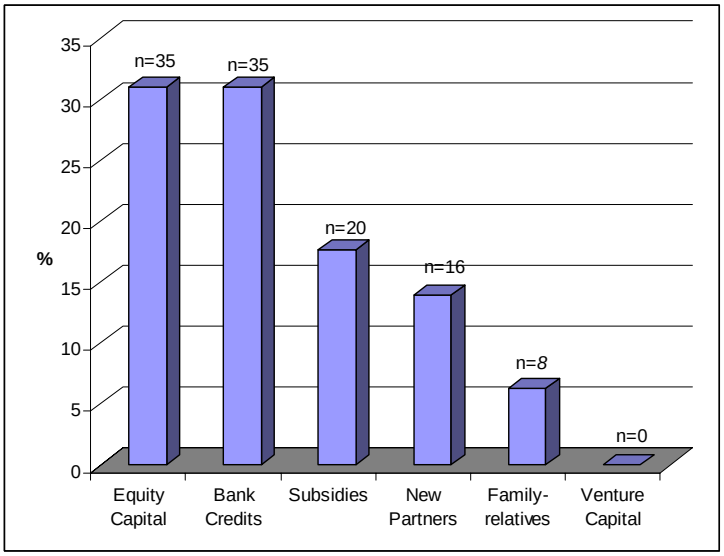


Figure 8: The Sources of Funds for a New Investment (%) (n=114)

As it is seen in Figure 8, the most important financial sources of a new investment of entrepreneurs are capital and bank credits, which lead us to think that entrepreneurs trust their project and expect to use bank credits. Moreover, this figure shows that entrepreneurs are interested in subsidies. However, entrepreneurs do not consider applying for venture capital for new investments. This draws attention to the lack of information about Venture Capital.

Section 5: Opinions and Expectations about the Integration of TR with the EU

Table 25: Opinions about the Integration of TR with the EU (%) (n=100)

Would be positive effect	41
Would be negative effect	28
No effect	11
No comment	20

As it is seen in Table 25, most of the entrepreneurs expect that their firms will be affected positively by the integration of TR with the EU, but many of them expect that their firm will be affected negatively.

Table 26: Effects That Expected From the Integration of TR with the EU (%) (n=194)

Easy access to financing	13.4
Competition will increase the quality of production and the standards will improve	28.8
New market possibilities will occur	25.2
Increased competition will affect negatively	17.1
The subsidies provided to firms will rise	15.5

From Table 26 it is revealed that there are two main positive effects expectations on firms which are caused by the integration of TR with the EU. One of the effects is the improvement in the quality of production and distribution standards that are caused by the increased competition. The other one is the increase of new markets possibilities.

However, entrepreneurs who think their firms will be affected negatively by the increased competition comprise the 33% of all. It is related with the importance given technological innovation by firms.

5.1.3. Research Findings

The survey result is summarized as follows;

58.5% of participant SMEs are established with a lack of capital (See also in Table 5) and amongst all firms, 66 % of them have important financial difficulties (See also in Table 11). The crosstabulation below shows the relationship between amount of establishment capital and financial problems of SMEs.

Table 27: Relation between Financial Problems and Establishment Capital Amount

			No financial problem	Lack of capital	Total
Establishment capital (thousand YTLs)	up to 5	Count	11	44	55
		% within financial prob.	36.7%	68.8%	58.5%
	5-25	Count	7	11	18
		% within financial prob.	23.3%	17.2%	19.1%
	25-100	Count	7	6	13
		% within financial prob.	23.3%	9.4%	13.8%
	100-250	Count	1	3	4
		% within financial prob.	3.3%	4.7%	4.3%
	250+	Count	4		4
		% within financial prob.	13.3%		4.3%
Total		Count	30	64	94
		% within financial prob.	100%	100%	100%

As it is seen in Table 27, 68.8% of SMEs suffer from lack of capital and they are established with limited capital and it is clearly revealed that the more amount of establishment capital, the less lack of capital problem firm has.

Moreover, 93.9 % of all participant SMEs are the owner-manager firms (See also in Table 6), and 64% of all participant SMEs do not have financial department in their firm (See also in Table 7). Whether the owner-manager firms have financial department is revealed in the following crosstabulation:

Table 28: Whether the Owner-Manager Firms Have Financial Department

		Financial department in the firm	No financial department in the firm	Total
The owner of the firm is the manager in the firm	Count	31	62	93
	% within owner-manager firms	33.3%	66.7%	100%
The owner of the firm is not the manager in the firm	Count	5	2	7
	% within owner-manager firms	66.7%	33.3%	100%
Total	Count	36	64	100
	% within owner-manager firms	36%	64%	100%

As it can be seen in Table 28, 66.7 % of all owner-manager firms do not have financial department. In these firms financial businesses are under the provision of either the manager or accounting department. Because they do not have sufficient knowledge about finance although they are qualified technically, firms' utilization of capital opportunities is inadequate. The crosstabulation below shows the relationship between financial department and SMEs' usage of bank credits.

Table 29: Whether Financial Department in the Firm Affects the Usage of Bank Credits

			Bank Credits		Total
			yes	no	
Is there a finance department in the firm?	yes	Count	27	8	35
		% within bank credits	43.5%	23.5%	36.5%
	no	Count	35	26	61
		% within bank credits	56.5%	76.5%	63.5%
Total		Count	62	34	96
		% within bank credits	100%	100%	100%

As it can be observed in Table 29, 43.5 % of SMEs that use bank credits in order to solve financial problems have financial department in their firm. However, 76.5 % of firms that do not use bank credits do not have financial department. It is revealed that financial department affects the usage of bank credits.

An important finding from the investigation is that reasons of lack of capital are low profit rates (20%), insufficient usage of bank credits (19.3%) and being unable to make payments on time (15.5%) (See also in Table 10). It shows us that SMEs run with low profit rates and as a result of that they can not produce high value added products. SMEs can not make their payments on time and this affects the other firms negatively, causes financial difficulties in SMEs in the market.

The crosstabulation below shows the relationship between determining the investment subject and lack of capital:

Table 30: Whether Determining the Investment Subjects Affects Financial Problems

			No financial problem	Lack of capital	Total
Determining the investment subject	Father's investment subject	Count	7	16	23
		% within financial prob.	21.9%	24.2%	23.5%
	Has an investment on the same subject	Count	7	2	9
		% within financial prob.	21.9%	3%	9.2%
	Seems Profitable	Count	3	8	11
		% within financial prob.	9.4%	12.1%	11.2%
	Former work experience	Count	11	33	44
		% within financial prob.	34.4%	50%	44.9%
	Feasibility-market research	Count	4	7	11
		% within financial prob.	12.5%	10.6%	11.2%
Total		Count	32	66	98
		% within financial prob.	100%	100%	100%

It is observed in Table 30, 50% of firms with lack of capital are established by the entrepreneurs with their former work experience while 24.2% of them with their fathers' investment subject. Therefore it can be stated from Table 29 and Table 30 that entrepreneurs who establish their firms on their former work experience or fathers' investment subjects suffer from low profit rates, insufficient bank credits and being unable to make payments on time. For these reasons they have financial difficulties. Increase in the number of firms that invest in the same subject causes a rise in costs and fall in profits.

According to the result of the survey, 26.5% of all participant firms use bank credits, 23.5% of them postpone their payments in order to solve financial problems. They postpone their payments which results in a reduction of cash flow in the market. Moreover, rate of solving financial problems through bank credits is low because banks run with collateral system, high interest rates, limited amounts and short pay back periods. 16.2% of them sell their assets (car, real estate, etc.) and collect cash in order to solve their financial problems. On the other hand, banks

require collateral assets. This contradictory situation creates a barrier for SMEs to take credits (See also in Figure 6).

It is revealed that main sources of fund of the enterprises in start-up periods are equity capital (52.3 %), borrowing from the family and relatives (28%) and bank credits (17%) (See also in Figure 5). Because equity capital is the main source of entrepreneurs, lack of capital proves the main problem of the firms. As a result of this, they endeavor to increase capital by adding their profits to their capital. The crosstabulation below shows the relationship between establishment capital and current capital of SMEs.

Table 31: The Relationship between Establishment Capital and Current Capital

			Current capital (thousand YTLs)					Total
			up to 5	5-25	25-100	100-250	250+	
Establishment capital (thousand YTLs)	up to 5	Count	3	6	22	13	11	55
		% within Est. Cap.	5.5%	10.9%	40%	23.6%	20%	100%
	5-25	Count	-	8	3	6	1	18
		% within Est. Cap.		44.4%	16.7%	33.3%	5.6%	100%
	25-100	Count	-	1	9	1	2	13
		% within Est. Cap.		7.7%	69.2%	7.7%	15.4%	100%
	100-250	Count	-	-	-	3	1	4
		% within Est. Cap.				75%	25%	100%
	250+	Count	-	-	-	-	4	4
		% within Est. Cap.					100%	100%
Total		Count	3	15	34	23	19	94
		% within Est. Cap.	3.2%	16%	36.2%	24.5%	20.2%	100%

It is clearly seen in Table 31 that most of the firms add their profits to their capital and 40% of all firms that established with less than 5 thousand YTLs raised their capital in average from 5 to 20 fold, and even 20% of them raised 50 fold and more.

Another important finding is 34% of all participant SMEs are not interested in consultancy services (See in Table 8). According to survey, it is revealed that most of the enterprises need consultancy, but do not apply for the available services, because consulting services are considered as additional costs by the enterprises

which already have financial difficulties. However, it is difficult to maintain a stable growth without consultancy services. In addition to this, it is also revealed from Table 8 that SMEs consider technical standards important in their production and distribution. 18.9% of them consider some standards like ISO and CE. Moreover, the entrepreneurs are interested in marketing (10.8%), accounting (9.3%) and research & development (9.3%). Research & Development and marketing are very important issues in terms of SMEs' improvement of innovativeness and competitiveness in national and international markets.

In the country, various instruments are used by different institutions in order to encourage SMEs. According to the result of the survey, 38% of all SMEs provide support from KOSGEB. KOSGEB which is established in order to maintain SMEs' accordance with the technological innovations, to strengthen their competitive forces and to increase their contribution to the economy is the most common office that SMEs are informed most about. In addition, 22.6 % of them are supported with tax exemptions, investment allowance, tax duties and fees exemption and Value Added Tax (VAT) support for the purchase of machinery and equipment and credit allocation from the fund to firms via Halk Bank by HM. 12.3% of them benefited from İGEME and OSTIM Industrial District Office which is an office that is much closer than many corporations to SMEs because it is located in OSTIM region. The low ratio of technology development support providing institutions such as TTGV (7%) and TÜBİTAK (2%) shows the weakness of the relationship between SMEs and these corporations as well as R&D supports. As it can be seen in Table 13, 53% of all enterprises do not benefit from the support that corporations provide.

It is revealed that usage of incentives is low, amongst all participant SMEs 22% of them use investment incentives and 10.1% of them use export incentives. The main reasons of low ratio of not benefiting from incentives are lack of information, lack of staff, insufficient subsidies and bureaucratic barriers (See also in Table 16 and Table 19). Ratio of no usage of supports provided by technology development support providing institutions is 70%. Among these supports ratio of market research is 13.6%, R&D is 10% and supports provided for participating in international fairs is 5.5%. It is emphasized in Table 19 that the relationship

between the institutions (İGEME, TÜBİTAK, TTGV, etc.) which provide these supports and SMEs is weak.

The data show that amongst all enterprises 1% of them have benefited credit guarantees. Credit Guarantee Fund is established for SMEs to help enterprises to receive financing by means of bank credits. Amongst all entrepreneurs 53% of them have never heard and 46% of them have heard of KGF but have never used (See also in Table 22). High level of unawareness about KGF explains low level of bank credit usage of SMEs. Firms that benefit from KGF are active in manufacturing sector, established with capital amounted 250 thousand YTLs or more, have more or less new technology, do not have financial difficulties. This leads us to think that KGF does not help investors with limited capital.

Another important finding is amongst all entrepreneurs, 45.5% of them have never heard of venture capital while 31.3% of them are not interested in applying for venture capital in the future. Only one firm applied but was rejected (See also in Table 23). This draws attention to the lack of information about venture capital and small and medium enterprises are not yet ready for this sort of partnerships. In addition, this leads us to think that SMEs do not have high growth potential. The firm rejected is an owner-manager firm and active in manufacturing sector, has an amount of capital less than 5 thousand YTLs, does not have a financial department, has financial difficulties, has an old production technology. These characteristics show that this firm is insufficient to obtain venture capital investment.

According to the survey 47.9% of participant SMEs plan to make new investments in the near future. It can be said that they are hopeful about the future of country's economic situation. The funds they consider to use in new investments are capital, bank credits, and subsidies. They prefer using their traditional funds in their new investments and do not show concern for new financing methods (See also in Figure 8).

Besides having positive expectations about the integration with the EU, they are afraid of disadvantages about competition since their competitive power is low. 41% of participant SMEs expect that their firm will be affected positively, but 28%

of them expect that their firm will be affected negatively by the integration of TR with the EU. It is revealed that there are two main positive effects of expectations on firms. One of the effects is the improvement in the quality of production and distribution standards that occurs by the increased competition. The other one is the increase in new market possibilities. However, entrepreneurs who think their firms will be affected negatively by the increased competition comprise 33% of all. It is related with little importance given to technological innovation by SMEs (See also in Table 25 and Table 26).

In conclusion, according to the results of the survey most of the small and medium enterprises have important financial difficulties. Furthermore, they have a stronger need for capital participation, credits and consultancy services for maintaining their functions and strengthening their innovativeness.

5.2. PART II – Interviews with Venture Capital Firms

5.2.1. The Data

Part II aims to understand the investment strategy of VC firms. And why the VC system has not been adopted yet. Furthermore, Part II aims to explain venture capital firms' expectations from the entrepreneurs, the reasons of rejection of projects and to evaluate whether a venture capital firm contributes socially and economically to the society.

While determining the samples in Part II, particular attention was paid to the necessity that the chosen sample is truly representing the venture capital sector in Turkey. Today, venture capital firms located in Turkey are Burhan Karaçam Partnership, Is Venture Capital Investment Trust J.S.C., Vakif Girisim Venture Capital Investment Company Co., Esas Holding J.S.C., Superonline, Ladybird and so on. Amongst them 3 venture capital firms are chosen to carry out the interview. They are Vakif Girisim Venture Capital Co., Is Venture Capital Investment Trust J.S.C. and Esas Holding J.S.C. Vakif Girisim was chosen as it was the first venture capital company of its kind until the third quarter of 2000 in Turkey. Is Venture Capital Investment Trust J.S.C. was chosen since it is the venture capital firm with

the biggest fund in Turkey. The reason for choosing Esas Holding J.S.C. is that attracts attention with various practices.

In the interviews each question was generally asked in the same order as seen below. There was not a specific question form. The interview lasted for nearly 2 hours.

- What is the mission and goal of VC firms?
- How do VC firms make investment? How do the venture capital firms evaluate the applications?
- In what stages and for what reasons have SMEs been rejected? What are the expectations of venture capital firms from entrepreneurs?
- Is there a social and economic contribution of venture capital firm to the society?

5.2.2. Results of Interview with Venture Capital Firms

The Mission and Goal of Venture Capital Firms in Turkey

According to results of interviews, the mission and goal of venture capital firms in Turkey is providing money by professionals to young, rapidly growing companies and successful entrepreneurs to maintain the realization of projects and to create new values. It gives firms not only financial supports but also management, operational and visional supports. The concept of venture capital comprises the investments in weightedly expansion stage firms, early and start-up stage firms. They are evaluating every kind of project that has suitable properties for the venture capital investments without making sector discrimination, interested in applicants that project new technology or product, a new product or service method.

Senior associate of Is Venture Capital Investment Trust J.S.C., İhsan Sancay, explains their firm's goals as such: "*Firms are established with small amount of capital in Turkey. In order to make expansion, they need additional financing. Venture capital is quite an important system as an 'alternative financing model' for entrepreneurs when they have financial problems. Our goal is to make firms*

world wide known which showed success earlier and now have the ability to grow and give higher than average returns."

How Do The Venture Capital Firms Evaluate The Applications And Make Investment?

According to results of interviews, venture capital firms in Turkey do not have a sector preference in its investments. However, they are interested in frequently firms active in sectors of chemical materials, durable and non-durable goods, sanitary, organic food and sports retail, energy, health, technology and telecommunication and, that have a potential and actual growth in terms of market share. Venture capital firms in Turkey are invested in expansion stage and early stage firms. Expansion stage capital is usually provided to companies that have expanded their initial capital and require funds for sales, distribution and manufacturing costs. Venture capital firms in focuses on the companies at this stage for its investment efforts here in Turkey. Early stage investments are done at the early stages of the companies' life cycle. Currently, VC firms selectively consider investments in the early stage of a company's life cycle. As it develops its knowledge and expertise, they intend to invest more of its capital in the seed and start up opportunities in Turkey.

According to Esas Holding, firms that made successful achievements, have strong feasibility and management are interested in venture capital investments. Generally, it is attracted to sectors in which products that can reach consumers one to one take place. The conditions that are needed for Esas Holding to find a project attractive are (www.esas.com.tr.);

- Being one of the front institutions in its sector.
- Owning a trademark.
- Continuing of its operational activities.
- Having a strong motivation, entrepreneurship and management.
- Being in need of support for the realization of its growth targets.
- Being an investment that is small and medium sized in general but has a potential.

Venture capitalists need the following to be prepared by the entrepreneurs in their plans of project during application:

- Business concept: Describe the business, its product and the market it will serve. (The entrepreneurs should point out just exactly what will be sold, to whom and why the business will hold a competitive advantage/uniqueness.)
- Financial features: Highlight the important financial points of the business including sales, profits, cash flows and return on investment.
- Financial requirements: Clearly state the capital needed to start the business and to expand. (The entrepreneurs should detail how the capital will be used, and the equity, if any, that will be provided for funding.)
- Current business position: Furnish relevant information about the company, its legal form of operation, when it was formed, the principal owners and key personnel, including c.v.s of its management team.
- Market & competition: Explain the industry national and international, the market size and the company's competition, pointing out its unfair competitive advantage.
- Major achievements: Detail any developments within the company that are essential to the success of the business. (Major achievements include items like patents, prototypes, location of a facility, any crucial contracts that need to be in place for product development, or results from any marketing test that has been conducted) (www.isgirisim.com.tr).

In general, venture capital firms invest 10-15% of their investment assets in these kinds of companies as a principle and plans to exit the firms in between 2-5 years in general. While exit, it uses certain methods such as IPO, strategic sale or sale back to the original shareholders.

One of the interviewed specialists, Mr. Sancay, says "*we make firm choices and not sector choices*" appends that *"Is Venture Capital does not only invest in firms of a specific. It has a tendency to invest in firms which are high growth potential, high rates of return on equity expectations, strong management team, marketing skills, potential for penetration of foreign markets. We do not invest in partnerships over 50% because we get married to get divorced. Is Venture Capital will be represented on the Board of Directors of the investee firm and always have a right to veto. Our veto right is valid for the decisions being taken for the usage of money that we give the firm we invest. We do not intend to play an active role in the day-*

to-day management of the firm." Mr. Sancay summarizes his expectations from firms as follows: "*I expect the entrepreneur to interpret his dream to me mathematically"*.

According to another investment specialist, Ms. Hale CAN, says; "*When we invest as Esas Holding, we do not make net sector discrimination however; our expectations from some firms are relatively more than the others. Particularly in Turkey we are more interested in food and sanitary sectors that have a high development potential and whose problems are intensive. Investments in both sectors should be managed more professionally and be formed more institutionally. We work to make it.*" CAN also explains that they do not have restrictive policies when investing, their equity owners are very experienced in Turkey for a long time anyway and this experience contributes much to them when evaluating investments. And she adds, *"Sometimes SMEs need management support we provide, but the owners of the firms object to it with the reason that we intervene their business. In this case, unless an agreement is made, the partnership may be spoilt. Therefore, the characteristic properties of the entrepreneur become important. As a result, you are obliged to participate in the management and check out their accounts."* In the applications together with the information like a short introduction of the firm and the project, introduction of the products in the project, analysis of the target market(s), market research, competitive in market, investment costs and analysis of firm capital requirement are expected to be presented, Can says that an entrepreneur should be able to answer the questions that are *"where does my firm stand now? Where do I see myself in the future? And for what do I need capital?"*

According to Ms. Doğan who is the manager of the Vakif Girisim, the firm makes investments as follows; *"Entrepreneur applies to Vakif Girisim with a written document including the cost of investment, operation expenses, marketing strategy, production method, management process, properties of managers, proposed financial structure, etc… Venture capitalists study the project and if it is understood the project complies with the aim and strategy of the company the owner is invited to develop the project. If the parties agree on the project, detailed*

work on the project starts. At this stage, economic, technical and financial structure of the project for at least 5 years period is examined as a projection. Feasibility study is prepared and analyzed. In the case the outcome of the analyses are positive, for venture capitalist, the entrepreneur determines the conditions to join the project. Therefore, it comes out in what ratio and conditions venture capital company joins the project according to the peculiar conditions of the firm. If the parties agree in the terms set by venture capital company, an investment contract, in which the rights and the liabilities are defined, is put into effect. Later, all the way to be followed must be parallel to this contract. All the know-how and the efforts of the parties are put into effect in order to execute the things ordered in the investment contract which starts with the founding of a partnership (A.Ş in Turkey). Venture capital company leaves the investment when it reaches to the point where the company once projected it is maturity level for venture capital investment, in regard to the exit conditions written in investment contract."

The Expectations of Venture Capital Firms from Entrepreneurs and Rejection Reasons of Entrepreneurs' Application

According to Mr. Sancay, there are 3 types of entrepreneurs who applied to Is Venture Capital:

1- Entrepreneurs who need bank loans,

2- Entrepreneurs who have an idea and wonder if it would attract venture capitalist,

3- Firms that have a strategic plan.

He adds; "*We have examined nearly 450 firms' applications so far. Almost 400 of them were rejected in the first stage. We interviewed all but 50 of them and finally decided on 5 firms; Probil, ITD, Nevotek, Cinemars and Step Carpet.*

There are 3 main reasons why applications got rejected: the first is that the cost of their investment is lower than 1 million USD and that they in fact need bank loans instead of venture capital. The second reason is that many of these firms do not have a growth potential and are not in harmony with the dynamics of the sector. The third reason is that we do not invest in firms which experience management and organization problems, which are commonly seen in family-run SMEs."

Ms. Can explains her opinions as follows: *"So far our holding has had 500 applicants. This number does not comprise the project which is about a support for*

a dentist to buy the next apartment in order to enlarge his office or about a demand for venture capital of a greengrocer, but only comprises investment projects that we evaluated. Because Esas Holding is open to every type of projects and because there is no minimum or maximum investment limit criteria in the projects, serious works are done about most of the projects. However, we have to be selective since we evaluate those projects with nearly 15 people in the assessment level and expend effort and time for each project. In this regard, we check the present or expected (if we intervene at the start-up phase) turnover of the firm and the projection numbers begin to be important. There are some firms which appreciated twenty fold all of a sudden. We try to notice these kinds of works. Its turnover may be very low now but what if it forges. Nevertheless we do not eliminate them quickly. We consider that investing may make sense, we do not eliminate soon, we still interview with the investor, and we think if other sectors in which we are can make synergy. Consequently, we spend too much time on each firm.

Until now we have given venture capital support to 9 firms. Among these firms there are investments which, apart from providing venture capital and management support, we purchased as a whole and continue to produce or we participate in with higher percentages."

Ms. Doğan explains her opinions as follows: *"Application of 57 projects in June and 470 projects in the first 6 months of 2005 have been made. With the application of projects, what the entrepreneurs plan to do is understood. Half of the projects are of dreamers. Two university students applied to us for their project about software. We demand 5 years history of firms we are interested in. What could we ask for from two students? We consider like we provide bank credits. We study on the projects that would be stable, credible, profitable, a future investment as we believe.*

The difference of some applicants among others is understood from their application files. Information is clear, prepared professionally. However, the ratio of this type of applications is relatively low in total. We evaluate the applications in 3 steps. Ones that are eliminated in the first step are the applicants that give it a try with no preparation. They comprise 40% of all applications. In the second step we ask for more information and documents. Almost 30% of the investors cannot

pass this stage. Interviews are made with the remaining ratio. So far we had partnerships with 7 firms."

Social and Economic Contribution of Venture Capital Firms

Venture capital contributes not only to the entrepreneur but also to the macro economy. According to a research conducted in the USA; firms that are invested in by venture capital firms exceed other firms in the following areas, at the following rates: in sales 1.6 times more; in export 1.9 times more, in R&D activities 2.9 times more and in taxes paid 2.8 times more. All these data show that as one of the alternative financing tools, venture capital can provide great utility both for the firm's development and for the macro economy when used for the right firms and right aims (Gazete Girişim).

According to the results of the interviews with the rejection of some of the applicant firms is also a social gain because these firms learn how to make their cost analyses, what strategic planning is, and what growth means during the evaluation process.

5.2.3. Research Findings

According to the interviews, the adoption of venture capital system in Turkey is directly related to with entrepreneurs that are conscious and willing to grow. The biggest challenges that they need overcome are SMEs with weak and disorganized managements, lack of vision and insufficient growth potential. When these difficulties are solved, the venture capital firms want to create trademark among in Turkey.

The biggest lack of SMEs is that they do not work out a calculation of their works. The expectation of venture capital firms from an entrepreneur is to describe his future well, to be aware of where he is and where he will be in, and to explain for what reason he needs capital.

In Turkey, generally the manager of the firm where he stands compared to his rivals, who his rivals are, following a classification we generally find out that the rival firm owners are either partners of him or one is an ex-employee of the other. The venture capital firms try to gather together some SMEs under their roof. Interviews consider that some firms are needed to be united under present conditions. If everybody considers leaving his/her job to his/her child, then

everybody will be unemployed. And everybody can not be a boss. It is required to maintain institutionalization.

Another important point is that SMEs work closed to them when their financial state is good. However, when they have financial difficulties and can not resolve their negative financial states, we recur to their minds. Even in that situation, the firm has currently many problems. Its debts are high, resources are consumed. This situation, for sure, makes negative effects in the evaluation phase of venture capital. Whereas if it applies consciously when its investment is powerful, it will not have any difficulties.

The results of the interviews summarizes as follows:

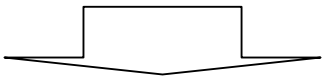
The purpose of the venture capital firms ⇨ Providing capital and management support to the firms which have higher growth potential.

The characteristics of SMEs interested in Venture capital firms

⇩

- sustainable growth potential
- competitive market power
- reliable management
- motivation and experience

Expectations of the venture capital firms from the entrepreneur:



"*What level does the entrepreneur consider himself in today and in the future? We expect him to know that and tell us*." (Esas Holding).

"*We expect the entrepreneur to explain his dream mathematically."* (Is Venture Capital).

"*We expect conscious investors."* (Vakıf Girişim).

The reasons of rejection of SMEs in general

- Project's needs bank credits not venture capital
- Not observing a growth potential in the project,
- The financial state of the firm is insufficient.
- Weak or disorganized management
- Unrealistic business expectations (volume and/or timing).
- Disagreements about management support because of no institutionalization of the firm.
- Lack of due diligence relating to business plans, projections, and assumptions.

It is revealed from the interviews that almost 100-1000 applications have been made by SMEs to venture capital firms in a year. Nearly 90% of these applicant enterprises are eliminated in the first stage, and 1% of them are invested in. In conclusion, it is revealed from the investigation SMEs in Turkey should be supported effectively in the pre-application period for VC. Furthermore, in order to increase the VC investments in Turkey, qualities of applicant SMEs need to be raised. Particularly supports are needed for the improvement of their projects technologically and preparation and presentation of required documents about business concept, financial features, financial requirements, market & competition

CHAPTER VI

EVALUATION AND CONCLUSION

Today, it is accepted that venture capital plays a critical role in maintaining technological innovation and regional development. The venture capital provides entrepreneurs with realization of their innovative projects, encouragement to produce new products or processes or to develop the already existing products or systems. Furthermore, venture capital differs from traditional financing methods because they are actively involved in the setting up, the managing, and the monitoring of SMEs. Moreover they provide technical support to SMEs. In other words, the venture capital model not only enables SMEs to realize their projects but also provides them with an opportunity to grow, to create more value and to increase competitiveness in markets. SMEs are significant in that they improve new technologies in the country, and overcome regional gaps to maintain social and economic stability. Thanks to their flexible structure, SMEs are more in harmony with changing market and environmental conditions than big firms. Also, their labor-intensive structure helps them solve unemployment problems in the regions, particularly in developing countries. In this way, VC has a vital role in maintaining regional development in that they encourage technological development and growth of SMEs and create innovative SMEs.

In this regard, the first venture capital company was established in 1996 in Turkey, which is one of the most important improvements related to the increase in the effectiveness of SMEs to achieve the above mentioned objectives. However, the development of VC sector and the amount of VC investments for the last decade emphasize that the system has not been adopted yet and also SMEs have limited economic and technological capabilities in Turkey.

In this respect, the main premise of this thesis is that development of VC in Turkey, to a large extent, depends on the improvement of economic and technological capacity of SMEs as well as increase in the level of knowledge of entrepreneurs about what VC firms are looking for, how to apply for VC and what VC can provide for SMEs in Turkey as there is a high level of unawareness among the entrepreneurs about VC. In order to overcome these difficulties, training SMEs concerning VC, KGF, investment incentives and export incentives, and technology development supports R&D, participating in international and national fairs and market research etc. are required in order to increase the level of usage them. In addition, a center needs to be established in order to prepare SMEs and their projects before applying venture capital firms.

Within this framework, in this thesis, the concept of VC in the world, SMEs' financial problems and the development of VC in Turkey are investigated. With a objective to determine the measures to be taken so as to increase VC investments, the empirical analysis has been made. The main purpose of the analysis is to understand why investments in SMEs of venture capital firms are limited in volume and in number in Turkey. The analysis consists of two parts. Part I is based on the examination of the general characteristics of SMEs, sources of funds to solve financial problems in start-up and expansion stages, the level of knowledge about KGF, VC, public supports and reasons for the low level of their usage. Part II is based on the determination of the structure of the investment strategy of the VC firms and their expectations from the entrepreneurs throughout the application period, and the reasons for the rejection of SMEs. In this respect, these two parts constitute the basic tools to bring the major problems of both SMEs and the VC sector into light.

According to the results of the analysis, financial difficulties in SMEs, projects without high growth potential, lack of knowledge and management skills comprise the most significant reasons for limited VC investments. Low profit rates and low level of bank credits usage are important reasons for the lack of SMEs' capital. Financial difficulties, additional cost of consultancy services, insufficient participation in supporting programs and high cost of R&D reduce SMEs'

effectiveness in the field of R&D as well as VC sector. In addition to above stated factors, insufficient knowledge level of VC and the failure to meet the expectations of VC firms in application and evaluation stages are the important reasons that reduce the effectiveness of SMEs in the VC sector. Hence, in order to increase the VC investment in SMEs, access to finance, innovativeness and the knowledge level of SMEs should be improved.

In this regard, the first step should be the strengthening of SMEs' accessibility to finance. According to the result of the SME survey in OSTIM, the main source of enterprises is equity capital and the main financial problem is the lack of capital. The low level of bank credits usage induces financial problems. SMEs are faced with difficulties due to the fact that banks run with the collateral system, high interest rates, limited amounts and short pay back periods. It is also revealed from the investigation that entrepreneurs sell assets (car, real estate, etc...) and collect cash in order to resolve the financial problems. However, banks require collateral assets. This contradictory situation creates a barrier for SMEs to take credits. Thus, this results in the need for improvement in the Credit Guarantee System, which leads to a significant increase in the SMEs' bank credit usage.

The second step should be increasing the innovativeness of SMEs. As the survey results indicate, related to the inadequate financial resources, insufficiency of capital and the inability to employ qualified personnel are primary difficulties that SMEs encounter regarding R&D. R&D activities are necessary since venture capital is mostly interested in new, high growth potential projects. However, SMEs in Turkey copy the past experiences instead of being innovative. Copying is considered reasonable for developing countries like Turkey, which follow developed countries. The problem is the failure to transform copying into creativity (Müftüoğlu, 1997).

The third step should be strengthening and training especially owner/manager firms during the pre-application period for VC. According to the result of the analysis, SMEs are generally family-run enterprises, which are frequently operated with the life-style aspirations of their owner-managers. Decision making is faster in these enterprises; however, it causes firms to have a narrow vision and a lack of

professional management. The owner-managers, in family-run enterprises mostly have a technical background. Furthermore, although they are very well skilled and experienced about the activities of their enterprises, they have insufficient knowledge about financing and accounting. Thus, they face difficulties in the preparation of documents and presentation of their projects. According to the evaluation of interviews, SMEs lacked the ability to express themselves and to explain their needs and projects mathematically. Moreover, it is quite difficult for the family-run firms to decide to share the management with a stranger. However VC investments are limited partnerships. As they are worried about losing their management autonomy in their firms, the owner-managers do not want to join such partnerships. This is the result of their unawareness of VC.

In order to solve those problems mentioned above;

- The support system needs to be coordinated and the level of knowledge of entrepreneurs about support system should be improved.
- The KGF should be more functional.
- The establishment of a center for the evaluation and development of applications of SMEs for VC is required.

Support system needs to be coordinated in such a way that it should cover not only the increase of the level of knowledge of SMEs about supports, but also the improvement of the R&D oriented support institutions and SMEs' innovativeness.

According to the results of the analysis, it is observed that SMEs' level of support usage (technology development supports, investment incentives, export incentives, supports for participation in international fairs etc.) is considerably low. The main reasons are insufficient information about supports, complexity of legislation, insufficient supports, time consuming and costly applications, lack of qualified personnel, and bureaucratic barriers. Furthermore, some supports (for example, participation in international fairs) are provided for entrepreneurs after they make the necessary expenditures, and this prevents SMEs from receiving support.

For these reasons, firstly, there should be a more systematic coordination especially among R&D support providing institutions, which meets the needs of SMEs in terms of receiving supports, reducing the complexity level of legislation about especially R&D supports as well as increasing effectiveness of R&D supports. Hence, R&D supports are usually accessible for firms which have a potential to innovate their projects but might lack capital to realize them, firms with a lack of ability to innovate their projects can not benefit from such an instrument. This means project-oriented supports should be restricted. Furthermore, particular attention should be given to the improvement of the knowledge level of especially owners/managers of SMEs through training, which enables them to be informed about all support programs and legislation in order to achieve widespread participation. The awareness of SMEs in terms of which supports are needed and which institutions provide those supports should be raised. Regarding the problem of unawareness about supports, KOSGEB may play an important role in promoting the use of supports by the SMEs. KOSGEB is already working for developing SMEs' technological skills, improving their training and information level, providing appropriate financial mechanisms, and improving their managerial infrastructure. However, KOSGEB which provides SMEs in 35 centers in Turkey with training, consultancy, market research, and R&D supports, should be strengthened to achieve above the mentioned aims.

Secondly, KGF needs to be more functional. SMEs have difficulty securing bank credits because they have few assets to offer as collateral. The credit guarantee application which leads to a significant increase in the bank credits to SMEs is of great importance. The credit guarantee fund in Europe has always received a very strong support from the governments. The amount of the fund should be higher in order to contribute to more firms by taking more risks than the risks taken currently in Turkey.

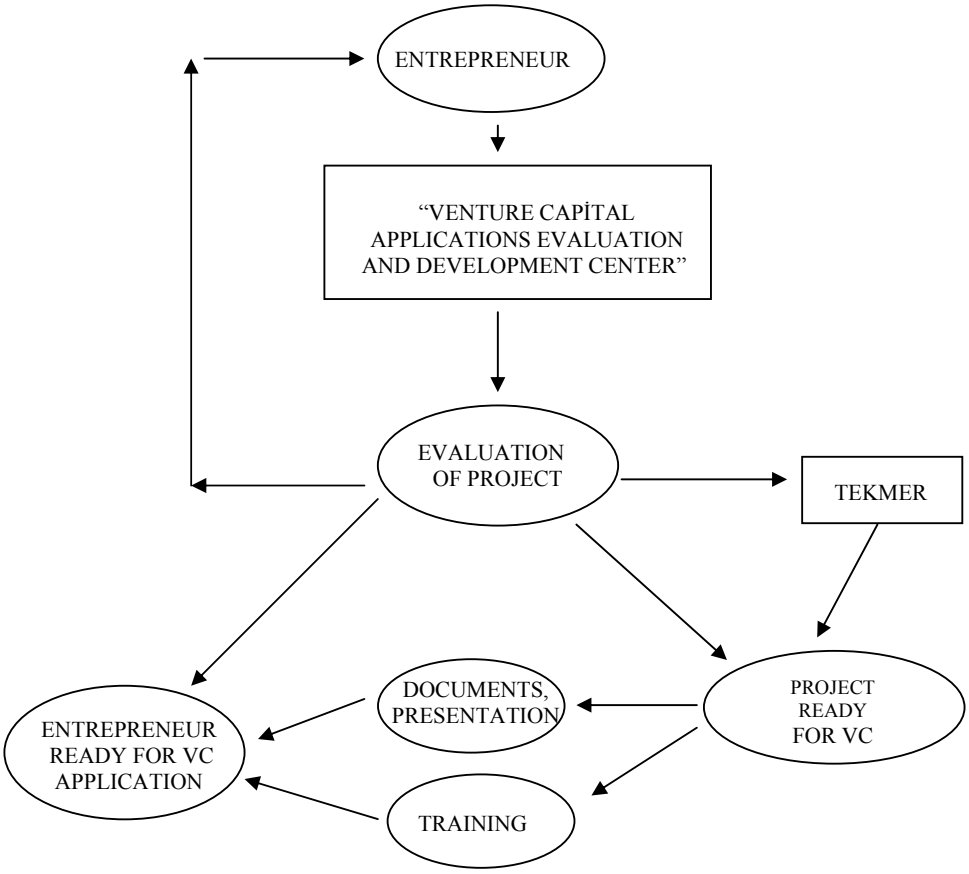
Thirdly, establishment of a center for the evaluation and development of applications of SMEs for VC is required. The center helps SMEs not only in applying for VC, but also in guiding them through R&D institutions and increasing innovativeness. According to the result of interviews, it is seen that in Turkey the

rejection rate of applicant SMEs at the first stage is nearly 90%. The first stage consists of the information given by SMEs about themselves, projects, financial accounting etc. The results emphasize that entrepreneurs should be supported about these issues. The mission of this center is to evaluate the projects of SMEs and direct them to TEKMER if necessary for providing R&D and lastly to provide supports for SMEs in the preparation of application for VC. Therefore SMEs get a chance both to develop their projects and to obtain financial support from VC. Since KOSGEB which has an important knowledge backup about general characteristics and problems of SMEs in Turkey plays an important role to determine SMEs' needs, this center can be established under the supervision of KOSGEB as an autonomous institution. Furthermore TEKMER, which has an important role in developing innovativeness, can give support to the center. TEKMER already provides SMEs with consultancy services, determines their needs and establishes ties with institutions such as universities that provide R&D supports for them. Personnel that work for this center must be proficient with full in VC applications as well as general characteristics and problems of SMEs. This center also needs the help of VC firms.

The work process of this center is as follow:

- Entrepreneur improves his project.
- Entrepreneur decides to apply for VC
- Entrepreneur brings the project to the center.
- The project is evaluated in the center by specialists.
- The project is sent to TEKMER if R&D activities are considered to be necessary at the end of evaluation.
- Financial features, business concept, cash flows, and return on investment etc. for the improved project are completed.
- Entrepreneur is informed elaborately about VC.
- Finally, entrepreneur applies for VC firm.

The scheme for the work process of the center:



Establishment of a center as such would play an important role in the improvement of VC investments in SMEs in Turkey, where one of the most crucial problems is the insufficiencies of SMEs. Furthermore, this center also would be a major instrument for the development of the ties between private sector and university-based R&D, for the prevention of usage of funds for political aims and for creating innovative SMEs with high growth potential.

In conclusion, it can be stated that improvement of the relationship between SMEs, R&D is a crucial means of enhancing the VC investments. According to the study, the reason of the low usage of VC among SMEs is the consequence of their low

level of awareness, projects without high growth potential and the insufficiencies with regard to what VC can provide and what VC expects from them. Moreover, to help SMEs during the application for VC a new center which aims at developing the projects of SMEs and training them during the pre-application period for VC should be established.

In addition, the analysis conducted for this thesis reflects the reasons why venture capital investments are limited in volume and in number in Turkey and the reasons which were revealed by the analysis form the base to make suggestions about the improvement of venture capital investments. However, the improvement of VC financing methods in the country does not depend only on factors above, but also on the economic and political stability which lead the investors who intend to provide funds for investments with high risk to VC investments. For these reasons, maintaining in economic and political stability in country and legislative amendments for the constitution of fund sources for VC necessitate more comprehensive investigations which are considerably important for the development of VC sector.

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APPENDIX A

THE SURVEY QUESTIONNAIRE

1- Write out the "main activity" subject and code of your firm by the help of The International Economic Activity Classification List.

Main Activity Subject ---------- Main Activity Code ----------

2- What is the amount of your firm's start-up capital?

○ Up to 5 billion TLs
○ Between 5-25 billion TLs
○ Between 25-100 billion TLs
○ Between 100-250 billion TLs
○ 250 billion and above TLs

3- What is the amount of your firm's current capital?

○ Up to 5 billion TLs
○ Between 5-25 billion TLs
○ Between 25-100 billion TLs
○ Between 100-250 billion TLs
○ 250 billion and above TLs

4- What is the number of the people employed in your firm?

○ 1-9 ○ 10-24 ○ 25-49 ○ 50-149 ○ 150+

5- Is/Are the owner/owners of the firm the manager(s) in the firm at the same time?

○ Yes ○ No

6- Is there a dept in your firm which is about financial business?

○ Yes ○ No

7- Choose one or more of the following consultancy service field(s) if your firm gets any.

○ My firm does not get consultancy service
○ Personnel Management
○ Accounting
○ Research & Development
○ Marketing
○ Production
○ Public Relations
○ Subsidies
○ Other(state)_____

8- What do you think about the state of your production technology?

○ I use the latest technology.
○ The technology I use is more or less new.
○ The technology I use is old.
○ The technology I use is very old.

9- How did you determine the subject of your investment?

- ○ I made feasibility-market research
- ○ I trusted my feelings, I did not know much
- ○ I have some other investments on the same subject
- ○ I found out it in others as a profitable sector
- ○ Former work experience
- ○ I took over my father's firm, I maintain the same subject

10- Choose the most important 3 at the start-up capital of your firm.

- ○ Capital
- ○ Family-relatives
- ○ Subsidies
- ○ Unofficial financial institutions (usurers etc.)
- ○ Bank Credits
- ○ Venture Capital

11- Do you have financial problems? If yes, choose one or more of the following.

- ○ I do not have financial problem.
- ○ The capital amount of my firm is inadequate.

12- Choose the most important 3 of the following reasons that cause financial problems in general.

- ○ Can not take bank credits.
- ○ The economic and political instability of the country.
- ○ Low profit rates
- ○ Unable to make payments on time
- ○ The instability of the foreign exchange rates.

13- Choose the most important 3 of the following methods you use for the solution of the financial problems that you have.

- ○ Bank Credits
- ○ Family-relatives
- ○ Postpone the payments
- ○ Selling The assets (car, real estate etc.) to collect cash.

14- Which one(s) of the following institutions that support SMEs, has your firm got support from so far?

- ○ I did not get any subsidy.
- ○ KOSGEB
- ○ MEKSA
- ○ IGEME
- ○ TUBITAK
- ○ TTGV
- ○ Treasury
- ○ OSTIM District Office

15- Have you ever used investment subsidies?

○ Yes ○ No

(If your answer is No to the 15th question, then skip to the 17th question.)

16- If your answer is Yes to the 15th question, choose one or more of the following that you have taken advantage of.

- ○ Tax exemption, investment deduction
- ○ Energy subsidy
- ○ Land subsidy
- ○ Budget oriented credit

17- If your answer to the 16th question is No, state why?

○ I have no idea about the subsidies.
○ Application takes time and is costly.
○ I do not have the staff to work on it.
○ I do not think the subsidies provided are sufficient.

18- Have you benefited from export subsidies?

○ Yes ○ No

(If your answer is No to the 18th question, skip to the 20nd question.)

19- If your answer is Yes to the 19th question, choose one or more of the following that you have taken advantage of.

○ Tax exemption,
○ Import exemptions
○ Equivalent goods

20- If your answer to the 18th question is No, state why?

○ I have no idea about the subsidies.
○ I do know about the subsidies but I do not export.
○ Application takes time and is costly.
○ I do not have the staff to work on it.
○ I do not think the subsidies provided are sufficient.

21- Choose one or more of the following technology development support that you got before.

○ R&D aid
○ Market inquiry aid
○ Aid for promoting and operating stores, offices in abroad.
○ Aid for participating to international fairs.
○ I did not get any subsidy.

22- If you have not benefited from any of the support, state why by choosing the most important 3 of the following reasons.

○ I have no idea about the subsidies.
○ I do know about the support but I do not do R&D.
○ I do not need to take support.
○ I need subsidies but the application takes time and is costly.
○ I do not think the support provided are sufficient.
○ I applied but I was rejected.

23- Have you ever benefited from Credit Guarantee Fund?

○ Yes, I did.
○ No, I have never heard of it.
○ I heard of it but I have never benefited.

24- Do you know about the Venture Capital?

○ No, I have never heard of it.
○ Yes, I have applied but I have been rejected
○ Yes, I have heard but I have never used, I am considered about using it in the future.
○ Yes, I have heard but I have never used, I am not considered about using it in the future.

25- Do you think about making a new investment in the next 2 years?

○ Yes ○ No

(If your answer is No to the 25th question, skip to the 27th question.)

26- If your answer is Yes to the 25th question, state below the 3 most important capital sources that you think about using while making a new investment.

○ Equity Capital
○ Family-relatives
○ Subsidies
○ Bank Credits
○ Unofficial financial institutions (Usurers etc.)
○ Partnership
○ Venture Capital
○ Other (state)_____

27- Do you think integration of Turkey with the EU will have an effect on your firm?

○ Yes, positively
○ Yes, negatively
○ No
○ I have no idea.

28- Choose the 3 most important effect that you think the integration with the EU will create.

○ It will facilitate financing.
○ Competition will increase, the quality of production and the standards will improve.
○ New market possibilities will occur.
○ Increased competition will affect negatively.
○ The subsidies provided to firms will raise.

Thank you for your co-operation with this survey.

APPENDIX B

THE INTERNATIONAL ECONOMIC ACTIVITY CLASSIFICATION LIST

1-TARIM, AVCILIK VE ORMANCILIK
01 TARIM, AVCILIK VE İLGİLİ HİZMET FAALİYETLERİ
02 ORMANCILIK, TOMRUKÇULUK VE İLGİLİ HİZMETLER
2-BALIKÇILIK
05 BALIKÇILIK, BALIK ÜRETME VE YETİŞTİRME ÇİFTLİKLERİNİN İŞLETİLMESİ VE BALIKÇILIKLA İLGİLİ HİZMET FAALİYETLERİ
3-MADENCİLİK VE TAŞOCAKÇILIĞI
10 MADEN KÖMÜRÜ, LİNYİT VE TURBA ÇIKARIMI
11 TETKİK VE ARAMA HARİÇ, HAM PETROL VE DOĞALGAZ ÇIKARIMI VE BUNLARLA İLGİLİ HİZMET FAALİYETLERİ
12 URANYUM VE TORYUM CEVHERİ MADENCİLİĞİ
13 METAL CEVHERLERİ MADENCİLİĞİ
14 TAŞOCAKÇILIĞI VE DİĞER MADENCİLİK
4-İMALAT SANAYİ
15 GIDA ÜRÜNLERİ VE İÇECEK İMALATI
16 TÜTÜN ÜRÜNLERİ İMALATI
17 TEKSTİL ÜRÜNLERİ İMALATI
18 GİYİM EŞYASI İMALATI, KÜRKÜN İŞLENMESİ VE BOYANMASI
19 DERİNİN TABAKLANMASI VE İŞLENMESİ; BAVUL, EL ÇANTASI, SARAÇLIK, KOŞUM TAKIMI VE AYAKKABI İMALATI
20 AĞAÇ VE MANTAR ÜRÜNLERİ İMALATI (MOBİLYA HARİÇ); HASIR VE BUNA BENZER, ÖRÜLEREK YAPILAN MADDELERİN İMALATI
21 KAĞIT VE KAĞIT ÜRÜNLERİ İMALATI
22 BASIN VE YAYIM; PLAK, KASET VE BENZERİ KAYITLI MEDYANIN ÇOĞALTILMASI
23 KOK KÖMÜRÜ, RAFİNE EDİLMİŞ PETROL ÜRÜNLERİ VE NÜKLEER YAKIT İMALATI
24 KİMYASAL MADDE VE ÜRÜNLERİN İMALATI
25 PLASTİK VE KAUÇUK ÜRÜNLERİ İMALATI
26 METALİK OLMAYAN DİĞER MİNERAL ÜRÜNLERİN İMALATI
27 ANA METAL SANAYİ
28 MAKİNE VE TEÇHİZATI HARİÇ; METAL EŞYA SANAYİ
29 BAŞKA YERDE SINIFLANDIRILMAMIŞ MAKİNE VE TEÇHİZAT İMALATI
30 BÜRO, MUHASEBE VE BİLGİ İŞLEME MAKİNELERİ İMALATI
31 BAŞKA YERDE SINIFLANDIRILMAMIŞ ELEKTRİKLİ MAKİNE VE CİHAZLARIN İMALATI
32 RADYO, TELEVİZYON, HABERLEŞME TEÇHİZATI VE CİHAZLARI İMALATI
33 TIBBİ ALETLER; HASSAS VE OPTİK ALETLER VE SAAT İMALATI
34 MOTORLU KARA TAŞITI, RÖMORK VE YARI RÖMORK İMALATI
35 DİĞER ULAŞIM ARAÇLARININ İMALATI
36 MOBİLYA İMALATI; BAŞKA YERDE SINIFLANDIRILMAMIŞ DİĞER İMALATLAR
37 YENİDEN DEĞERLENDİRME

5-ELEKTRİK, GAZ, SU
40 ELEKTRİK, GAZ, BUHAR VE SICAK SU ÜRETİMİ VE DAĞITIMI
41 SUYUN TOPLANMASI, ARITILMASI VE DAĞITILMASI
6-İNŞAAT
45 İNŞAAT
7-HİZMET SEKTÖRÜ
50 MOTOSİKLET VE MOTORLU ARAÇLARIN TAMİR, BAKIM VE SATIŞI; MOTORLU ARAÇ YAKITININ PERAKENDE SATIŞI
51 MOTORLU TAŞITLAR VE MOTOSİKLETLER DIŞINDA KALAN TOPTAN TİCARET VE TİCARET KOMİSYONCULUĞU
52 MOTOSİKLET VE MOTORLU ARAÇLAR DIŞINDAKİ PERAKENDE TİCARET; KİŞİSEL EŞYALAR İLE EV EŞYALARININ ONARIMI
55 OTEL VE LOKANTALAR
60 KARAYOLU TAŞIMACILIĞI; BORU HATTI TAŞIMACILIĞI
61 SU YOLU TAŞIMACILIĞI
62 HAVAYOLU TAŞIMACILIĞI
63 DESTEKLEYİCİ VE YARDIMCI ULAŞTIRMA FAALİYETLERİ; SEYAHAT ACENTALARININ FAALİYETLERİ
64 POSTA VE TELEKOMÜNİKASYON
65 SİGORTA VE EMEKLİ SANDIĞI HARİÇ, MALİ ARACI KURULUŞLARIN FAALİYETLERİ
66 ZORUNLU SOSYAL GÜVENLİK HARİÇ, SİGORTA VE EMEKLİLİK FONLARI
67 MALİ ARACI KURULUŞLARA YARDIMCI FAALİYETLER
70 GAYRİMENKUL FAALİYETLERİ
71 OPERATÖRSÜZ MAKİNE VE TEÇHİZAT İLE KİŞİSEL EŞYA VE EV EŞYALARI KİRALANMASI
72 BİLGİSAYAR VE İLGİLİ FAALİYETLER
73 ARAŞTIRMA-GELİŞTİRME
74 DİĞER İŞ FAALİYETLERİ
75 KAMU YÖNETİMİ VE SAVUNMA; ZORUNLU SOSYAL GÜVENLİK
80 EĞİTİM
85SAĞLIK İŞLERİ VE SOSYAL HİZMETLER
90 KANALİZASYON VE ATIKLARIN TOPLATILMASI, HIFZISIHHA VE BENZERİ HİZMETLER
91 BAŞKA YERDE SINIFLANDIRILMAMIŞ ÜYESİ OLAN KURULUŞLARIN FAALİYETLERİ
92 KÜLTÜREL VE SPORTİF HİZMET FAALİYETLERİ
93 DİĞER HİZMET FAALİYETLERİ