

# ATTRACTING VENTURE CAPITAL TO THE WOODWORKING INDUSTRY OF THE CHERNIVTSI REGION

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## ***Abstracts***

*The downturn on traditional for the Ukrainian venture funds markets (construction, financial, retail) intensified the problem of finding projects attractive for both the venture capital and regional growth. Woodworking industry is among the state's strategic priorities in many countries, including Ukraine; it is developing in regional clusters with synthetic knowledge base and requires more venture capital for fast innovative transformation. We offer a mechanism for creation and developing of the regional competitive advantages and attraction of venture capital.*

**Keywords:** venture capital, woodworking cluster, innovations.

**JEL Classification:** E<sub>22</sub>, E<sub>24</sub>, J<sub>21</sub>.

Stable regional development in the conditions of finance crisis and knowledge-based economy is impossible without the innovation processes that turn the knowledge and ideas into the new goods, processes and services. Strong and innovative active regions are the basis of the competitiveness of the nation. Venture capital plays an important role in stimulation of regional innovation economic development. The venture investments flow to the new and growing companies in the most dynamic industries of the region. The growth of new companies, working places, competitiveness of products, revenues, productivity and the quality of the management in venture-backed companies is much higher than average in the economy. New generations of technological companies in the region create the effect of so-called serial entrepreneurship, inflow of highly qualified labour and development of other industries in the region due to the secondary creation of new enterprises. Besides, venture capitalists take an active role in activity of the venture-backed companies, bringing their knowledge, networking ability, experience. The main functions of venture capital in stable

regional development of scientific-industrial, incubation of local entrepreneurship, investment supply, guarantee the structural renewal of the regional economy. Venture capital also develops physical infrastructure of the region – roads, communications, services etc. that has a positive impact of the regional economic development.

Venture funds are mostly active in highly technological spheres that are concentrated in the industrial and scientific regions of the country. But the welfare of the nation is being formed in the result of the rational utilization of all the resources of the country. That is why such areas as materials, chemistry, optics, energy saving, forest-based industries become more attractive for the venture capital in the global economy and under the pressure of the financial and economic crisis. Such simple commodities as concrete, wood and other building materials are being transformed in the result of innovations financed with venture capital. The downturn at the traditional for the Ukrainian venture capital markets like construction, finances and retail challenge venture capitalists to look for the new projects that can bring desired profit for the investors and have a positive impact on the regional development. The woodworking industry is quite important for many regions of the country and requires venture capital for the fast innovative transformations. Such countries as Canada, USA, Austria, Italy, Germany, New Zealand and Australia consider the woodworking industry among the state strategic priorities and develop it in the framework of regional clusters with a lot of support of the venture capital. In most cases a woodworking cluster consists of suppliers of the raw materials, equipment, services, knowledge and technology, finances (first of all venture capital); producers, distribution system on the national and international markets. The most well-known and successful woodworking clusters are the Livenza River (Italy), Salling (Denmark), Salzburg (Austria), Oregon, Main, Kentucky and New-York (USA), Lorain and Champagne-Arden (France), Howk-Bay (New Zealand), National Woodworking Cluster (Slovenia), Cluster Pannon (Western Trans Danube Region, Hungary). Clusters based on furniture techno parks function in Russia – “Furniture Techno Park” in Saints Petersburg and “Peresvet” in Moscow. The initiative of the local authority and the ability of the venture capitalists to understand the perspective of the development of both the industry and the project play an important role in the development of woodworking clusters. The regional authorities of Chernivtsi region have determined the forest-based industries among the priority directions for investments: deep wood processing, producing of fuel briquettes and equipment for their use, furniture industry, and production of woodprocessing equipment. A cluster analysis of the forest sector of the Western region of Ukraine (Transcarpathian, Chernivtsi, Lviv and Ivano-Frankivsk regions) that are responsible for the 40 % of the industrial products of the industry is under the development in the framework of the Swiss-Ukrainian project of the development of the forest sector.

The analysis of the state and private programmes of support of the forest-based industries in many countries showed that all of them are focused on creation of new innovative programs, technologies, products that ensure the creation of the higher added value, energy saving and environmental protection, that is for the creation of the clear competitive advantages of certain companies, regions and countries. These activities attract venture capital to the development of woodworking industry. For example, the Chinese venture funds had invested more than 150 billion USD in the industry during just two last years. There are a lot of examples of venture financing of projects in forest-based industries in Canada, USA, Europe, and Russian Federation. Many American and European venture funds are sure about substantial perspectives of development of such forest-based markets as bioethanol, biomasses and granules for heating.

Ukrainian programmes of regional development and venture funds consider woodworking industry as non-innovative; they are oriented on the support of the current conditions in the industry and stable social and economic development of the regions. Despite this fact, there are a lot of scientific and research activities in the forest-based institutes. But too little companies are introducing really innovative technologies now. With the average number of innovative active companies in the Ukrainian economy of 14.2 % in 2007, the figure for the woodworking industry is only 8,2 %. Most of them report about introduction of process innovations and products that are new for the certain company. This corresponds with the research of innovative activity of woodworking companies in the USA and Mexico that showed that big woodprocessing companies with large financial resources outperform small companies in process innovation, while the managers of small companies are quite active in product and business innovations that allows them to compete with big companies.

The indices of innovation activity of the Ukrainian woodworking companies are too small to ensure for the fast growth of the industry and attraction of venture capital. There is a point of view that Ukrainian woodworking scientific and research institutes, small companies have a lot of developed technologies and just need the money for their implementation but the investors just do not see them. But in most cases these are just the ideas that are not suitable for the market, consumers of investors. They are on the R&D stage and require a lot of money and time for testing and development. But the consumers want the goods not the concepts, investors are ready to invest in contracts not in ideas on conceptual stage. On the other hand, it's quite difficult to offer a breaking technology or product that will change the world and will compete on the global level. The company Innovative Ventures Inc. (USA) has offered a very interesting way of creation and development of the national technologies and knowledge that become the basis for the formation of the competitive advantages of a country on

international markets. The Ukraine can use this scheme in the woodworking industry in the following way.

First of all we need to define the local needs and concentrate on their satisfaction. For example, the IKEA Company has been planning to enter the Ukrainian market for a long period of time. Its business approaches are very innovative; a lot of products are produced locally. To make it possible for IKEA to work on the Ukrainian market, there should be a domestic supply chain built accordingly to the European standards. Besides, there is a need for development of logistics that includes different technologies. That will enable Ukraine to use the geographical advantages of the country and the fact that more and more furniture and woodworking products are moving between Asia and Europe. Having a developed woodworking and furniture infrastructure it is possible to provide a lot of different additional services like further processing, storage etc. in the framework of the logistics chain.

The realization of such a plan requires a purposeful investment support from both the state and private investors. Ukrainian woodworking companies should clearly understand, define and substantiate the needs to be satisfied with the new technologies and products, understand the real demand for these technologies and products, develop the idea for the immediate implementation if they are to obtain venture capital. Besides the idea they need to have a realistic business-plan that shows the potential market growth that is very important for the venture capitalists. There also should be an exit strategy for the venture fund. It's almost impossible to go to IPO for the young company in Ukraine. That is why it's important to concentrate on the possibility of merger of MBO in 5-7 years. That is possible under the condition of having a strong brand that creates a market value of the company. Another direction is the development of technologies that ensure the cost reduction, quality improvement that are vital for the national market. In the future they will become the catalyst of the development and the object to sale on the world market.

So, the analysis of the possibility of attraction of venture funds for financing of the regional projects in the woodworking industry showed that it's quite possible, especially in the conditions of the financial crisis with the shifts to the real economy. Despite the stable growth during the last years and good perspective of the development of the market even in the crisis conditions, weak state regulation, quite competitive market environment, presence of raw materials, introduction of new technologies the woodworking industry is not considered to be the most attractive for the venture capital by the Ukrainian venture funds. But the foreign experience show that purposeful policy aimed on creation and development of new resource saving technologies and productions, fundamental changes in the quality of goods for the domestic markets can be a catalyst for the development of the originally non-technological industries and spur on the development of similar technological industries. And

this attracts venture capital for the commercialization of technologies and allows offering the products to the companies of the same industry of the other countries. Also, taking into account the low level of the development of the stock market in the Ukraine, the woodworking companies should develop the brand and management technology, especially logistics to ensure for the high market value of the company at the time of exit of venture capital.

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