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VENTURE CAPITAL FINANCING IN THE REPUBLIC OF MACEDONIA: WHAT IS DONE AND WHAT SHOULD BE DONE?

Veland Ramadani[1]
[1]South-East European University, Macedonia

Abstract. *Venture capital represents a very interesting solution for the new and existing small and medium sized enterprises which have interesting and attractive ideas and projects, but are short of finances. The specific importance that lies on venture capital and its impact on small and medium sized enterprises is the fact that they provide much more than money for them. Beside the money they offer advices, experiences and contacts, which can increase the success possibilities of small and medium sized enterprises. This paper provides analyses of the current situation in the Republic of Macedonia related to the development of venture capital - what is done and what should be done? It also gives data on the features of investments made by venture capital funds, established by Small Enterprise Assistance Funds - SEAF from USA (SEAF Macedonia, Small Investment Fund and SEAF Fund for Southern Balkans) as the only funds which provide venture capital in Macedonia. The data are related to the number of investments made in Macedonia, preferred sectors for investments, amounts of invested capital, factors that affected these investments, received benefits of businesses from invested venture capital, level of success achieved from investments etc. In this paper also are given some measures, which should be taken into consideration for the development of venture capital in Macedonia.*

Keywords: *Business angel, venture capital, venture capital fund, carried interest, management fee, SEAF Funds, Macedonia.*

Introduction

Venture capital, as an equity financing is “now considered an integral part of a healthily functioning economy, enabling the formation and growth of businesses that are unable to raise debt or other sources of finance.” (DTI 2005, p.9). Some evidences show that investing in the equity of companies begun during the Roman Empire (Caselli 2010, p.3), which mean that the idea of investing capital in risky businesses and seeking sources of capital is not new. Further in the fifteenth century explorers - adventurers to sail around the world looking for a big wealth in exotic locations was needed to find financial resources from someone. Using their connections with the king or queen they came to the appropriate financial means for realization of their goals. It can be stated that the first venture capitalist was the Spanish Queen Isabella, who invested in its well-known entrepreneur Christopher Colombo for various researches and searching for new places (Hill & Power 2001, pp.2-5). In the nineteenth century a large number of wealthy individuals and families financially helped researchers of new technologies. Immediately after The World War II, in 1946 was formed the first venture capital fund, American Research Development Corporation, which initially invested in new companies with great growth potential, mainly composed by soldiers returning from the war, and later it invested in other businesses types as well (Ibanez 1989, p.32). It is assumed that the term "venture capital", for the first time is mentioned by Jean Carter Witter in 1939 in an open forum at Convention of Associations of Investment banks of United States of America, and since then venture capital began to be considered as a particular source of financing small and medium enterprises (Kenney 2000, p.2). The term "venture capital" derives from the nature and characteristics of investment projects in which the capital is invested. Because the bulk of investment projects are characterized by a high degree of risk and the capital invested in them is qualified as "risky." (Gladstone & Gladstone 2002; Ramadani & Gerguri 2011)

Venture capital is often invested in small enterprises which deal with scientific studies and application of modern technology, in which investments are characterized with a high risk. If they realize a successful penetration in the market, then they will achieve a high level of profitability, in compared with other enterprises. In the seventies as risk investments were considered companies that were engaged in production and development of computers (Ramadani & Gerguri 2011).

As features of small and medium enterprises, which are distinguished by a high degree of investment risk, are: the availability of a strong potential of growth and development, orientation to the rapid growth and great development of the product for a short time period; appearance on the market with completely new products or products that have been modified.

But it should be noted that not all businesses are attractive for investment by venture capitalists. According to many studies in different countries of the world, venture capitalists analyze 100 to 200 projects before they invest their financial means, and invest only in small number of them (Silver 1985; Van Osnabrugge & Robinson 2000; Benjamin & Margulis 2001, Fiti 2007, Gaston 1989).

At the new era, venture capital marks developments even in some countries in transition, including and Macedonia. Causes for this capital development are different, for example, 1) necessity that investment project with a high degree of risk to be financed in a more flexible way rather than financing through bank loans, which are characterized by fixed costs and fixed date credit returns and 2) development of small and medium enterprises as a source of innovation, new jobs creators and their role in the holistic development of the state.

Characteristics and importance of venture capital

Venture capital (VC) represents the financial funds, usually in equity form and know-how management, which are invested by individuals and institutions in small and medium enterprises, which are not listed on the stock exchange and have high growth potential. Cary (1993) defines a venture capital as external capital, usually in equity form, invested in high risk new companies and new technologies, which offer the possibility of gains as a compensation for the high risks involved in such investments. According to Albach, Hundsiek and Kokalj (1986, p.166), venture capital represents “long-term investment in the form of equity capital, or similar to it, in small and medium enterprises - new and existing, which includes not only financial resources but also managerial advices”.

Duffner (2003) explain venture capital through seven characteristics: finance of risky ventures, equity capital finance or similar, minority shares, limited time horizon, private intermediary, control and monitoring rights and management support. The explanations of these characteristics are shown in Table 1.

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Table 1. Characteristics of Venture Capital Financing (Source: Duffner 2003, p. 19)

Characteristic	Explanation
Finance of risky ventures	Portfolio companies are small growth companies
Equity capital finance or similar	Renunciation of fixed claims lowers the risk of early bankruptcy
Minority shares	The portfolio company's character as independent enterprise stays alive
Limited time horizon	The investment is to be drawn out after 5 to 10 years; the venture capital firms profits from capital gains
Private intermediary	The venture capitalist is a private profit-seeking intermediary
	between investor and portfolio company
Control and monitoring rights	These ensure that the portfolio company behaves as planned
Management support	Active increase in value by assisting the portfolio companies'management

Venture capital can be presented in two basic forms, *business angels*, as informal venture capital funds and *formal venture capital funds*, which will be addressed in the following pages.

Informal venture capital: Business angels

Business angels (angel investors) as an informal source of capital, represent important force in the financing and the management support to newly created enterprises. According to Ramadani (2012; 2009), business angels represent private investors who, during their active work, have gained wealth and experience and are ready to invest in new enterprises in order to help young entrepreneurs and profit simultaneously. Mason and Harrison (2008, p.8) define business angels as individuals, who act alone or in a formal or informal syndicate, who invest their own money directly in an unquoted business in which there is no family connection and who, after making the investment, takes an active involvement in the business.

In literature and practice we can see certain types of business angels. Main division is as follows: active, latent and virgin angels (Mason 2006; Ramadani 2009) *Active angels* are people who have great experience in investment and continue to seek investments permanently. *Latent* a*ngels* are passive investors who have experience in investments, but have not invested in the past three years. *Virgin angels* are people who want and seek to invest, but have not made their first investment yet.

Sørheim and Landström (2001) have identified four types of angel investors (lotto, trader, analyst and real angels) in their research in Norway, taking as criteria the investment activity and the competencies of the angel investors. *Lotto-angels* are characterized by the following: Investors with a limited managerial and entrepreneurship experience; Insist on realizing less income and wealth in comparison to other investors; Invest a small share of their fortune in companies that are not highly ranked in the stock market; Media are a significant source of information. Very few, if none, use the networks to find information about investment possibilities; their involvement in the companies they invest in is very little; do not invest in cooperation with another investor, but do so alone. *Trader-angels* are characterized by the following: Investors that have a high level of investment activity, make an average of 4,5 investments in a period of 3 years; Have a limited managerial and entrepreneurship experience; Investors that insist on realizing high income and wealth; Invest a significant portion of their fortune in companies that are not highly ranked in the stock market; Their involvement in the companies they invest in is relatively limited; The investment period lasts less than 3 years. *Analyst-angels* are characterized by the following: Investors that possess great managerial and entrepreneurship experience, but have a low level of investment activity; Invest a small portion of their fortune in companies that are not highly ranked in the stock market; Their friends and colleagues represent a significant source of information; Realize their investments in cooperation with other investors; More than 2/3 of these investors invest regionally, in a period of three years. *Real angel investors* are characterized by the following: Investors with a very high level of investment activity, realizing an average of 7,3 investments in a period of three years; Investors with a large managerial and entrepreneurship experience; A large number of these angel investors invest in cooperation with other informal investors; A large percentage of these angel investors function as leaders; Personal and business networks are their primary source of information, whereas media are rarely used as a source of information; Generally, for these angel investors the investment period lasts longer in comparison with the other three types of investors; They play an active part in the companies they invest in, as members of the board or advisors.

Coveney and Moore (1998) identify three types of business angel: Entrepreneur angels, income seeking angels and wealth maximising angels. The characteristics of these types of business angels are presented in Table 2.

Table 2. Types of business angel (Source: Coveney and Moore, 1998)

Characteristic	Entrepreneur angel	Wealth maximising	Income seeking
Total funds invested	590.000 £	131.000 £	35.000 £
No of investments	3.4	2.1	1.5
Personal net worth	74% > £1m	43% > £1m	35% > £1m
Reason for investing	returns/fun	returns	job/income
Average total amount invested	174.000 £	54.000 £	24.000 £
Average initial amount invested	111.000 £	21.000 £	17.000 £
Average number of rounds	2	1.75	1.5
Average number of co-investors	2.3	2.5	3.0
Average size of equity stake taken	38%	31%	20%

Benjamin and Margulis (2000) identified nine types of business angels: value-added investors, deep-pocket investors, consortium of individual investors, partner investors, family of investors, barter investors, social responsible private investors, unaccredited private investors and manager investors.

Business angels, in order to raise their relevance and efficiency establish their own syndicates and networks.

Business angels' syndicates are associations of angels, who combine their capital, experience and knowledge in order to share risk and invest in better and bigger deals. The syndicate, which was established in Silicon Valley in 1995, named as Band of Angels, is considered as the first angel investors' syndicate. Then were formed and other angels' syndicates, such as Tech Coast Angels (1997), Sierra Angels (1997), Common Angels (1997) and The Dinner Club (1999). In the U.S. there are about 200 angels' syndicates. They are grouped according to sectors in which they invest, investors' gender, etc. such as health care angel's association, female-angels' associations, national association of cohesion and meeting the angel syndicates, in order to transfer knowledge and experience, lobbying, data collection, etc. (Mason, 2006).

Business angels' syndicates have appeared since individual angels found advantages of working together, greater flow of investment opportunities (deals), better evaluation of investment opportunities (due diligence), ability to make more and larger investments, and other benefits.

Business angels' syndicates can be managed in two ways. They can hire a professional manager, or may choose one or more members of the syndicate who will manage them. A professional manager manages all things of the syndicate, such as looking for interesting deals, analysing and evaluating them and if there is an interesting deal, he recommend the syndicate to invest on it. Manager for his work done in the syndicate can be paid through salary, participates in part of the profits of a successful deals, or a combination of these two ways of compensation. Syndicates managed by their members elect the most prominent members to manage the syndicate's issues. The members elected to manage the syndicate's issues in some cases are compensated for their work, but in most of cases, they manage the syndicate's issues without any compensation. These members are bound to find interesting deals, to evaluate them and to present them to the other syndicate's members eventually to invest in them.

Business angels' syndicates organize meetings once a month, while some of them has meetings every week. They are more in the form of a joint dinner at which syndicates' members discuss specific investment opportunities, their characteristics, etc. At these meetings could be invited 1-3 entrepreneurs who will present their business plans, under which angel investors would decide to invest in their enterprises.

Business angels' networks are organizations whose main goal is to connect owners of small and medium enterprises and angel investors, or they are organizations which facilitate the process of connecting entrepreneurs and angel investors.

There are two approaches for establishing networks of business angels, such as:

- Top-down approach,
- Bottom-up approach (Gullander and Napier, 2003).

Top-down approach is used when public authorities initiate the establishment of the network. For example, the Danish government has initiated a National network (DMBA), and after that DMBA helped the building of several regional networks. In cases where the private sector initiates the establishment of a network, that approach is known as bottom-up approach. Such is the case with the Danish biotech network. Angel investors of existing regional networks identified a lack of investment opportunities in bio-technology sector, and therefore developed a new network with his specific activities and own management team (Gullander and Napier, 2003).

Formal venture capital

The origins of modern formal venture capital is related with the formation of the American Research and Development Corporation (ARDC) in 1946, which was mentioned beforehand, at the initiative of General Georges F. Doriot, who is also known as "the father of the formal venture capital", together with Ralph Flanders and Karl Compton, in order to support investments in the weapon industry, and soldiers returning from World War II to form and lead their own businesses (Ibanez 1989, Berkery 2008, Gompers & Lerner 2000). ARDC, as the first formal venture capital fund, the most successful investment marked in 1957 when it invested $ 61,400 in Digital Equipment Corporation (DEC), which in its first appearance on the stock exchange in 1968, was valued at $ 355 million. DEC began with "a table and two people", while in 1971 numbered 7000 employees. ARDC Fund continued to invest up until 1971, when the founder George F. Doriot was retired. In 1972, Doriot merged ARDC with another fund - Textron. ARDC had so far invested in more than 150 enterprises. According to the ARDC system, other venture capital funds were formed (Duthel 2008; Bygrave & Timmons 1992).

The formal venture capital represents the capital mobilized by pension funds, insurance companies, corporations, financial institutions, academic institutions, individuals and others from the venture capital firm, which manages the same and invest in small and medium enterprises that are not listed on the stock exchange within a limited period in order to realize a profit for themselves, investors and entrepreneurs.

There are several types of formal venture capital. On the basis of who provides the capital, we can distinguish *state venture capital* (government, is usually the sole investor), *financial venture capital* (investors are banks and other financial institutions), *corporate venture capital (*non-financial corporations are investors) and *venture capital partnership* (partnership between so called institutional investors and venture capital firms).

Formal venture capitalists invest large sums of capital in the enterprise, which are already developed, respectively, have exceeded the risky stages of their life cycle. In this way, formal venture capitalists support only when entrepreneurs are convinced that the business to some extent has proven to be successful, this mostly can be seen through the positive sales figures and profits. They simply are "part” of a particular investment in a period of 3-10 years.

The companies that work with venture capital are divided in independent, captive and semi-captive (EVCA 2007; Sherman 2005; Megginson 2001). *Independent companies* are those which raise capital for investments from other sources (pension funds, insurance companies, corporations, wealthy individuals and families, etc.) and invest in small and medium enterprises. *Captive companies* are those that raise capital for investment by the parent company, which is the dominant financer of the investment fund, which is created by the company for venture capital. The captive company is a subsidiary or department of a bank, financial institution, insurance company or industrial company. These firms are formed to seek new ideas and projects for investment, which are related to the sector in which the parent company operates. Banks create these firms/sectors to distinguish their commercial activity from the investment one. *Semi-captive companies* are almost the same with the previous, with the difference here that aside the parent company, largely as financers a third party appears.

Venture capital companies, in most cases are structured as partnerships or limited liability company, as presented in Figure 1.

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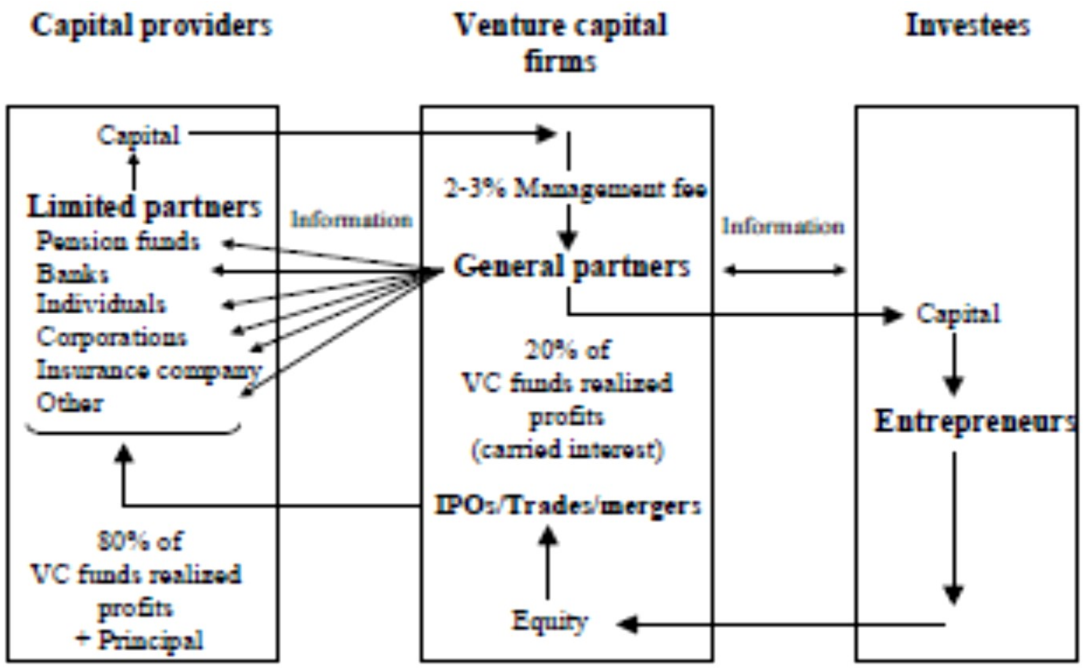
Figure 1. Venture Capital Partnership (Source: Based on Bygrave et al., 1999; Smith and Smith, 2000.)



Venture capital companies for their efforts and investments made are compensated in two ways, through a *management fee* and *carried interest*.

Venture capital companies receive annual compensation, known as *management fee*, which amounts to about 2–3% of the committed and dedicated capital for investment. Management fee usually serves for payment of workers engaged in the investment process, office rent, phone, electricity, travel expenses and marketing costs. Litvak (2009) investigated thirty–seven partnership agreements of seventeen companies for venture capital to analyze the ways of determining the forms of management fee. Each form contains two basic elements: (1) base, and (2) part of the base which is paid annually to companies for venture capital. The base can be comitted capital, managed capital or some combination of these two. The base and the percentage added to the base can be constant or variable. She noted the following forms of setting the management fee:

a) Flat fee based on a percentage of committed capital – the fee is a pre–set percentage of committed capital - the total amount that investors have agreed to contribute to the fund;

b) Declining fee based on percentage of committed capital – the fee is calculated as a percentage of committed capital, but the percentage declines in later years of fund's life;

c) Declining fee based on combination of committed and managed capital – early–year fees are set as a percent of committed capital, while later-year fees are set as a percent of managed capital;

d) Fee based entirely on managed capital – the fees are calculated on the basis of managed capital throughout the life of a fund;

e) Absolute dollar amount – the management fee is set as a flat dollar amount, rather than as a percent of committed capital and this amount declined over time.

Carried interest is around 20% of profits from investments made. It is distributed to venture capital companies, after the investors (limited partners) have returned their invested means.

Figure 2. Venture capital investments worldwide (Source: Lerner, 2011.)

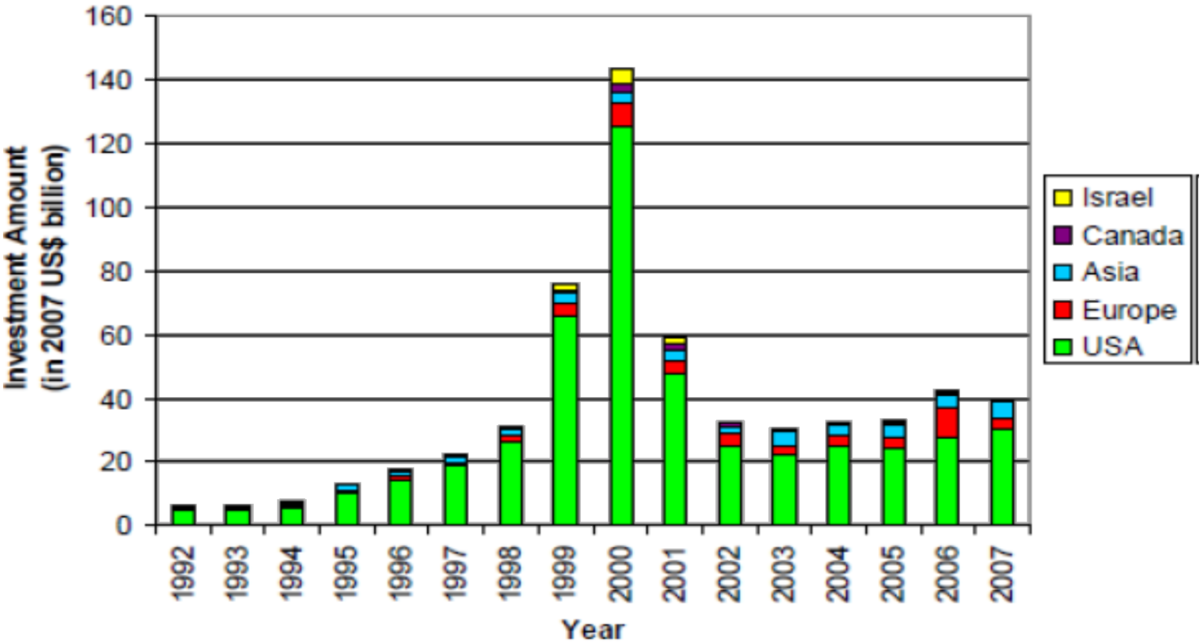


Table 3. Venture capital activity by top ten countries (Source: Brander et al. 2010.)

Country	*No. of enterprises*	*Enterprise with GVC finance (%)*	*Enterprises with an exit (%)*	*Enterprises with IPO (%)*
USA	10,869	4.53	17.4	1.55
UK	1,515	3.43	12.94	3.96
South Korea	1,394	4.23	13.2	13.92
China	1,308	19.8	15.67	13.3
India	855	18.13	14.5	6.78
France	815	24.91	12.39	4.05
Japan	771	1.30	14.66	8.3
Australia	659	3.95	17.91	8.5
Germany	492	34.76	10.77	3.66
Canada	426	51.88	21.83	6.1

Venture capital is particularly important for small businesses. *Firstly*, the amount of funds that venture capitalists (formal and informal) have invested or intend to invest is quite significant (See Figure 2 and Table 3). Just to illustrate, in the U.S. in 1999, formal venture capitalists have invested about $ 8 billion. This amount was distributed in 1.840 deals, or in average, $ 4.35 million per deal. In 2000, there were invested $ 105 billion, followed by a real collapse in the next years, as in 2003 there were invested only $ 20 billion, which represents only one fifth of the funds invested in 2000. A slight improvement followed afterwards, where in 2007 they invested $ 31 billion (Erber 2009). Regarding the business angels, there are 300.000 - 350.000 active business angels in the United States, who invest $ 30 billion per year in 50 000 deals, while in the United Kingdom there are 20.000 to 40.000 business angels, who invest £ 0.5 to 1 billion per year in 3,000 to 6,000 companies (Mason 2006). If we take into consideration the fact that business angels prefer to remain anonymous, then the above given calculations are underestimated and differ from the real situation. According to Sohl (1999) the ratio between active and potential business angels is 5:1. *Secondly*, many entrepreneurs are interested in the so called “smart money”, which would mean that venture capitalists in companies do not invest only money, but expertise and know-how as well, and due to this reason, venture capitalists are more and more “interesting” for entrepreneurs in comparison to other sources of capital. *Thirdly*, venture capitalists have a lot of experience in the business. During their work, venture capitalists have earned many relationships, namely have created a network of contacts like successful entrepreneurs, bankers, insurance companies, accountants, etc. Once they invest in small and medium enterprises, they use these contacts in order to help these enterprises to develop and reach positive financial results. This will make their dream come true. *Fourthly*, the importance of venture capitalists for small and medium enterprises is linked to succession. It often happens that after retirement or death of the owner of the enterprise, a part of his successors do not want (or cannot) carry on the same business. According to a research made in Australia, 63% of businesses are in hands of the succeeding first generation, and only 7% of businesses are led by the third and 4% by the fourth generation, respectively (Abernethy & Heidtman 1999, p.53). In such cases, business will survive, if it is successful or it has the needed potential to be successful, thankful to venture capitalists, especially to business angels.

Evolution and perspectives of venture capital industry in Macedonia

Venture capital investments in developed countries contribute to creation of so-called "success stories" that were a sufficient motive to transition countries to start thinking about this kind of investments. Venture capital investing, although in much smaller scale, recently became a reality in countries in transition. The financial system in Macedonia is shallow and unbranched system and is characterized by limited access of SMEs to financing sources needed for their growth and development. Venture capital as an important source of financing is almost completely absent in the Republic of Macedonia. Consequently, our small and medium enterprises are deprived from "one of the most favorable and most quality financing sources for their development" (Fiti 2007, p.215).

In 2007 the Government launched an initiative to open three venture capital funds (with the participation of state capital) in order to determine is there a willingness of the private sector to invest together with the government in promising, risky investment projects. Some activities around this initiative took place during 2007, but ended unsuccessfully (Ministry of Economy of the Republic of Macedonia, 2008).

Legal context and institutions

Eventhough announced for several times, a special legal framework for establishing venture capital funds in the Republic of Macedonia has not adopted yet. However, the establishing and operation of these funds in some extent is regulated under the Law on Investment Funds (from 2000, which suffered amendments in 2007 and 2009), which enables the formation of private funds, whose operation is similar with the operation of venture capital funds. Private funds are established to raising funds through a private offering, which are then invested according to the aims of the fund. According to Article 41 b of the Law on Investment Funds (Official Gazette of Republic of Macedonia 2007): a) A private fund is established in temporary basis that can not be shorter than eight years; b) The size of the fund is at least 500.000 € converted in denars. Under the fund's size means a committed capital from all investors during the entire time of existence of the fund; c) Minimum taken concerted commitment of investment of each investor in the private fund can not be less than 50.000 €

converted in denars which the investor is obliged to pay on a call of the company for managing private funds in accordance with the provisions of the prospectus; d) The maximum number of private investors in the fund is 20 investors; e) Private fund is established and managed by a company for managing private funds; f) To establish a private fund, the company for managing private funds adopts a statute and prospectus of the fund; g) The private fund can borrow without any limit.

The venture capital market in Macedonia is very poor. Recently the interest for formal venture capital started to take place, while business angels still remained “unknown term”.The only funds which invest in the form of venture capital and operate in Macedonia are funds established by the U.S. Fund for Small Businesses - SEAF (Small Enterprise Assistance Funds - SEAF). SEAF is a global investment company based in Washington, where its work focuses on providing capital for business development in fast growing markets as well as those who lack traditional sources of capital. These funds are: SEAF Macedonia Small Investment Fund (SIF) and SEAF Fund for South Balkans.1

SEAF Macedonia was established in 1998. SEAF Macedonia is a small venture capital fund with total capital of $ 13 million. The founders and investors of SEAF Macedonia are: The European Bank for Reconstruction and Development (EBRD) - which has invested $ 4 million, the International Finance Corporation (IFC) - 2,5 million $, the German Investment Company (DEG) - 2,5 million $ and The U.S. government's Agency for International Development (USAID) - $ 4 million. The mission of SEAF Macedonia is making wise investments in small and medium businesses.

Small Investment Fund (SIF) was established in July 2007 and until now has made three investment in Macedonia, such as: Oktober (company for producing toilet paper), INet (system integrator and distributor of various products of information and communication technology) and Urban Invest (the largest producer of concrete paving elements and mosaic products).

SEAF Fund for South Balkans was established in 2006. The headquarters of the fund is in Belgrade, Serbia. This is a regional fund and operates in Serbia, Montenegro and Macedonia. SEAF Fund for South Balkans has not invested in any company in Macedonia. Currently is preparing three investments in our small and medium enterprises, but because the principle of "business secret" the names of companies and amounts of investments were not disclosed.

Until now, in Macedonia is registered only one angel investors’ network, called *I2BAN*. This network was established on May 2011 as a part of USAID Competitiveness Project. I2BAN aims towards: a) Bringing together the most renowned and prominent business-people in Macedonia and connect them with the best investment opportunities in start-up businesses; b) Building new venture investment culture in Macedonia by creating more financial sources for start-up companies. The vision of I2BAN is to become the leading angel network, investor club and seed investment platform in Macedonia for innovative startup companies. I2BAN already has 10 members - business angels and dozens of proposals for business that are currently being evaluated (Ramadani 2012).

1 Data on realized investments of SEAF and their specifics are primarily. They were obtained through questionnaire with companies and interview with Mr. Martin Stosic - Investment analyst in SEAF, carried out by the author.

Venture capital investments features

Until now, SEAF is the only one fund that has invested in Macedonia and based on these investments we should provide a profile of venture capital investments in our country.Venture capital investments features can be summarized as follows:

a) *Provided services*. Investments in these companies are carried out in combination with management training and technical support in order to improve their business performance and achieve their development goals. The fund actively supports its portfolio companies in implementing appropriate improvements in the techniques and practices of management, particularly those related to financial control, cost accounting, quality control and marketing (see Figure 3).

Figure 3. Types of support offered by SEAF Macedonia

b) Preferred sectors. Information obtained from our research related to SEAF funds investments say that they mostly are focused in the sector of production (42.86%), followed by trade sector (28.57%), media (21.43%) and internet traffic (7.14%).

c) Invested amounts and preferred development satge of the company. In terms of invested amounts, for the most part, respectively 35.71%, they moved within 100,001 to 500,000 $. The most part of the investments were made in the early stage of development of enterprises, in 78.57% of total investments. Only one investment is made in seed phase, while none in the start-up phase of development. In the late stage are made 14.29% of the investments.

d) Ownership share. In enterprises where SEAF invested his funds, the percentage of the share of ownership that was taken from SEAF, in 42.86% of cases is moving from 20-40% (the share of ownership does not exceed 49%, with the exception of On.Net, where SEAF had taken 64% of ownership).

e) Exit strategies. SEAF used these strategy to exit from its investments: management by out (42,86%), exit through strategic partner (14,29%), selling to third party (14,29%) and others (28,56%). Until now, only from three investments SEAF has not exited yet.

f) Results from the investments. According to SEAF, from previous investments made, in terms of success, they are categorized as follows: 42.86% moderately successful, 28.56% very successful, 14.29% slightly successful and 14.29% finished with failure (realized loss).

g) Portfolio of companies. SEAF Macedonia has invested in 14 enterprises in Macedonia: Login Systems (authorized distributor of the largest IT companies in the world, such us Microsoft, Cisco Systems, Hewlett-Packard, Navision Solution Center and provider of solutions and services from business-information sphere in Macedonia and the region), Fonko (dealing with air conditioning, but produce and wine and men's shirts), Mako Market (one of the leading suppliers of consumer goods in Macedonia to the most wholesalers and retail enterprises in Macedonia as Vero, Tinex, Skopje Pazar, Tediko and others), Gica (production of animal feed), Tinex (one of the leading supermarket chains), Krug (publisher of one of the most sold daily newspaper "Dnevnik"), On.net (one of the most popular ISP in Macedonia), Pilko (the largest Macedonian producer of fresh chicken), Datapons (one of the leading printing houses in the country), Medium Export (one of the largest exporters of red pepper and lamb meat), Nasto (producer of dairy products, the most famous cheese like "Gauda" and "Ajdamer”), Magnolia (children's apparel manufacturer) Ivoprom (production of spices) and Planet Press (publisher of the journal "Tea Moderna", "Tin shema" and "Tea krstozbor”). SEAF no longer invest in Macedonia.

h) Investment criterias and factors. Key factors which attracted SEAF to invest in these companies were: entrepreneur/management team of the company, solid history of the operation of the company, the development phase of the company, product innovation and technical innovation. They are presented in Table 4.

Table 4. Factors for attracting venture capital from SEAF

Factor	Percentage
Entrepreneur / management team of the company	100,00
Solid history of the operation of the company	78,57
The development phase of the company	42,86
Product Innovation	42,86
Technical Innovation	35,71

Considering the presented information we can conclude that SEAF funds did not have a significant impact on the financing of small and medium enterprises. In fact, very few companies in Macedonia were able to use venture capital as a source of funding, respectively only 17 companies of about 70,000 active companies. However, the role of SEAF funds is immense because they laid the foundation of the functioning of venture capital in our country.

Venture capital investments barriers

Previously presented data and information confirm that venture capital in Macedonia is not developed yet. Barriers to the development of venture capital in Macedonia, and in transition countries in general, are: poor investment climate that reigns in these countries, which is reflected through unprotected property rights, underdeveloped capital markets (stock markets), a small number of domestic and foreign investors for higher risk investments, untrained and inexperienced management, corruption, poor regulation, bureaucratic and administrative barriers, unfavorable tax treatment for this type of investment, etc.

Although Macedonia significantly improved the general investment climate in recent years, as Doing Business in its 2011 Report ranked it 38th out of 183 countries (IBRD/World Bank 2011), however, in certain segments that make up the overall investment climate, major changes are needed. There are things that have improved or are improving, as well as things that mark significant slowdown.

Regarding the key segments that make up the investment climate, the situation in our country is as follows:

a) Ownership Rights. Good protection of property rights, effective execution of contracts and the law is directly related to fostering and development of the venture capital investments. The protection of property rights remains to be a real challenge for Macedonia. According to International Property Rights Index 2011, from 129 analyzed countries, Macedonia is on 87th place, a position which shows that in our country property rights are not strongly protected (Jackson, 2011).

b) Corruption. Corruption in the bodies of the system, especially in the judiciary and public administration remains "unhealed wound". According to *The 2009 Global Corruption Barometer Report* of Transparency International, on the question "which sectors/institutions are most affected by corruption", the answers were as follow: 50% of respondents said that it is the judiciary, 23% said it is the public administration and 11% pointed at the political parties (Riaño *et al*. 2009, p.33). Therefore, it is neccessary for state institutions to undertake more concrete and stringent measures in this direction, that would result in cutting lengthy court procedures, simplifying complicated procedures for obtaining various permits, facilitating the introduction and transfer of new technologies, consistently protecting intellectual property etc. This can increase the rate of entry of new small and medium enterprises and enterprises with high growth potential, as well as the interest of potential investors to invest money, expertise and time.

c) Administrative and bureaucratic obstacles. Long administrative and bureaucratic procedures represent a serious obstacle of doing business. Many studies noted high correlation between the administrative and bureaucratic procedures (expressed by the number of necessary procedures and required days for starting a new business) and corruption – the more procedures, the more opportunities for corruption. Regarding this issue, the Republic of Macedonia marks a significant improvement. The introduction of the so-called one-stop system in 2006 contributed significantly to shortening the procedures and time to start a new business.In the first months of 2006 were registered 5.400 new businesses (EBRD 2006, p.118). The time needed for registration of new enterprises was cut from 48 to 4 days, while the number of procedures has been shortened to only 4. These improvements contributed as the Doing Business Report 2011 ranked Macedonia in the 5th place out of 183 analyzed countries in terms of this issue. But, when it comes to the question of closing a business, Macedonia is ranked 116th place, because this activity takes 2.9 years (IBRD/World Bank 2011, p.3).

d) Tax Policy. The Republic of Macedonia introduced the flat tax in 2007, which reduced the tax burden on enterprises. Income tax paid by businesses firstly decreased from 15% to 12%, while in the beginning of 2008 it decreased to 10%. The existing three marginal tax rates for personal income tax (15%, 18% and 24%) were replaced with one rate - 10%. But, there is no special relief for venture capital investment as in the practice of developed countries, where venture capital represents a significant source of financing small businesses.

e) State regulation. Considering this issue, it is necessary to strengthen the independence of regulatory bodies, thus ensuring fair and predictable regulation of the domains of market failure (public goods, asymmetric information, externalities, the existence of monopolies, unequal distribution of income, etc.) and deregulation, removal of numerous administrative and bureaucratic obstacles that impede faster growth of businesses respectively. According to Shwab and Sala-i-Martin (2009), Republic of Macedonia is in the 83th place, out of 133 analyzed countries with a score of 3.7 (1-7, where 1 is the worst, while 7 is the best rating).

f) Infrastructure. Infrastructure as a general input of economic activity has a significant impact on costs for business. This applies to large-scale infrastructure such as roads, railways, airports, energy, telecommunications, etc. According to the Report of the World Economic Forum, Republic of Macedonia is in the 88th place (out of 133 countries analyzed) in terms of quality of instracture. Separetely, in terms of the quality of roads, it is in the 87rd place, quality of rail in the 71st place, quality of electricity supply in the 79th place, the quality of telecommunications in the 58th place. The worst position is related to airports, as Macedonia takes the 123rd place (Shwab & Sala-i-Martin 2009).

In order to encourage venture capital investments, Republic of Macedonia should provide a favorable, friendly investment climate which means good protection of property rights, effective execution of contracts, rule of law, qualitative and non arbitrary regulation, stable and predictable government policy, fight against corruption, elimination of administrative and bureaucratic barriers, favorable tax policy provisions for this type of investment, opportunities for broad absorption power of the market, etc.

Conditions for venture capital market development: What should be done?

Measures which were taken in developed countries and those in transition countries were different. As a measure that was most exploited in the some analyzed countries (USA, UK, Sweden, Australia, Poland, Hungary, Slovakia, Russia) was the establishment of state funds of venture capital – from which after a certain period, the state retreated and were transformed into a private commercial venture capital funds. Significant role in the development of venture capital have played and the European Bank for Reconstruction and Development (EBRD) and International Finance Corporation (IFC), which initiated the formation of many venture capital funds and networks of business angels. In certain states to encourage investment by venture capital have been introduced and numerous tax incentives by the state, particularly in income tax.

Considering the experiences of countries in which venture capital is present and developed as a source of financing for small and medium enterprises, we suggest the following measures which should be taken to promote the role and importance of venture capital in the Republic of Macedonia:

a) Raising awareness about the benefits of venture capital for small and medium enterprises. Considering that in Macedonia venture capital is not enough known concept, it is needed to organize seminars, workshops, conferences, etc., introducing the curricular content in the programs of faculties of economics and business administration, publication of professional and scientific papers, where in the explicit way will be explained all the good and bad sides arising from this method of financing.

b) Increasing the number of investment opportunities. This can be achieved with the development of entrepreneurship and small business in the country, i.e. by creating more business incubators, business centers, science parks and so on, where we could develop and present interesting business ideas. We should consider that venture capitalists prefer to invest in interesting entrepreneurial businesses with high growth potential.

c) Establishment of state funds for venture capital. Starting from the experiences of countries in transition in which has been developed this way of financing, the first venture capital funds/companies should be established by the government itself, which may appear as a single investor (which is not very desirable), or in cooperation with international institutions and agencies such as the European Bank for Reconstruction and Development (EBRD), International financial corporation (IFC), the American Aid Agency (USAID) and others, which confirmed that they are willing to invest risk capital (for example, they supported the establishment of SEAF funds). Table 5 shows the characteristics of some Malaysian state venture capital funds.

Table 5. Malaysian government venture capital funds (Source: Ajagbe & Ismail, 2014.)

Name of fund	*Purpose*	*Amount*	*Managed by*
Graduate entrepreneurship fund	Encourage university graduates to become entrepreneurs in specific sectors	-	SME bank
Small entrepreneurs guarantee scheme	Provide cover to viable TBFs for loans obtained from commercial banks	RM50,000 max.	Credit guarantee corp. Malaysia
Seed capital scheme	Promote textile and craft industry	RM20 K–RM 250 K	SME bank
Matching grant for business start-ups	Support manufacturing and service industries in the TBF sector	-	SME corp.
Cradle investment programme (CIP)	Provide funding to TBFs from idea to commercialisation	RM150 M total	Cradle fund/MOF
CIP catalyst	Support a team of technopreneurs with ideas	RM50 K max	
CIP U catalyst	Support ideas from academic or research area to help commercialise	RM50 K in 3 tranches	
CIP 500	Help TBFs from seed to commercialisation	RM500 K up to 2 deals	
MDEC pre-seed fund	Help develop business plans, to commercialise, prototype design, grow to VC funding, incubator support, value added	RM150,000	MDEC/MSC Malaysia
MTDC fund			
TAF 1	Acquisition of machinery and equipment	Max. RM4 M	MTDC/ MOSTI
TAF 2	Acquisition of machinery and equipment	Max. RM1 M	
CRDF 3	Training, feasibility study, IP protection, marketing, staff salary, utility cost.	Max. RM500 K	
CRDF 4	Training, feasibility study, IP protection, marketing, staff salary, utility cost	Max. RM4 M	

d) Foundation of a hybrid venture capital funds. Besides establishing pure state funds, good practice is the creation of so-called hybrid funds, where besides the government, as investors may appear institutional and private investors, such as corporations, banks, pension funds and wealthy individuals. This measure was successfully implemented in Hungary (Karsai & Gabor, 2005).

e) Establishment of networks of business angels. Networks of business angels can be formed with government (central or local) and private initiative. These networks will provide connectivity to prospective investors with entrepreneurs, which can have a good business idea but have lack of funds.

f) Providing a supportive fiscal policy. Almost all countries in which venture capital operates and is quite developed, as an incentive to include institutions and wealthy people in this type of investment is tax relief or full exemption from the government. Our country applies a flat tax, which is 10%. As a good measure to encourage venture capital investment could be if the potential investors in the year in which they investment to be completely exempt from income and profit tax, while the profit tax be reduced to 50% in first 3 years from the moment when the investment is made.

g) Further development of the stock exchange market. Venture capitalists invest in companies that are not listed on the stock exchange. In the meantime, these companies are growing, becoming known to the market, and to the additional funds coming through the stock market. Venture capitalists are willing to sell their shares of ownership, in these companies. If there is no effective stock market and they can not sell their shares to gain profits from investing, they would not be willing to invest in new businesses. In this context, is very important the establishment and development of the OTC market (over the counter market), which is characterized by much more liberal entry conditions for enterprises, which would enable the listing of successful small and medium enterprises. These are practices of developed countries such as USA, Great Britain, France, Sweden and others. It should also be offered a special service that would pick up buying and selling share prices from various dealers that would be presented to potential investors. Then, investors will complete the transaction through special computer software, without the help of a broker. For example, NASDAQ, Reuters, Telerate and Bloomberg work on these principles (Petkovski 2004).

h) Reduction or elimination of investment restrictions of pension funds in risky deals. According to the Law on Mandatory Fully Funded Pension Insurance, pension funds are not allowed to make investments that are typical for venture capital. Under Article 108 of this law, the assets of pension funds can not be invested in stocks, bonds and other securities which are not listed on official stock market or are publicly traded, instruments that can not legally be available, material goods which are rarely traded on organized markets and whose assessment is uncertain except in securities which are issued based on mortgage and indirect investment through investment funds. Under the same law, Article 106 and 107, pension funds can invest: maximum 30% of the assets of pension funds in securities issued by foreign governments and central banks of EU countries and OECD countries; maximum 80% of the assets of pension funds in securities guaranteed by the Government or the National Bank of the Republic of Macedonia; maximum 60% of the assets of pension funds in bank deposits, certificates of deposit, commercial bills, bonds and securities based on mortgage of domestic banks; maximum 40% of the assets of pension funds in bonds and commercial bills of domestic corporations other than banks; maximum 30% of the assets of pension funds in shares of domestic corporations and maximum 5% of the assets of pension funds in share documents and stocks of Macedonian investment funds(Official Gazette of Republic of Macedonia 2009). But pension funds in our country are not quite developed and have no practical experience in investing in the stock market or small businesses. They also lack managerial staff to do this kind of investments. Hence, the implementation of this measure is too risky. It could be implemented in the future, in a further phase of development of venture capital.

i) Training of talented students from different fields about the functioning modes of venture capital. The students who have shown excellent results during their studies, from various fields, government and other institutions and organizations may provide scholarships for training and further formation outside the country, specifically in those countries that are characterized by a developed venture capital, such as United States, Great Britain, Ireland, Sweden, France and others. Once they complete their training, they will return to the country with the obtained experiences and knowledge related to the functioning of venture capital.

j) Support and promotion of venture capital from other sources of funding. Commercial banks, savings and other various funds should promote and support the venture capital, as a specific and particularly important source of capital because they give great help in the creation of new enterprises. These enterprises, once they stand on "healthy legs" in the subsequent phases of development will require funding from these sources in the form of loans, allowing the realization of income in the form of interest payments, commissions, etc. Also, commercial banks and other financial institutions can establish a separate department/sector for venture capital, where interesting businesses will be financed, and where they will gain additional profits and other benefits.

Conclusion, discussion and recommendation

Venture capital is a very useful mode of financing fast growning companies, whereby an investor takes an equity participation in them (Berlin, 1998). Even that venture capital sector in USA and Europe has made big strides these last few decades (Global Insight 2004; Virtanen 2001; Alemany 2006; Sohl 2003;1999), in the Republic of Macedonia it is not yet developed (Fiti and Ramadani, 2013). The history of venture capital in Macedonia is quite recent compared with other countries, it is a new phenomenon. It started from 1998 year. The first and only funds that invest and operate in the form of venture capital in our country are those established by the U.S. Fund for Small Businesses - SEAF (Small Enterprise Assistance Funds-SEAF). SEAF is a global investment company based in Washington, where his work focuses on providing capital for business development in fast growing markets as well as those who lack traditional sources of capital. These funds are: SEAF Macedonia, Small Investment Fund (SIF) and SEAF Fund for South Balkans. Barriers for the development of venture capital in our country, and in countries in transition in general, mainly are related to: underdeveloped capital markets (stock markets), a small number of domestic and foreign investors, higher risk for investment, untrained and inexperienced management, corruption, bad regulation, unfavorable tax treatment for this type of investment, bureaucratic and administrative obstacles and so on.

Our findings show that venture capital investments mostly are focused in the sector of production (42.86%), followed by trade sector (28.57%), media (21.43%) and internet traffic (7.14%). The most part of the investments were made in the early stage of development of enterprises, in 78.57% of total investments. Only one investment is made in seed phase, while none in the start-up phase of development. In the late stage are made 14.29% of the investments. Then, the percentage of the share of ownership that was taken from venture capitalists in our country, in 42.86% of cases is moving from 20-40% (the share of ownership does not exceed 49%, with the exception of On.Net, where VCs had taken 64% of ownership. Venture capital invesments, in terms of success, are categorized as follows: 42.86% moderately successful, 28.56% very successful, 14.29% slightly successful and 14.29% finished with failure (realized loss).

The economic impact of venture capital seems very important. They company that are backed by venture capital, formal or informal usually grow faster, are more innovative, invest greatly and create new jobs (Global Insight 2004; Virtanen 2001; Ramadani and Gerguri, 2011; Alemany 2013). Based on this, central and local government in Rrepublic of Macedonia should consider all positive effects of venture capital and assist in moving forward the development of this source of financing, especially in terms of providing legislative framework which will encourage entrepreneurs and venture capitalist to be more involved in this sector. Measures of initiation and development of venture capital that were undertaken in developed countries and those in countries in transition were different (Gompers and Lerner 2000; EVCA 2002; Romaní and Atienza 2006; Romaní 1997). As a measure that was most exploited, particularly in countries in transition was the establishment of state funds of venture capital, from which after a certain period, the state retreated and they were transformed into a private commercial venture capital funds. So the first venture capital funds/companies should be established by the Government of the Republic of Macedonia, which may appear as a single investor or in cooperation with international institutions and agencies such as the European Bank for Reconstruction and Development (EBRD), International Financial Corporation (IFC), the American Aid Agency (USAID) and others. Besides the formation of pure state funds, good practice is the formation of so-called hybrid funds, where despite the government, as investors may appear institutional and private investors, such as corporations, banks, pension funds and wealthy individuals. This measure was successfully implemented in Hungary as a country in transition. Almost in all countries where venture capital operates and is quite developed as an incentive to include institutions and wealthy people in this type of investment is tax relief or full exempt from the government. Besides these, other measures that should be taken to promote the role and importance of venture capital in the Republic of Macedonia and the development of it, we suggest the following: to continue improving the general business climate, raising awareness about the benefits of venture capital for small and medium enterprises, increasing a number of investment opportunities by creating a greater number of business incubators, business centers and so on, forming networks of business angels, further development of the Macedonian Stock Securities and establishing and development of the OTC market (over the counter market), allowing pension funds to invest in risky deals, training of talented students from various areas about the operation of venture capital, promotion and support of venture capital from other sources of funding.

Future research

The purpose of this paper is to share our findings about venture capital invesments in the Republic of Macedonia. This paper is among the few researches that broadly consider venture capital in our country, identifying the current state of development, legal context, investment criteria, preferred sectors and investment stages. Moreover, useful recommendations on how to develop venture capital market in the country are given in this paper. Future research should be oriented towards the issue whether our small business owners show readiness to accept the way how venture capital functions and what kinds of benefits they see from this type of financing. This is a matter that deserves further research, since it might represent an important asset to the governmental institutions when drafting policies that encourage the development of venture capital in Macedonia.

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