# Preface

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This special issue, 'Financing SME innovation: venture capital and other practices in Latin America and Europe', aims to analyse the implementation of different innovation policies addressed to finance innovation processes of Small and Medium Enterprises (SMEs), with special emphasis on venture capital experiences in Latin America and Europe.

SMEs are increasingly recognised as national and regional development agents. Their role is not limited to creation of employment alone. In the last decade, many of them have also shown an increasing capacity to innovate and compete internationally. This has happened in spite of the obstacles these enterprises face, particularly, when trying to innovate. In fact, it is usually recognised that one of the most relevant limitations for SMEs to materialise their innovative potential is the difficulty to get funds for their ventures.

National and regional economic policies have shown growing awareness about the need to create an appropriate climate for the creation of competitive SMEs networks able to innovate as a means to attain greater growth and development. For this reason, some instruments to facilitate resource access or to promote technology transfer, among others, have been articulated. As Ana Isabel Viñas Apaolaza shows in her article 'Regional innovation policies in Spain: the technological diffusion centres' network of

Madrid', the situation differs from that in the 1960s and 1970s, which existed direct finance to promote R&D projects. Now there are interactive ways directed to link enterprises with intermediate organisations supporting innovations processes, or those that contribute to their knowledge and networks, either public or private, to increase enterprise competitive potential.

It is well known, however, that the proportion of SMEs liable to innovate is reduced and that most of their projects involve high risk. To face these problems from both public and private sectors, organisations and devices have been created to support SMEs with strong innovative potential. One of these instruments, Venture Capital (VC), receives special attention in this issue.

Venture Capital or Smart Money fits the interactive model of innovative process since it is not only capital support for enterprises with high growth potential in exchange of minor participation in enterprise equity, but also the provision of management skills and networks that may increase the innovation and competitive capacity of the enterprises it supports. Venture capital originated in the USA in the 1930s and after seven decades of experience it has become a highly specialised industry in this country. Throughout this period, VC has confirmed its capacity to contribute to the creation of innovative and competitive SME networks and also to strengthen the country's stock exchange market and technological development. The success of this industry in the USA has caused VC activity to progressively extend to other continents. The world's cumulative rate invested in activities of venture capital and private equity between 1998 and 2003 amounts to approximately $690.63 billions, North America accounting for 60%; Europe 26%; Asia and Pacific 9%; Latin America 2.6%; and Africa and Middle East 1.92%. Despite its expansion, venture capital investment rate has decreased since 2001 owing mainly to the distrust cause by NASDAQ financial bubble boom, but now it seems to be emerging from a standstill period. Although current investment is lower than in 2000, this form of financing has attracted greater public interest in the last three years and investment is beginning to grow again, particularly in developing countries.

The USA experience has proved that venture capital industry does not emerge spontaneously, but it requires a series of conditions for its development. Currently, it is possible to say that favorable conditions have not currently developed for venture capital to reach its highest potential as a device for financing innovative SMEs, except in the USA. In the case of Latin American countries, economic and political instability, flaws in institutions regulating this activity and cultural aspects of the region have prevented VC from taking off, as shown by Gianni Romaní Chocce and Miguel Atienza Úbeda in their article titled 'Venture capital in Latin America: evolution and prospects in Chile' Roberto Charvel, Luis Fernando Gonzalez and Dario Olivas in 'The unfulfilled need of venture capital in Mexico'; Juan Carlos Carullo and Felipe Vismara in 'Venture capital in Argentina: public policies and cooperation between private and public sector'; and Tales Andreassi and Eduardo Madureira Rodrigues Siqueira in 'The funding of new technology-based firms in Brazil'.

However, despite funds investors' returns have been low or even negative in nominal terms, as shown by Walter L. Ness Jr. and Valdir de Jesus Lameira's paper on 'Venture capital in Brazil: early experience of emerging company investment funds', most authors describe the increasing efforts made by public powers in Latin America are making to foster VC development by implementing incentives, mainly fiscal ones, to finance SMEs with high growth potential. Though important, this type of incentives is not the only factor necessary to promote venture capital. In their paper 'Brazilian high-tech entrepreneurs' perceptions and attitudes towards venture capital', Antonio J.J. Botelho and Eva G. Jonathan point out the importance of the relationship between entrepreneurship and venture capitalists. In their paper, perceptions and cultural attitudes of Brazilian high-tech sector entrepreneurs are shown as critical factors for the generation of a fluent and high-quality treatment of venture capital.

Outcomes of VC in Europe are quite similar to those in Latin America, although the size of this industry is bigger in Europe. Despite economic and political stability, cultural aspects and, above all, the way European financial markets currently operates, have prevented VC from having the same prestige as in the USA. In this sense, Bernard Guilhon and Sandra Montchaud's paper on 'The difficulties of financing innovation in Europe' analyses a sample of 15 European countries and the USA, and find the existence of a gap in R&D, which are explained by the characteristics of European financial systems. Several articles insist on this point: José Martí and Marina Balboa's paper on 'Self-regulation in European venture capital and private equity markets', analyses a sample of 16 European countries between 1987 and 2000 and concludes that European venture capital and private equity development requires not only the existence of potential investments, but also ways to exit from investment, like efficient local stock exchange markets. Wolfgang Gerke and Ferdinand Mager in their study on 'Venture capital, initial public offerings and political economics: the case of Germany' also conclude that venture capital market success depends on the existence of attractive exit channels for venture capitalists, like IPO. Moreover, they point out the limitations for venture capital development in a cultural context accustomed to the Social Market Economy. Luisa Alemany's paper on 'Venture capital in Spain: evolution, characterisation and economic impact analysis' is more optimistic in her analysis of venture capital growth in Spain but agrees that the main obstacles for the development of this activity are the excessive proportion of deals in latter stages and the limited alternatives to exit. On the other hand, Marco Giorgino in his paper on 'Public models to support venture capital markets', using data from four public venture capital companies between July and December 2004, shows the importance of Venture Capital Public Funds as an instrument to support innovation and research policies in Europe.

Finally, S. Mohanan, in his paper on 'The venture capital scenario in India', describes the evolution of Venture Capital in India, and shows that this industry is still in its initial stage despite its rapid growth in the last few years.

Since SMEs innovation and venture capital are nowadays in the economic and political agenda of many countries, this special issue on 'Financing SME innovation: venture capital and other practices in Latin America and Europe' has aimed to contribute modestly to enlarge the knowledge about what is happening in different countries, and to pose various questions about the future development of this industry that deserve further research.

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