ARGUMENTA OECONOMICA
No 1-2 (17) 2005
PL ISSN 1233-5835

II. ARTICLES

*Dariusz Klonowski**

DEVELOPMENT OF VENTURE CAPITAL IN CENTRAL AND EASTERN EUROPE

This article examines the evolution of the venture capital industry in the most developed markets in Central and Eastern Europe (CEE), with an emphasis on Hungary, Poland, the Czech Republic and Slovakia. The analysis focuses on the three statistics (fundraising, investing, and exiting activities) which indicate the strength of venture capital development in the CEE countries. The paper has two major conclusions. Contrary to suggestions from earlier studies, Poland, not Hungary represents the most developed venture capital market in CEE. Secondly, the CEE region cannot be treated as a homogenous bloc by venture capitalists.

Keywords: venture, capital, CEE, market

INTRODUCTION

The countries of Central and Eastern Europe (CEE) are presently engaged in a long-term process of transition to a market economy. The creation of market-orientated enterprises is a crucial element of this transition, and has been taking place both through the establishment of new businesses and the privatization of state-owned enterprises. These privatization processes occurred either through sales to strategic investors or financial institutions (Western and local), or to incumbent management and employees. While these developments have already led to significant private sector development throughout CEE, a number of major problems need to be addressed before the transition to a fully functioning market economy is achieved. Firstly, the development of entrepreneurship was severely constrained under the regimes in existence prior to 1989, and although there has been extensive creation of new businesses since then, considerable progress still needs to be made in the development of entrepreneurial skills. Secondly, although much of the state-owned enterprise sector has been transferred to the private sector,

* Department of Business Administration, Brandon University, Canada

major problems remain in converting them into commercially viable enterprises, a consequence of age, vintage of production capacity, and the commercial skill levels of managers.

Since the early 1990s, the CEE region has been undergoing an in-depth economic "overhaul", changing from a socialist to a market economy. The major macroeconomic goals accomplished since then include the stoppage of "galloping" inflation and its systematic reduction, the reduction of interest rates, the stabilization and convertibility of the Polish currency, and the privatization of state-owned enterprises. Product and service prices were liberalized and allowed to find their own market equilibrium. The achievement of these ambitious macro-economic objectives, as well as the creation of legal and administrative foundations to encourage competition and free market economy behavior, has led to strong private sector growth.

In the micro-economic scale, enterprises in the CEE region have generally undergone transformation in two critical areas: improvement of competitiveness and increased reliance on external financing. Many companies previously enjoying monopolist positions in their respective industries began to compete with private, newly created local firms and Western multinationals. In response to this increased competition, many companies in the CEE region began to better match their products to consumer expectations (both in terms of quality and price), introduce modern internal management systems (mainly in areas of finance, marketing, and logistics), and focus on improving their human resources. Competition has also produced undesirable results: many companies either permanently lost their market positions or wound up their operations.

Economic stabilization, strong growth, and favourable business outlook in the countries of the CEE region have provided a strong foundation for an active and developing venture capital industry. According to local venture capital associations, there are 27 fully active venture capital firms in Hungary, 28 in Poland, 14 in the Czech Republic, and 5 in Slovakia. Cumulative statistics from the European Venture Capital Association (EVCA) indicate that the total amount of venture capital fundraising in the CEE region equalled $2,149 million, investing $1,389 million, and exiting $562 million.

This article focuses on the evolution of the venture capital industry in emerging markets by examining the venture capital industry in Hungary, Poland, the Czech Republic and Slovakia between 1998 and 2003. The

paper is important for the following reasons. Firstly, even though the number of academic studies pertaining to venture capital activity in the CEE region has been increasing in recent years (Tamowicz, 1995; Weclawski, 1997; Karsai et al, 1997; Karsai et al, 1998; Wright et al, 1999; Bliss, 1999; Klonowski, 2002; Klonowski, 2004), the coverage of this topic is still relatively weak and the industry's developmental processes in these markets are not understood properly by the individuals, businesses, and academics focusing on the region. Secondly, the study focuses on the years between 1998 and 2003, the most important period in the development of the industry. Additionally, because the venture capital industry undergoes long-term cycles, shifts in trends in fundraising, investing, and exiting activities can only be observed by analyzing longer data series. No other study in the CEE region has focused on analyzing venture capital data over a longer period of time. Thirdly, the evolution of the venture capital industry in the CEE region may serve as a "blue print" for venture capital development in other emerging markets in the region. Venture capital industries in countries like Bulgaria, Romania, and Croatia already appear to be going through developmental phases similar to those in the more developed markets of Poland and Hungary, an important trend given that several initial problems can be avoided by understanding the dynamics of the more developed venture capital industries in the region.

1. VENTURE CAPITAL IN CENTRAL AND EASTERN EUROPE

The venture capital industries in the region were established in the early 1990s, and their development coincided with early economic transformations occurring in the CEE countries. In the early stages, the investment activity was fuelled by privatization processes which supplied investment projects and foreign government assistance projects initially set up to revitalize entrepreneurship in these countries. Examples of such developments include the initiatives undertaken by the American Congress. These initiatives would lead to the development of the Hungarian-American Enterprise Fund ($70 million) that was established in 1990, the Polish-American Enterprise Fund ($240 million; 1990), and the Czech-Slovak American Enterprise Fund ($15 million; 1991). These initiatives were further complemented by capital from international institutional investors, such as the International Finance Corporation

(IFC) and the European Bank for Reconstruction and Development (EBRD). The investors engaged in direct participation by acting as investment managers that would identify and complete investment projects (sometimes relying on assistance from local offices to do so). They also participated indirectly as fund-of-funds operators who could provide financial resources to newly created private venture capital firms in the region. It may be argued that the venture capital industries in these markets would not have developed without the commitment of these two international financial institutions.

With the initial success of these early entrants, multinational private venture capital firms began to penetrate the market. Additionally, a number of newly created venture capital firms were formed by private consultants previously operating in the region. The methods of operation employed by these newly created firms, however, differed. Some institutions decided that they could build their local presence and focus on the entire region by initially serving the market from their corporate headquarters (often based in London), while others decided to make a commitment to establishing a local office staffed with local managers. Other venture capital firms chose a combination of various strategies (local office staffed with expatriates, local office staffed with local managers but with the decision capability located in corporate headquarters outside of the local market, etc.). Most venture capital firms decided to develop a pan-regional focus.

The late 1990s and early 2000s saw corrections to the development of the local venture capital industries in the region, especially in countries like Hungary and Poland. While a number of local venture capital funds continued their success with strong exits, the managers of other funds were either unable to raise subsequent capital or closed or suspended operations due to poor financial performance. The total amount of capital raised for the countries in the region declined from $517 million in 1998 to $144 million in 2003. Hungary and Poland were most affected by the decline. In addition to the reasons specific to each country, there are at least two regionally associated macro-reasons to account for the poor allocation of capital by Western investors towards Central and Eastern Europe. The first reason relates to how the Western financial institutions' initial view of Central Europe was negatively influenced by the Russian crisis in 1998. This functioned as an investor turn off for allocation of capital in the CEE countries. The second reason is connected with the first one, namely that many regional companies were also negatively

influenced by the crisis. Many companies in the region that had strong trading activity with Russia saw a significant decline in sales (on occasion as much as thirty percent) and a corresponding decline in profitability. Consequently, the result was a weaker supply of high quality investment opportunities and a decline in the amount of capital invested, down from $352 million in 2000, the peak year, to $163 million in 2003. Western financial institutions found a better risk/return trade-off for their capital by placing funds into debt instruments and shares in North America. The 1998 Russian crisis was a trigger point for the reallocation of capital to other markets, something that regional venture capital markets have still not recovered from. The poor economic performance of the countries in the region assured that the level of capital injected into the market would decline after 1998, especially in Hungary and Poland.

Local venture capital associations affiliated with the European Venture Capital Association (EVCA) were established by several of the countries in the region. These associations promote the benefits of the venture capital industry to entrepreneurs and the economy and provide a networking forum for suppliers and demanders of capital. They also allow local investors to share their investing experience (and act as industry representatives in discussions with governmental institutions regarding the legal and regulatory environment) and encourage the highest business practice standards in venture capital investing.

The analysis of available secondary data on the venture capital activity in the CEE countries focuses on three statistics: fundraising, investing and exiting. These statistics may be indicative of the strength of venture capital development in these countries. The fundraising activity indicates the attractiveness of the market to potential investors, both domestic and foreign. The investment activity reflects the amount of high quality projects found by venture capitalists. Lastly, exit or realization activity denotes the venture capitalists' ability to convert their non-liquid investments into cash, be it at a profit or a loss. The key statistics come from the European Venture Capital Association (ECVA), the most reliable source of information on venture capital activity in the region. Relying on this secondary data, however, is somewhat limiting. For one thing, the venture capital industry is a cyclical business. Even analysis based on a few years of comprehensive data may not show long-term trends, and the timing for changes in trends may not be precisely pinpointed. Secondly, even though the local venture capital industries

generally formed after 1990, different markets began their development at different times and developed at various growth and development patterns. Figure 1 presents the key indicators of the venture capital industry in the CEE region between 1998 and 2003.

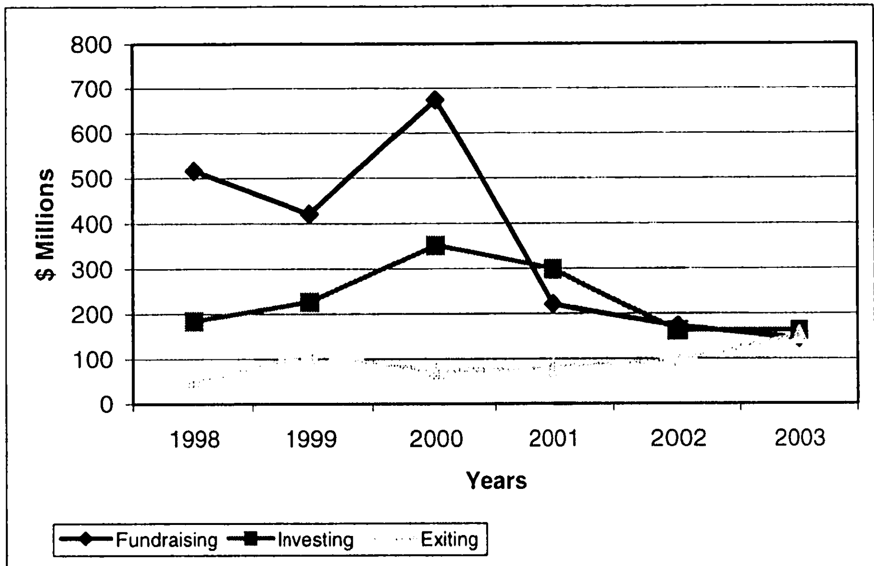

Figure 1 Fundraising, investing and exiting activities in the CEE region between 1998 and 2003
Source: EVCA Yearbooks (2000-2004) and own calculations

1.1. Hungary

The Hungarian venture capital market is often thought to be the most developed in the CEE region (Karsai et al, 1997; Karsai et al, 1998; Wright et al, 1999; Venture, 2003; Karsai, 2003). The foundation of the industry was established with the creation of the Hungarian American Enterprise Fund, a fund raised with the financial support of the American Congress and which dedicated $70 million to support local entrepreneurship. The Hungarian Venture Capital Association (HVCA), established in 1991, is currently comprised of 27 members, up from 17 members in 1996. Table 1 presents the key statistics for Hungary between 1998 and 2003.

Table 1

The key statistics for the venture capital industry in Hungary between 1998 and 2003

(In $ millions)	1998	1999	2000	2001	2002	2003	Mean	Range	
								Min	Max
Fundraising:									
Value	79	62	70	54	12	35	52.0	12	79
Cumulative	-	141	211	265	277	312			
Investments:									
Value	42	8	47	128	16	30	45.2	8	128
Cumulative	-	50	97	225	241	271			
# of Investments	34	7	51	32	33	41	33.0	7	51
Value per Investment	1.2	1.1	0.9	4.0	0.5	0.7	1.4	0.5	4.0
Exits:									
Realized Value	11	10	26	48	13	39	24.5	10	48
Cumulative	-	21	47	95	108	147			
# of Trade Sales	1	5	2	3	0	0	1.8	0	5
# of IPO's	5	2	2	0	3	0	1.8	0	5
# of Write-offs	1	1	2	3	4	0	1.8	1	4

Source: EVCA Yearbooks (2000-2004) and own calculations

Between 1998 and 2003, the amount of capital raised by venture capitalists varied, and ranged from a minimum of $12 million (2002) to a maximum of $79 million (1998). The cumulative amount of capital raised in the period was equal to $312 million. The amount of funds raised for the market steadily declined after 2000 (with the exception of 2003), reflecting a worsening economic performance and the perceived reduction in the supply of quality projects. The banking sector also played an important role as a supplier of capital for the venture capital industry, and accounted for between 60 to 80 percent of the total funds raised. Foreign investors were the leading capital providers. Karsai et al (1998) confirmed the existence of three main sources of financing in the Hungarian market. Firstly, there were international venture capital firms, mainly from the U.S. and the U.K., which made investments through firms dedicated specifically to Hungary. These firms accounted for approximately 70 percent of the total available capital. Secondly, large institutional players such as EBRD and IFC follow similar direct/indirect strategies. Thirdly, the development of the Hungarian Development Bank (HDB), a specialized state-owned financial institution with a strong country-wide presence, supported the government's economic development objectives and helped to fulfill its policies. As a part of its strategy to support local entrepreneurship, the HDB became a part of the European Investment Fund, a fund owned and operated by the European Central Bank. HDB, through its Development Capital Investment Program (launched in June 2003), aims to financially support the development of small and medium-sized firms, often targeting those with strong growth potential in terms of

sales and profitability. This effort is indicative of the unique approach adopted by the Hungarian government among countries in the region, and is likely to address the lack of available venture capital financing in SMEs and promote investment in the sector.

Like the uneven pattern observed in fundraising activity, the amount of investment varied sharply from year to year (Kopits, 2001). Over the years, capital was predominantly directed towards three sectors: food processing, machine tools, and IT and telecommunications (Karsai et al, 1998; EVCA, 2003). While it may be difficult to point to specific reasons behind the sharp decline in investment activity in Hungary, local venture capitalists stress the gap in expectations between entrepreneurs and venture capitalists as the driving force behind the industry's challenges. This gap in expectations occurs at different levels. The first one pertains to an operating or philosophical gap (Kopits, 2001; Karsai, 2003). While venture capitalists stress the importance of a firm's sales growth and profitability as a way to secure a profitable exit, entrepreneurs are not always in agreement. *Venture* (2003), HVCA's newsletter, outlined such a discrepancy in the following manner: "Most of the owners and managers of these one million SMEs consider business and doing business a lifestyle, without paying attention to calculating profits, or often being in a position to do so". Similar points were outlined in the study by Fogel (2001). Secondly, venture capitalists in Hungary prefer to invest larger amounts of capital into firms with strong growth potential and profitability (Karsai, 2003). The lack of such companies in Hungary is, as Karsai (2003) notes, the key reason for the limited growth of the country's industry. Local venture capitalists confirm that even after venture capital investment has occurred, local firms are too small to either list on the local exchange or attract strategic investors' interest. The result is a limited liquidity for venture capitalists at the end of their holding period and firms that make for unattractive investment targets.

2001 saw a reversal of this negative trend when $128 million in large-scale transactions was invested, positively influencing the aggregate value of investment for the period. Investment in start-up companies accounted for 29% in 1999 and then rose to 30% between 2001 and 2003. Companies requiring expansion accounted for over 40 percent of the total amount invested. Growth in investment activity between 1999 and 2001 was fuelled by increased investment in the new economy and the entry of smaller venture capital funds focusing on small and medium-sized companies. Investments in the new technology sector, including communications, continued to be strong between 1999 and 2003, with investments in communications attracting the highest share of investment in 2000 (48 percent). A focus on smaller entrepreneurial firms is reflected in

smaller deal sizes, which declined from $4 million per investment in 2001 to $0.7 million per investment in 2003. Declining deal sizes are generally problematic for the larger, pan-regional venture capital firms that have been able to raise more capital, as it is uneconomic for them to pursue smaller transactions.

Exit activity in Hungary has been relatively weak. Between 1998 and 2003, a total of 15 trade sale deals were reached, and 12 divestments were achieved through public offering. In spite of the two successful exits achieved by major international venture capital firms, made possible through listing their portfolio companies' shares on the Budapest Stock Exchange (BSE), local venture capitalists confirm that exit opportunities have been limited in the last few years. This was also confirmed in earlier studies by Karsai at el (1997). The number of investments written off by venture capital funds has been increasing steadily since 1998. Traditional exit routes, like initial public offerings or trade sales, were commonly employed in 1999 and 2000, when both categories accounted for almost 85 percent of the amount of realizations. In later years, exit routes less desirable to venture capitalists (i.e. write-offs) prevailed. Writing off their investments and selling their shares back to business owners was likely to translate into losses. At best, the firm might recover the value of the initial investment.

1.2. Poland

As in the Hungarian market, the foundations of the venture capital industry in Poland were laid by foreign public institutions, both American and European, in an effort to develop and rejuvenate local entrepreneurship (Bliss, 1999). In 1990, the first venture capital firm, the Polish-American Enterprise Fund (operated by Enterprise Investors), was established and capitalized in the amount of $240 million by the American Congress. In addition, the Danish Fund for Central and Eastern Europe and the Society for Social and Economic Initiatives were established in the same year. In 1992, the EBRD with multiple partners including the Fund for Development of Polish Agriculture and the Co-operation Fund, created Caresbac. That same year, Enterprise Investors founded Polish Private Equity Funds I and II ($151 million) and became the leading venture capital fund with nearly $400 million under management, accounting for 86 percent of the total funds managed in the market. In 1994, with the assistance of the PHARE program and the British Know-How Fund, two Regional Investment Funds were formed. Today, the Polish Venture Capital Association has 28 members. Table 2 presents the key statistics for Poland between 1998 and 2003.

Table 2

The key statistics for the venture capital industry in Poland between 1998 and 2003

(In $ millions)	1998	1999	2000	2001	2002	2003	Mean	Range	
								Min	Max
Fundraising:									
Value	386	273	255	141	107	23	197.5	107	386
Cumulative	-	659	914	1,055	1,162	1,185			
Investing:									
Value	124	186	186	135	111	119	143.3	111	186
Cumulative	-	310	496	631	742	861			
# of Investments	61	111	102	68	102	63	84.5	61	111
Value per Investment	2.0	1.7	1.8	2.0	1.1	1.9	1.8	1.1	2.0
Exiting:									
Realized Value	26	87	22	26	64	102	54.5	22	87
Cumulative	-	113	135	161	225	327			
# of Trade Sales	8	28	7	10	14	10	12.8	7	28
# of IPO's	0	8	1	5	8	22	7.3	0	22
# of Write-offs	1	6	1	10	5	13	6.0	1	13

Source: EVCA Yearbooks (2000-2004) and own calculations

Foreign institutional investors, multilateral institutions, and foreign governments were the primary sources of capital. Between 1998 and 2003, investors dedicated $1,185 million to investment. The largest venture capital firm in Poland, Enterprise Investors, has over $1 billion under management and is the largest venture capital investor in the CEE region. The venture capital firms were financed from non-Polish sources that, over the years, have accounted for over 90 percent of the total provided capital. Polish corporate investors also became active in the venture capital industry – market participants were found mostly among the former foreign trade companies that were trying to employ excess capital effectively. As was the case in Hungary, the Polish venture capital industry saw a decline in fundraising activity beginning in 1998. This was in spite of strong economic growth in prior periods, the improvement of the entrepreneurial environment (i.e. by lowering corporate tax rates), changes to the commercial code, and the establishment of the secondary stock market. However, in spite of this declining trend, the amount of new capital committed to the market exceeded that achieved in Hungary four-fold. The nature of sectoral focus and completed investment transactions reflect the types of available projects, demand for specific products and services, sophistication of financial investors, and the development of the financial institutions seen in the market. The initial investments focused on basic sectors such as manufacturing, construction, food processing, and services and investments. In later years, the focus was on communications, manufacturing, and

services. Research by Klonowski (2004) confirms that the local venture capital firms focused on three types of investment deals: Western transfer deals, consolidation deals, and regional expansion. Western transfer deals involve the adaptation of proven Western business models to fill "market holes" resulting from central planning distortions. Consolidation deals are focused on sectors that need significant consolidation. Regional expansion involves investment in firms that focus on consolidating their regional positions and extending their domestic strengths across CEE. As in the Hungarian market, attractive investment opportunities were difficult to generate by 1998. The amount of capital per investment declined from $2 million in 1998 to $1.1 million in 2002, and returned to $1.9 million by 2003. According to Klonowski (2004), there have been relatively few problems across the diverse range of firms in the venture capital firms' portfolio companies.

Between 1998 and 2003, a total of $327 million was realized through a combination of trade sales and initial public offerings. In spite of strong exit performance during the period between 1990 and 1994, when a total of 45 exits were achieved (Klonowski, 2004), the amount and value of exits declined. A more positive trend has been observed since 2000, with the amount of realizations increasing, stimulated by small growth in trades sales and IPOs.

1.3. The Czech Republic

The Czech Republic venture capital market is one of the weakest in the CEE region. In spite of the fact that the Czech Venture Capital Association (CVCA) was established in early 1991, the number of full members has declined in recent years. In the last two years, several financial institutions, including notable regional players such as Baring Communications, GE Capital, Advent International, and AIG-CET, left the organization, citing a poor investment climate and their membership in other regional associations as the key reasons for market withdrawal. There are at least two reasons behind the weak development of venture capital markets in the Czech Republic. The failure of the voucher privatization program, embarked on by the government of former Czechoslovakia in the early 1990s, is often cited as one of the key reasons behind the sluggish development of the private sector. Romaine (2003) specifically cites the two components of the voucher privatization program that had the most negative impact on entrepreneurship and private corporatism: the lack of new human capital injected in enterprises and the lack of hard budget

constraints (i.e. pursuit of profitability). Cross ownership between various institutions emerged as a result of the voucher program. Secondly, new entrepreneurial firms continue to face negative selection in credit and equity markets. Table 3 presents the key statistics for the Czech Republic between 1998 and 2003.

Table 3

The key statistics for the venture capital industry in the Czech Republic between 1998 and 2003

(In $ millions)	1998	1999	2000	2001	2002	2003	Mean	Range	
								Min	Max
Fundraising:									
Value	49	84	346	21	46	83	104.8	21	346
Cumulative	-	133	479	500	546	629			
Investing:									
Value	17	31	112	28	33	12	38.8	17	112
Cumulative	-	48	160	188	221	233			
# of Investments	12	19	32	35	18	13	21.5	12	35
Value per Investment	1.4	1.6	3.5	0.8	1.8	0.9	1.7	0.8	1.8
Exiting:									
Realized Value	7	14	24	5	19	12	13.5	5	24
Cumulative	-	21	45	50	69	81			
# of Trade Sales	3	2	5	2	2	9	3.8	2	9
# of IPO's	0	0	0	0	0	1	0.2	0	1
# of Write-offs	0	2	0	2	9	2	2.5	0	9

Source: EVCA Yearbooks (2000-2004) and own calculations

The level of venture capital funding committed to the market has been increasing and reached a peak of $346 million in 2000, the time when many new funds made an entry into the Czech market. Towards the end of the 1990s, capital came from pension funds; in the early 2000s, it was generated from financial institutions. Private individuals made significant capital contributions to the industry throughout most of the period. The market also saw a shift in the geographic origin of capital over the period. While non-European sources were prevalent at the end of the 1990s, the 2000s saw a shift to domestic sources.

Investment activity patterns followed the trends observed in fundraising activity. Investments predominantly focused on expansion opportunities in computer, consumer, and communications related sectors. Exits in the market have been limited in terms of trade sales and IPOs. In 2002, 75% of the divestment amount occurred through write-offs. The local market is perceived as relatively weak and is an unlikely source of exit opportunities for venture capitalists.

1.4. Slovakia

The Slovak venture capital market has many of the same characteristics observed in the Czech market (Karsai et al, 1998). In 1995, several financial institutions operating in Slovakia founded the Slovak Venture Capital Association (SLOVCA). This development was supported and funded by the Slovak American Enterprise Fund (SAEF), one of its founding members. After a period of limited activity between 1998 and 2001, SLOVCA, in 2003 and 2004, became more active in promoting venture capital as a source of financing for local entrepreneurs. It also engaged in discussions with government officials about creating a positive investment climate for venture capitalists. The key statistics between 1998 and 2003, displayed in Table 4 below, reflect these facts.

Table 4

The key statistics for the venture capital industry in Slovakia between 1998 and 2003

	1998	1999	2000	2001	2002	2003	Mean	Range	
								Min	Max
Fundraising:									
Value	3	2	3	5	7	3	3.8	2	7
Cumulative	-	5	8	13	20	23			
Investing:									
Value	2	2	7	8	3	2	4.0	2	8
Cumulative	-	4	11	19	22	24			
# of Investments	13	9	9	13	20	16	13.3	9	20
Value per Investment	0.2	0.2	0.8	0.6	0.2	0.1	0.4	0.1	0.8
Exiting:									
Realized Value	5	0	0	1	1	0	1.2	0	5
Cumulative	-	5	5	6	7	7			
# of Trade Sales	1	0	0	3	0	0	0.7	0	3
# of IPO's	0	0	0	0	0	0	0.0	0	0
# of Write-offs	12	1	0	0	0	0	2.2	0	12

Source: EVCA Yearbook (2000-2004) and own calculations

Between 1998 and 2003, a total of $23 million was committed to the market, mainly by foreign investors and foreign government programs. There are only four active venture capital firms with offices in Slovakia: the Slovak American Enterprise Fund, SEED Capital Company, Rozvojovy Fond, and Genesis Capital. The amount of investment per year is negligible. During the peak of investment activity, which occurred in 2001, $8 million was invested in firms operating mainly within manufacturing sectors. Exit activities in Slovakia are also negligible. The highest amount of realization was achieved in 1998, when local venture capital firms made a decision to write off their investments to the total value of $5 million.

CONCLUSIONS

The venture capital industry in the CEE region has gone through its initial "teething" problems. $1,389 million has been invested between 1998 and 2003, and there have been many success stories with respect to strong firm growth and profitable venture capital exits (Central and Eastern Europe Success Stories, 2004). Venture capitalists continue to be optimistic that the favourable economic conditions in these countries, especially after EU accession, should secure good overall returns in the foreseeable future. On the other hand, local businesses learned to attract venture capital into their businesses, and venture capitalists contributed by providing valuable advice and capital. Additionally, the active interaction between representatives of both venture capital funds and entrepreneurial firms enabled venture capital firms to become a source of capital for companies and know-how to managers.

There are two major conclusions that can be derived from this paper. Firstly, contrary to suggestions in earlier studies by Karsai et al (1997), Karsai et al (1998), and Wright et al (1999), Poland, not Hungary, represents the most developed venture capital market in the CEE region. While the Hungarian venture capital industry developed strongly in the early and mid 1990s, its development between 1998 and 2003 was disappointing. During this period, Poland enjoyed stronger growth in the venture capital industry, as evidenced by its fundraising, investing, and exiting activities. The cumulative amount of funds raised in Poland between 1998 and 2003 was $1,185 million (compared to $312 million in Hungary); the cumulative amount of investments in the same period was $860 million (Hungary - $271 million). Similar trends are observed in the exiting activities.

Secondly, the countries in the CEE region cannot be treated as one homogeneous "block". The development of venture capital activity in each country is different, and reflects, among other things, varying economic and market conditions, the involvement of the government, and entrepreneurial spontaneity. It is clear that the development of industry in Poland and Hungary is stronger when compared to the other countries in the region, the Czech Republic and Slovakia. The differences are most apparent in the amount of fundraising, investing and exiting activities occurring in these countries.

REFERENCES

Bliss, R., *A venture capital model for transitioning economies: the case of Poland,* "Venture Capital", Vol. 1, Issue 3, pp. 241-257, 1999.

EVCA Task Force, *Central and Eastern Europe Success Stories,* 2004.

EVCA Yearbook, *Annual Survey of Pan-European Private Equity & Venture Capital Activity, European Private Equity and Venture Capital Association,* the Netherlands, 2004.

EVCA Yearbook, *Annual Survey of Pan-European Private Equity & Venture Capital Activity, European Private Equity and Venture Capital Association,* the Netherlands, 2003.

EVCA Yearbook, *Annual Survey of Pan-European Private Equity & Venture Capital Activity, European Private Equity and Venture Capital Association,* the Netherlands, 2002.

EVCA Yearbook, *Annual Survey of Pan-European Private Equity & Venture Capital Activity, European Private Equity and Venture Capital Association,* the Netherlands, 2001.

EVCA Yearbook, *Annual Survey of Pan-European Private Equity & Venture Capital Activity, European Private Equity and Venture Capital Association,* the Netherlands, 2000.

Fogel, G., *An analysis of entrepreneurial environment and enterprise development in Hungary,* "Journal of Small Business Management", Vol. 39, Issue 1, pp. 103-109, 2001.

Karsai, J., Wright, M., Filatotchev, I., *Venture capital in transition economies: the case of Hungary,* "Entrepreneurship Theory and Practice", Vol. 21, Issue 4, pp. 93-110, 1997.

Karsai, J., Wright, M., Dudzinski, Z., Morovic, J., *Screening and valuing venture capital investments: evidence from Hungary, Poland and Slovakia,* "Entrepreneurship and Regional Development", Vol. 10, pp. 203-224, 1998.

Karsai, J. *The impact of venture capital investments on the Hungarian economy, Hungarian Venture Capital Association,* pp. 1-6, 2003.

Klonowski, D., *Venture capital in Poland: Venture capitalists' decision criteria in venture evaluation,* "Argumenta Oeconomica", No. 2, Issue 13, pp. 173-189, 2002.

Klonowski, D., *The evolution of the venture capital industry in transition economies: the case of Poland,* unpublished working paper: Brandon University, 2004.

Kopits, S. K., *The year in review – 2001,* unpublished paper, Hungarian Venture Capital Association, 2002.

Romaine. K., *Can venture capital play a critical role in economic restructuring during the transition process?,* unpublished working paper, London School of Economics and Political Science, 2003.

Tamowicz, P., *Fundusze inwestycyjne typu venture capital, [Investment funds as venture capital funds],* Centre for International Private Enterprise, 1995.

Weclawski, J., *Venture capital: nowy instrument finansowania przedsiebiorstw, [Venture capital: a new instrument for financing companies],* PWN: Warsaw, 1997.

Wright, M., Karsai, J., Dudzinski, Z., Marovic, J., *Transition and active investors: venture capital in Hungary, Poland, and Slovakia,* "Post-Communist Economies", Vol. 11, Issue 1, pp. 27-46, 1999.

Venture, Newsletter of the Hungarian Venture Capital Association, Autumn, pp. 2-3, 2003.

Received: March 2005, revised version: July 2005