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Innovative Startup Investment Funds in Viet Nam

Tran Thi Thu Huong
(Finance Faculty, Banking Academy, Ha Noi, Viet Nam)

Abstract: In order to promote national innovative startups, it is necessary to encourage individual and institution to invest in this field, in which innovative startup investment funds play very important role. The problem is that how to establish, manage and use these funds to ensure its effectiveness. Moreover, whether governments should invest the state budget in innovative startup firms at the beginning, then move gradually to non-govermental funds. In Vietnam, start-up and innovative startup investment fund have been new concepts. This paper has discussed about problems related to innovative startup investment funds such as establishment, management, using mechanisms in Viet Nam based on current regulations and suggest several solutions to develop this type of fund.

Key words: innovative startup investment fund; innovative startup firms; finance sources
JEL codes: O3

1. Introduction

There are many definitions of investment. In an economic sense, an investment is the purchase of goods that are not consumed today but are used in the future to create wealth. In finance, an investment is a monetary asset purchased with the idea that the asset will provide income in the future or will later be sold at a higher price for a profit.

In board meaning, investment is the sacrifice of current resources to implement activities with the aim of achieving higher results than the beginning capital. The resources could be money, natural resources, labor, and intelligence while the results could be the increase in financial assets, physical assets, intellectual property and other resources. In narrow meaning, investment includes activities that use current resources to gain higher profits for the economy and society in the future over invested resources.

Any business activity needs invested capital, including innovative startup — a highly risky business. What are financial sources and mechanism for effective innovative startup business? This problem should be considered and solved to promote innovative startup activities. In the context of the market economy and the 4.0 revolution, regulations and policies for innovative startup and innovative startup invesment funds should be set up to ensure investment willingness of all investors.

In Viet Nam, Decree 38/2018/NĐ-CP regulates that investment in small and medium sized innovative startup enterprises refers to financing that investors provide to do business activities via capital contribution to establishment of startups, or purchase of shares or stakes of startups which are not public companies. It is clear

Tran Thi Thu Huong, Ph.D. Candidate, Finance Faculty, Banking Academy; research area/interest: finance. E-mail: tranhuong@hvnh.edu.vn.

that Viet Nam just had regulations of investment in small and medium innovative startup enterprises. As a result, if innovative startup firms are not small and medium, it could be difficult to manage and foster investment.

Furthermore, “innovative startup” term should be understood clearly before setting any rules to develop this business model. According to Clause 2, Article 3 in Law on provision of assistance for small and medium-sized enterprises (2017), small and medium sized innovative startup enterprise is an SME that is established to implement its business ideas based on the exploitation of intellectual property, technology and new business models and is able to grow quickly. Article 17 in this law also determine conditions that small and medium sized innovative startup enterprises receive the assistance as the following:

- The startup has been put into operation for up to 5 years from the day on which its first enterprise registration certificate is issued
- The startup has not initiated public offering of its securities (in case of a joint-stock company)

Moreover, Decision 844/QĐ-TTg on approval for assistance policies on national innovative startup ecosystem to 2025 point out the beneficiaries include individuals or groups having startup projects or startups that may be potential for rapid growth by utilizing propriety assets, technology and new business initiatives; or startups operating for not exceeding 5 years from date on which the first enterprise registration certificated is issued.

It is a problem that what new idea is and how to implement new idea by exploiting propriety assets, technology (intellectual property rights problems). How is new business model? How are projects or startups that may be potential for rapid growth? So, it is nescessary to make as many details as possible in definition of innovative startup in order to distinguish from other types of startup and business activities.

Nowaday, many countries have joined new free trade agreements, leading to new development spaces, required each country to choose and change. It creates opportunity for the development of innovative startup investment funds. This paper analyses innovative startup in Vietnam and innovative startups investment funds to find out some problems that need to be changed to stimulate the growth of startup firms.

2. Literature Review

2.1 Researches on Startup Companies and Funding Sources

Maurya (2012) pointed out that the startups’ life cycle includes 3 stages of development. The first stage is the Problem/solution fit, starting from a problem that needs to be solved. It is necessary to find out solutions for this problems and implement these ideas. The second phase Product/ Market fit is a step to test whether these solutions really fit to the demand. The last stage is Scale when startup companies expand and grow, increase market shares and could earn higher income. In this model, time for raising fund is after phase 2 or when the market has been tested to see the potential startup growth. On the other hand, Marmer et al. (2012) point out that startups’ development includes 6 stages: discovery, validation, efficiency, scale, prfit maximization, and renewal or decline. At the last stages, the company could cease to be a startup and go to public.

Innovative startups could gain capital from insider, outsider and other funding sources like financial bootstrapping, crowding funds, IPO (Čalopa, Horvat &Lalić, 2014). Insider funds include founders, family and friends (Bygrave & Hunt, 2008; Campbell & De Nardi, 2009). Outsider funding comes from grants and public debt, commercial debt, business angle, venture capital. Another source of capital for startups is crowd-funding that are going to be more popular all over the world. In 2011, the global crowd-funding market increased by 10-times in 2011-2015 period (Veselovsky et al., 2017). Angle investors or venture capital funds may have more knowledge than other investors. However, the opinion of a group of investors could be more efficient than that of smaller groups based on the argument “wisdom of the crowd”.

It is well known that there are limited number of startup companies succeed. Most startups are difficult to get bank loans because of complex procedures and evaluation based on credit history and property (Söderblom & Samuelsson, 2014). A research of Brown et al. (2012) using panel data of 9715 startup companies in period 2007-2009 shows that high-tech startups could not get bank loans compared to other field startups. This type of startups due to higher potential growth can exploit seed investments via private investors who want to invest their capital into potentially successful businesses.

Čalopa, Horvat and Lalić (2014) cited in their study that financial sources for startup companies could be divided to 5 phases. In the experimental phase, entrepreneurs often use their own funds or funds from their family and friends. In initial phase, startups could collect funds from loans, angle investors, and venture capital funds. In the expansion phase, the most common sources of funds are venture capital funds and loans. In the last phase, private equity funds are the main source. Söderblom and Samuelsson (2014) research Croatian startup companies and showed that they prefer traditional and informal financial sources like family and friends. When moving to expanding phase, they could collect monney from other funding sources such as business angles, and seed investments.

2.2 Researches on State Budget for Innovative Startups

As can be seen, innovative startup companies could receive funds from the state budget. Many countries pay attention to high-tech startups and entrepreneurship. In 1999, the Singapore government set up the US$1 billion Technopreneurship innovation fund (TIF) to implement the new Technopreneurship 21 programme in order to promote entrepreneurship in technology by improving the environment for business. To foster innovation and entrepreneurship, Singapore government has implemented a national programme, named National Framework of Innovation and Enterprise (NFIE) in 2008, to commercialise leading-edge technologies created by the public research institutes and institutes of higher learning of Singapore (Cheah, Ho and Lim, 2016). Many investors started to pay attention to startups and startup community was built including researchers, innovators, entrepreneurs, investors, incubators and accelerators. In Singapore, public funds are the popular sources of fund for the very first stage of startups, the venture capital funds play increasingly important role in the early stages of the startups.

Similarly, in America, state governments provide funds to new science and technology companies. Fairlie (2012) showed that in US, high-technology startups have created most of new jobs in the period of 2000-2010. This paper tests the effect of state R&D grants on startups by using data collected form Michigan government, from 2002-2008. It is showed that state funds play important role to the commercial viability of recepient firms. At present, in Russia, funding souces for innovative startups could be own funds, loans, grants, funds from investors, crowding funds, and Russian Fedearation (Veselovsky et al., 2017). Startups could receive funds from state grants. It also attracts other non-profit organizations.

There are some reasons that governments need to support innovative startup firms (Zhao & Ziedonis, 2012). Firstly, without intervention of government, the R&D field is under-invested (Griliches, 1992; Jaffe, 2002). Government pays attention to this field because R&D products is similar to public goods when it could be used by many people or many firms. It means the social benefits of R&D investment can exceed the private returns to private companies. Secondly, capital markets are not perfect. It could decrease incentives to invest in R&D of private sector (H. Hall & Lerner, 2010). Startups need financial support to develop and commercialize new technology products while it is difficult for investors to find good projects to invest due to imperfect information. It could lead to higher cost of capital (H. Hall & Lerner, 2010). Lack of R&D financing from the state makes difficult for innovative startups to run business (Zhao & Ziedonis, 2012). Government attend to the market to facilitate the supply of financing to startups. The particaption of government could correct the market failures that result in the under-capitalization of innovative projects or firms. However, it is required that governments need to maintain balancing act when correcting for these types of maket fairlures to limit inefficient investment (Georghiou, 2002). State government pursue more parochial interest to develop state economy and diversify the tax base (Acs et al., 2011). As a result, state budget for R&D is spent only on startups that have headquarters of major R&D facilities within the state.

The assistance of government could be in the form of tax exemption, patent laws, credit ceilings, loan guarantee schemes and other benefits (Mason and Harrison (2003); Revest and Sapio (2012)). It also be direct in form of grants, public fund invested in firms. Grants are funds that do not have to be paid back but which must be used for predefined purposes. Public debt could be used by state governments to support innovative startups. Public funds provided by governments are common source for Swedish ventures, especially in very first stage of firms. It’s also right in Ailen when study of Hogan and Hutson (2011) determines the significant source of capital for startup firms comes from government.

3. Innovative Startup Investment Funds in Viet Nam

3.1 Innovative Startup Investment Funds in Viet Nam

With the aim of encouranging individual and institution to invest in innovative startups and innovative startup investment funds, the Government needs to create suitable environment for investment, including legal environment. In Viet Nam, there are many regulations on funds, however lack of regulations on innovative startup investment funds.

Based on the Law on provision of assistance for small and medium-sized enterprises (2017), investors in creative startups shall include creative startup investment funds and domestic and foreign organizations and individuals doing business via contribution of capital to establish startups, purchase of shares or stakes of startups. A creative investment fund which is created from capital contribution of private investors aims to invest in startups according to the following principles:

- The amount of investment in a small and medium sized creative startup shall not exceed 50% of charter capital of the post-investment startup
- The private investor who contributes capital to the fund shall be financially capable and take the responsibility for his/her stakes.

In addition, according to Decree 38/2018/NĐ-CP, innovative startup investment fund means a fund which is established from investments made by private investors to invest in startups. This fund does not have legal status and is established by capital contributed by not more than 30 investors according to the fund’s Charter. An innovative startup investment fund is not entitled to make investments in other innovative startup investment funds.

An innovative startup investment fund shall be managed under at least one of the following models:

- General meeting of investors, the fund management company;

- General meeting of investors, the fund’s Board of representatives or Director, the fund management company;
- General meeting of investors, the fund’s Board of representatives and Directors, the fund management company.

The fund’s investors may either establish or hire a company to take charge of managing the innovative startup investment fund. The fund management company shall carry out procedures for establishment of this fund and apply for registration of its additional business sector, which is management of venture capital fund, in accordance with the law regulations on company registration when taking charge of managing the innovative startup investment fund. The management of this fund prescribed herein shall be done according to the fund’s charter and agreements or contracts signed with the fund (if any), and not be governed by regulations of the Law in securities.

It is a problem because these regulations could limit the activity of innovative startup investment funds. In fact, investment funds usually exsit in 2 forms of contracts and firms. Corporate investment funds are legal entity. The Board of directors is elected by the shareholders, who are investors of fund, acts as the fund management agency, selects fund management company and supervises the investment activities oft the fund management company. In Viet Nam, this type of fund is not existed because Viet Nam has stipulated investment funds don’t have legal entity. Another type of fund is contractual investment fund. It is an investment fund without a legal entity status and investor is a person who contributes capital to the fund and entrusts the invesment to the fund management company. According to the current regulations in Viet Nam, the innovative startup investment funds would be established and operate under this form.

It is suggested that in Viet Nam, there should be regulations and mechanisms for the diversifications of the organization and operation of funds for investment in creative startups. So it is possible to encourage individuals and institutions to contribute capital to this highly risky investment fund because there are more suitable choices for different kinds of investors. Furthermore, it would be easier for innovative startup investment funds to raise capital of qualified and expert investors if these funds exist in form of corporates. So creative startup firms could receive better consultant and administration from owners of the invesment, supporting to the successful start-up business.

In case of applying only contractual investment funds, some regulations in Decree 38/2018/NĐ-CP should be reconsidered.

- Firstly, the management of innovative startup investment fund shall be done according to the fund’s charter and agreements or contracts signed with the fund (if any). A problem is that creative startup investment funds are not legal entity. It means these funds are not independent of fund’s investors. Consequently, these funds could not a part of contracts.
- Secondly, innovation startup invesment fund is the fund which is established from investments made by private investors to do creative startup. Could this regulation limit the participation of other types of investors? It is suggested that the definition of private investors should be made clearly and the Government should consider the regulation of limited investors. Besides, it is necessary to stipulate the finance sources being used to contribute to innovative startup investment funds due to its highly risky feature. For example, the state budget should not be used to invest in these funds.

3.2 Problem of Using Local Government Budgets for Small and Medium Sized Innovative Startup Enterprises

The Law on provision of assistance for small and medium-sized enterprises (2017) and the Decree 38/2018/NĐ-CP provides guidelines for using of local government budgets to make investments in startups besides innovative startup investment funds. Based on the reality of local government budget, each People's Committee of the province shall send the People's council of the province a request for the decision on assigning state-owned finance organizations of the province, including the local financial agency is organized and operates in the form of an extra-budgetary fund or in the form of an enterprise, to invest in startups according to the following principles:

- The eligible innovative startup investment funds shall be selected to invest in creative startups;
- Investments from the local budget shall not exceed 30% of total capital raised from eligible innovative startup investment funds selected by the startups;
- The investments shall be transferred to private investors within 5 years from the day on which the stakes is contributed. The transfer of invesments shall comply with regulations of law on management and use of the state capital invested in business operation activities at premises of enterprises.

The local financial agency shall select innovative startup investment funds to jointly make investments. An innovative startup investment fund to be selected must: (1) make a commitment with the local financial agency to jointly make investments in small and medium creative startups, (2) have at least 01 year of experience in investing in startups; (3) be financially capable of making investments and (4) satisfy other requirements (if any). The local financial agency shall annually evaluate, amend and publish the list of selected innovative startup investment funds on its website and the website of Provincial Pepople's Committee. Within 5 years form the investment date, the local financial agency may carry out procedures for transfer of its shares or stakes in the invested startup to a private investor. Innovative startup investment funds that jointly make investments in a startup and existing shareholders of the invested startups shall be given priority to such transfer of invested capital.

However, it is recommended that the Vietnamese government should not utilize the state budget to invest directly in creative startup firms via state-owned finance organizations. The state budget should be used only to support and create better environment and conditions for creative startups, along with suitable tax incentive. The reasons are as the following:

- All state budget expenditures don't have direct refund feature. As a result, investing state budget directly in small and medium creative startup firms may lead to the inequality among investors of creative startups.
- Because investing in creative startups is risky, it is difficult to impute the blame to somebody if the state budget is used to invest in unsuccessful creative startups.
- The local governments investing in creative startup firms need a state-owned finance organizations of the province. However, what a state-owned finance organization is has not been shown clearly.
- The local financial agency shall annually evaluate, amend and publish the list of selected innovative startup investment funds on its website and the website of Provincial Pepople's Committee. But what are criteria to evaluate and choose? If the specific criteria could not be set up, there would be unequal among creative startup investment funds.

In the market economy, international integration and the 4.0 revolution context, in order to promote creative startups for sustainable development, it is nescessary to support small and medium sized startup enterprises by the state government, but based on the market economy rule, such as consulting intellectual property (exploitation and development), support for applying technology transfer, support for creating criteria to measure and evaluate, support for testing new products and new business model, support for educating and providing information, support of infrastructure....Clearly, the state budget should be used to support innovative startup firms, instead of investing capital directly in firms. Direct investment could be executed by other investors, including creative startup investment funds.

4. Conclusion

Innovative startup investment funds provide essential financial source for creative startups. With investment specialists, it is easy for these funds to collect money from investors, including nonprofessional investors. When suitable mechanism for the development of creative startup investment funds is stipulated, it is possible for all investors putting their money in creative startups. The reason is that investors could invest in these funds without too much money and could diversify portfolio to reduce risks. Moreover, investors' rights and benefits could be protected under legal system.

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