

THE REALITY OF VENTURE CAPITAL COMPANIES IN ALGERIA AND THEIR ROLE IN FINANCING ENTREPRENEURSHIP: ICOZIA COMPANY AS A MODEL

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Abstract:

This study aims to introduce venture capital as a newly developed tool for financing projects in Algeria in particular, through examining the contribution of Ecozia Company in this field.

Ecozia Company is considered one of the most important venture capital companies in Algeria, having achieved a certain degree of success over the last decade, due to its flexibility in financing projects across various sectors compared to other companies, with a focus on industrial projects exceeding 50%.

Keywords: venture capital, project financing, Ecozia.

JEL classifications : G24, G32, P45.

1. Introduction:

In recent years, interest in economic projects has increased due to their significant role in achieving economic development for countries. The establishment and continuity of these projects and their achievement of the intended objectives represent a major challenge for many countries. Despite the efforts made by countries in general and Algeria in particular, projects still face many obstacles, the most important of which is the problem of financing, which remains their main concern at the present time.

Financial institutions do not take risks in financing projects; rather, they require guarantees for the funds they provide to project owners as a condition for financing.

The reluctance of traditional financing institutions to finance projects is considered a main reason for the emergence of venture capital companies as a newly developed financing alternative to these institutions and to projects that involve high risk in achieving results. These companies contribute to the capital of risky projects and provide administrative and organizational support in return for achieving high profits over a period ranging between (05–07) years. Eventually, they exit by selling their share to the project owner or offering it for trading in financial markets. Algeria, like other countries, has licensed and adopted this type of company as a newly developed financing method starting in 1991, with the licensing of the first venture capital company, FINALEP, followed by several other companies, most notably Ecozia, which is characterized by great flexibility in this activity and significant success in this field. Based on the above, how do venture capital companies contribute to financing projects, and what is the reality of this role at Ecozia Company?

Hypotheses:

- Venture capital is one of the most important financing methods that has proven its effectiveness despite the high level of risk it involves.
- Ecozia Company has achieved a certain degree of success in venture capital activity, which has contributed to financing many start-up projects, thereby adding value to the national economy and the market.

Importance of the research:

The importance of this study lies in shedding light on the financing of economic projects in Algeria and the important role played by newly developed financing through venture capital companies in supporting these projects in the long term, regardless of their financial situation.

Objectives of the study:

Through this study, we seek to achieve a set of objectives summarized as follows:

- Clarifying the concept and characteristics of venture capital financing as a newly developed financing tool, and highlighting its main advantages compared to traditional bank financing.
- Determining the impact of the financing aspect of venture capital companies on project creation by analyzing Ecozia Company's financing activity for these projects.

Methodology adopted:

This study relies on the descriptive and analytical approaches, which are appropriate for this type of research, through reviewing a set of references, books, journals, and national and foreign scientific theses, and collecting information related to the theoretical aspects of the study, with an attempt to apply them to the case study of Ecozia Company.

2. The conceptual framework of venture capital:

In the 1950s, a new type of investment emerged known as venture capital. This concept has been given several doctrinal, economic, and legal definitions, some of which are presented below:

2.1 Definition of venture capital:

Economically, venture capital is defined as “one of the forms of corporate financing in which a business enterprise provides part of the ownership and management rights of the enterprise in exchange for capital within a specified time period, usually ranging from 3 to 5 years and possibly extending to 7 years. Investments typically range between 500,000 dollars and five million dollars, although venture capital investments sometimes decline to 50,000 dollars or rise to 20 million dollars” (Sahraoui, 2009, p. 12).

The European Association defines it as “any capital invested through a specialized financial intermediary in private projects with high risk, characterized by the potential for strong growth but not involving, at present, certainty of obtaining income or assurance of recovering the capital at a specified date, in the hope of obtaining capital gains in the relatively distant future upon the resale of the institution's share after several years” (Ahsan, 2017, p. 20).

In Algerian law, the Algerian legislator defined venture capital companies in Law 06/11 of 25 June 2006 concerning venture capital companies as “companies that aim to participate in the capital of a company and in any operation consisting of providing portions of private or quasi-private funds to enterprises in the phase of establishment, growth, transformation, or privatization” (Law 06-11, 2006, p. 3).

Based on the above, venture capital can be considered a financing technique carried out by venture capital companies through contributing to the capital of projects and enterprises, regardless of their size, that require financing for a period ranging between 5 and 10 years. During this period, these companies bear the risks resulting from uncertainty about achieving a positive return, in exchange for a very high return in the end, which concludes with the transfer of these shares to the financed institution, to other venture capital companies, or through the stock exchange.

2.2 The difference between venture capital and risk capital:

It is important to distinguish between venture capital and risk capital. The former focuses on financing enterprises and projects at all stages of the life cycle of the enterprise and the project by providing capital to the enterprise in order to develop products, increase working capital, and acquire existing enterprises that face problems. Risk capital, on the other hand, focuses on financing the initial stage of the emergence of a project or enterprise. This means that risk capital is part of venture capital (Bouqfa Ahlam, 2017, p. 197).

2.3 Parties involved in venture capital financing:

The venture capital financing process requires essential parties that interact with one another in order for the financing operation to take place, starting from the establishment of the venture capital company, through project financing, and ending with the termination of financing. These four parties are:

2.3.1 Investors:

They are the contributors to the capital of the venture capital company, including banks, pension funds, public authorities, private investors, etc.

2.3.2 Venture capital institutions:

Financing companies that contribute to the capital of enterprises and various projects in need of financing at all stages of their activity.

2.3.3 Beneficiaries:

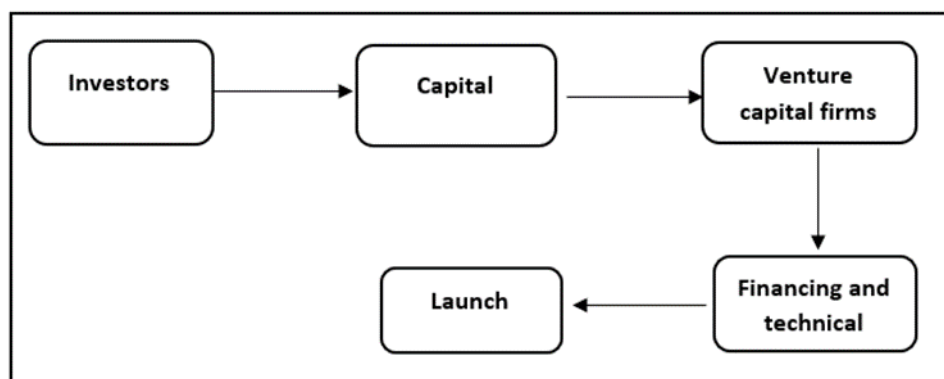
These include all enterprises, whether small, medium, or even large, as well as various projects whose owners seek financing.

2.3.4 Buyers:

Those who purchase the company's shares from the venture capital company upon its exit from the partnership with the enterprise or project after the expiration of the financing period.

To further clarify the interaction process among the four parties in venture capital financing, it can be summarized in the following figure:

Figure 01: "Interaction of financing parties in venture capital companies".



2.4 Types of venture capital:

Venture capital includes four types of capital related to the stages of financing enterprises through this newly developed technique, which can be listed as follows (Qara Rabah, 2017, pp. 9–11):

2.4.1 Risk capital:

This is the capital allocated to financing the pre-start-up stage of the project (feasibility capital) and the start-up stage (creation capital).

2.4.2 Development capital:

This involves financing the enterprise or project during the growth stage to increase sales through financing working capital, increasing production capacity by financing the expansion stage, and finally financing the waiting stage in preparation for entry into the stock exchange.

2.4.3 Buyout capital:

This is allocated to financing the acquisition of an already existing enterprise that is experiencing a decline stage.

2.4.4 Turnaround capital:

In this case, another venture capital company finances or repurchases the shares of an enterprise facing difficulties.

2.4.5 Characteristics of venture capital:

Venture capital is characterized by several features derived from its definitions in various economic, legal, and doctrinal fields. The most important of these can be highlighted as follows:

- ✓ Achieving added value for investors' capital by financing efficient enterprises.
- ✓ Contributing a relatively small share of the company's capital.
- ✓ Ambitious financing.
- ✓ Achieving positive capital gains upon selling shares at the exit stage.
- ✓ Differing from traditional loan-based financing.
- ✓ Contributing to social capital.

3. The venture capital experience in Algeria:

Financing in Algeria was limited to traditional financing methods that mainly relied on bank loans, due to the limited number of venture capital institutions until 1991, when the first venture capital company was established following a proposal by the European Investment Bank and the French Development Agency to support the development of investment in Algeria. This resulted in the creation of the Algerian-European Investment Company (FINALEP) (Qashida Souria, 2012, p. 169). Algeria contributed 60% of the capital, with the remaining share being French, in accordance with the monetary and credit law in force at that time. Subsequently, a set of legal provisions was enacted to regulate the practice of venture capital activity in Law 06/11 of 24 June 2006 relating to venture capital companies, as well as Executive Decree 08/56 of 11 February 2008 concerning the conditions for practicing the activity of venture capital companies, which enumerated a set of conditions for the accreditation of these companies, to be addressed in the following section.

3.1 Conditions for venture capital companies to operate in Algeria:

To practice venture capital activity, Law 06/11 issued in 2006 relating to venture capital companies set out a number of conditions that companies must comply with, the most important of which are: The law requires these companies to obtain authorization from the Ministry of Finance (Executive Decree 08-56, 2008, p. 08).

- ✓ The company must be a joint-stock company with a minimum capital of 100 million dinars through public subscription.
- ✓ These companies may not contribute more than 15% of their capital and reserves to a single enterprise.
- ✓ They benefit from a tax exemption for a period of 5 years, provided that they commit to maintaining the invested funds in an enterprise for a period of no less than 5 years.
- ✓ The company may not lend more than 10% of its net own funds.
- ✓ The company may not hold more than 49% of the capital of a single enterprise.

3.2 The main companies operating in venture capital activity in Algeria:

There are 14 venture capital companies operating in Algeria; 08 of them are public companies, namely: the Algerian European Investment Company FINALEP, the Financial Company for Investment, Contribution and Placement SOFINANCE, the National Investment Fund FNI, Algeria Investment, 48 provincial investment funds, the Algerian Investment Fund FAI, Ecozia Investment Company ICOSIA SPA, and the Algerian Startup Fund ASF. There are also 05 foreign-capital companies (AFRICINVEST, SWICORP, ABRAAJ, ECP, RIVA & GARCIA) and one mixed company (the Algerian-Saudi Investment Company ASICOM) (Bouqfa Ahlam, 2017, p. 201). These companies intervene in productive and service enterprises, excluding the agriculture and fishing sectors. The contribution of venture capital companies does not exceed 49% of the capital of these enterprises subject to Law 06-11.

3.2.1 The Algerian European Investment Company FINALEP:

It is a financial company specialized in venture capital, established in 1991 with a capital of 73 million and 750 thousand Algerian dinars in the form of a joint-stock company. Algeria contributed 60% of

the capital, distributed between the Local Development Bank (BDL) with 40% and the Popular Credit of Algeria with 20% of the company's capital. The French state's contribution, estimated at 40% of the capital, was divided between the French Development Agency with 28.74% and the European Investment Bank with 11.26% of the company's capital (Sebti Mohamed, 2009, p. 172). FINALEP was accredited by the Ministry of Finance in 2012, and in 2015 the company's capital was increased to 1 billion and 200 million Algerian dinars, of which Algeria contributed more than 96%, distributed between the Local Development Bank BDL with 64% and the Popular Credit of Algeria CPA with 32%. The remaining share belongs to the French partner represented by the French Development Agency AFD with 04%. The company focuses on financing new ideas and start-ups in Algeria, with particular importance given to risk capital financing, which represents 80% of the volume of its financing.

3.2.2 The Financial Company for Investment, Contribution and Placement SOFINANCE:

It is a public company established within the framework of the economic reform policies adopted by the Algerian government. It was accredited by the Bank of Algeria on 9 January 2001 with a capital of 5 billion Algerian dinars (Bouqfa Ahlam, 2017, p. 109), financed by the Algerian Treasury. It carries out all financial activities except deposits. SOFINANCE focuses in its activity on leasing, which represents up to 67% of the volume of its financing (Brish Said, 2017, p. 12).

3.3.3 Algeria Investment ELDJAZAIR ISTITHMAR:

It is a venture capital company accredited by the Ministry of Finance in 2010 with a capital estimated at one billion Algerian dinars, divided between the Bank of Agriculture and Rural Development BADR with a percentage of 70% and the National Savings and Reserve Fund CNEP BANQUE with a percentage of 30%. It focuses on financing industrial projects, which represent 50% of its total financing.

Algeria Investment aims to finance small and medium-sized enterprises, particularly those operating in the technological field, within the framework of supporting and developing SMEs in Algeria (Abed Nassira, 2018, p. 215).

3.2.4 The Algerian-Saudi Investment Company ASICOM:

It is a venture capital company established by an agreement signed in 2004 between the Algerian Ministry of Finance and the Saudi Ministry of Finance. It began its activity in 2008, with a capital of 8 billion dinars equally divided between the two countries, i.e., 4 billion dinars for Algeria and 4 billion dinars for Saudi Arabia.

3.2.5 The National Investment Fund FNI:

It is a public institution specialized in supporting investment, established in 1963 when it was called the Algerian Development Fund CAD, and its name was changed in 2011 to the National Investment Fund FNI. This fund is mainly concerned with the financial services sector, which ranks first, followed by the industrial sector (Hamdani Mohamed, 2019, pp. 32–33).

4. Case study: Ecozia Company:

In this study, Ecozia Company is taken as a case study by identifying its investment portfolio and analyzing the various financing operations it has carried out since the beginning of its activity up to the present day.

4.1 Presentation of Ecozia Company ICOSIA:

It is a venture capital company accredited by the Ministry of Finance under Decision No. 29 dated 15 March 2018. Its capital amounts to 1.5 billion dinars and is wholly owned by MADAR HOLDING SPA. Its main activity is entering into the capital of projects at the stages of establishment, growth, and transformation¹.

4.2 Development of venture capital financing activity of Ecozia Company:

It should be noted that in 2009 the first venture capital company was accredited in Algeria.

Table 02: Investment portfolio of Ecozia Company during 2011–2020.

Intervention stage	Financing value in million dinars	Contributing percentage	Sector of activity	Region	Number of projects	Year
No financing						2018
No financing						2019
Establishment	29.4	% 49	Industrial		01	2020

The third company operating in this activity in Algeria is Ecozia Company, ICOSIA CAPITAL SPA, which obtained authorization from the Ministry of Finance on 15 March 2018.

The company, with an estimated capital of 1.5 billion dinars, is owned by MADAR Holding. In 2018, its activity was limited to undertaking the administrative procedures necessary for operation, in addition to procedures and surveys conducted with some small and medium-sized enterprises seeking financing.

4.3 Analysis of the company’s activity for the year 2019:

The company has six (6) approved projects under review with an estimated amount of 716 million dinars. These projects relate to the fields of technology, media and communication, life and health insurance, and industry. Most of these projects are at the stages of establishment, development, and transformation.

The company suffers from instability at the level of its general management. Since obtaining authorization to operate in 2018, three (3) general managers have been replaced in order to achieve effectiveness in the company’s targeted activity.

The company offers investment activity and develops it with companies whose sales volume exceeds 5 million dinars.

4.3.1 Analysis of the company’s activity for the year 2020:

The number of projects under review within the company amounts to 13 projects specialized in information technology and communications, health, and industry. Most of these projects are at the establishment stage.

At the end of the first half of 2020, the company carried out one investment in the capital of an industrial project at the establishment stage, with an estimated amount of 29.4 million dinars, with a participation rate of 49% of the company’s capital. As of 31/12/2020, this company was not yet operational due to the non-arrival of the equipment necessary for production as a result of the situation caused by the COVID-19 pandemic.

The company continues to record losses due to the absence of a sufficient portfolio that achieves balance and generates profits adequate to cover operating expenses. The income generated comes from time deposits originating from financial institutions or related activities.

It should also be noted that the company complies with Law 06-11 by not exceeding a financing rate of 49% of the project’s capital.

5. Conclusion:

At the end of our study, we reached the following conclusions:

- Venture capital is a modern financing technique through which companies known as venture capital companies finance projects with a high level of risk. This financing is carried out through participation in the project's capital for a period ranging from 5 to 7 years in exchange for a high return, with the possibility of incurring losses. This participation ends with the company's exit after the project reaches the stage of self-sufficiency. This has proven its success as a newly developed alternative to traditional financing, which confirms the validity of the first hypothesis.
- The venture capital financing technique includes four types of capital: risk capital to finance the pre-start-up stage, development capital to help the project grow, buyout capital, and finally turnaround capital.
- There are 14 companies in Algeria that practice venture capital activity, including 8 public companies, 5 foreign-capital companies, and one mixed company. FINALEP was the first company of this type in Algeria.
- The Algerian legislator regulated the activity of venture capital companies through Law 06/11 of 2006, which clarified the methods of establishing these companies, the conditions for practicing this activity, and the methods of supervising them. The conditions for practicing venture capital activity were then reformulated in 2008 through Decree 08/56 dated 11 February 2008 concerning the conditions for practicing the activity of venture capital companies.
- Ecozia Company is one of the venture capital companies in Algeria, having started its activity in 2018, and it financed one project in 2020 in the industrial sector.
- Ecozia was characterized by the limited scope of its activity due to its recent establishment. Among its objectives is to focus on operating with great flexibility in practicing venture capital activity by responding to the various needs of projects, financing between 1% and 49% of the capital of these projects, in compliance with Articles 17 and 18 of Law 06/11, which stipulate that companies must not contribute more than 49% of the capital of a single project. It also focuses its activity on start-up projects due to the lack of financing and the lack of technical and procedural expertise in this type of project, which proves the invalidity of the second hypothesis.

Based on the results obtained, the following recommendations can be presented:

6. Recommendations:

- ✓ Promoting and encouraging financing through venture capital, which is considered an exemplary model for creating employment opportunities and wealth.
- ✓ Encouraging the private sector to establish venture capital companies and not limiting them to the public sector, while expanding the volume and scope of investments.
- ✓ Encouraging venture capital companies to jointly participate in financing projects, along with activating the Algiers Stock Exchange to help companies exit project capital by selling their shares on the stock exchange.

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Footnote:

- ¹Presentation of the institution, available on 01/08/2022 at 21:00 on the website (<https://www.icosia.com/a-propos/>)

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- Source: Cherif Mondher, 2002, p. 19
- Source: Prepared by the researcher based on company information