THEORETICAL ANALYSIS OF THE STATUS OF VENTURE CAPITAL IN CAPITAL STRUCTURE OF THE RETAIL UNIT

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Abstract: *Conditions of these turbulent times specified number of factors affecting the value of the company's capital. One of them is the accessibility and usability of the necessary resources for new activities. Many retail businesses must sneak peek for new forms of obtaining funds. Thus, we can define a venture capital, which is currently gaining its potential. Contribution Article turns its attention to the analysis of the position of that source of finance in the capital structure of the retail business. To provide a complete view, work utilizes the most important economic indicators for the selection of capital to capital structure and expresses them through mathematical formulas. Article dimensiones three variants of the capital structure of the retail businesses that use for the practical analysis of the status of venture capital compared to other funding opportunities. In conclusion, article looks at the issue of contradiction of interests of the owner / manager of retail against to investor of venture capital. This point defines as the most significant limitation for full use of potential of venture capital.*

Keywords: *venture capital, capital structure, retail unit, costs, investors*

JEL Classification: *G32, M21*

1. INTRODUCTION (PURPOSE OF ARTICLE)

Every business activity - including also the retail activities – requires the existence of the necessary assets to implement the plans. It is important to note that very important factor for long-term planning and development is time. It stems from the need to define the correct structure of long-term capital items. Here as the objective can be defined as the mission of maximizing the market value of the company's capital with due regard to the many influencing factors

Conditions of current turbulent times specified number of factors affecting the value of the company's capital. One of them is the accessibility and usability of the necessary resources for new activities. Many retail businesses must sneak peek for new forms of obtaining funds. Thus, we can define a venture capital, which is currently gaining its potential.

2. SCIENTIFIC AIM, METHODOLOGY/METHODS

Theme of paper is a theoretical examination of the status of this specific form of investment in capital structure of defined retail businesses. Attention is also focused on analyzing the effects of venture capital to the management of such units. Narrowing the focus on the retail industry stems from the orientation of downstream research[1].

Article uses mathematical expression of the essential determinants for the selection of capital in the capital structure which are applied in terms ofe three variants of retailers that are created for the research in this work. .

3. FINDINGS

As a capital structure could be defined as a structure of enterprise sources in the long-run term. This is the definition of such capital items that are available for use and tying in different forms of property long term. Generally, it is recommended to allocate this capital in the current assets.

Financial planning and deciding about the optimal capital structure puts emphasis on maximizing of the market value of the retail business. Access to capital structure refers Stephen A. Ross with coauthors as a "model of cake". According to this explanation, the value of a company is the sum of the market value of debt and market value of equity (Ross – Sesterfield – Jaffe, 1990, p.382).

Dedication to the proper assembly of the capital structure necessarily involves the consideration of all causes and consequences that could result from a particular form. The most important definition from all theories of capital structure is defined by so-called compromise theory.

Cost of capital is an important parameter for the enterprise decision-making. It is also an important factor that significantly affects its competitive position and determines its overall prosperity and the volume of economic activity, as well as the successful growth and development (Sivák – Mikócziová, 2006, p. 40). In terms of corporate finance, capital costs represent expenditure that a company must pay for the acquisition and binding of various forms of capital to finance their activities (Vlachynský, 1999, p. 195).

In connection with the subject of this paper is important to define venture capital and define its relationship to the capital structure. Clearly speaking (de jure), it is the form of the company's share capital. In terms of financing of the company, venture capital is invested by professional venture capital firms to start-up, development or transformation of private companies with growth potential (Hečková - Hrabovská, 2006, p.26). It adds added value in the form of advice in finance, strategy or even marketing.

Based on the theoretical background can be defined venture capital as a form of own sources which come from

[1] After offered theoretical analysis, research will move towards to more detailed analysis of the impact of venture capital on the key management of the retail unit.

the external environment. Due to its essence, which is financing of start-ups or expanding businesses, it is necessary to process the correction in defining the basic relations:

1. venture capital enters into equity as an entity of "companion" (effect of cooperation is not just a one-time deposit of funds into the capital, but also the provision of know-how and other investments),
2. venture capital company (investor) behaves rationally also prudently in order to sell share with the maximum price after the contractual partnership to client - the recipient of the investment (i.e. the expected growth rate of earnings for the investor is significant but not overriding),
3. implementation of interim returns on investment for the investor and the client is taken from the net profit after tax and payment of interest, i.e. EAIT (earning after interest and taxation), after deducting the agreed rate of reinvestment of profits.

Criteria for selection is determination of the optimal capital structure in view of the cost of all forms of capital, their average value (WACC - Weighted Avarage Capital Costs), as well as other influencing factors according to various theoretical approaches (especially the compromise theory of capital structure).

For presenting the status of venture capital in the capital structure of the company, presented paper compares three variants of allocation of capital in defined retail companies A, B, C. These come from and also follow the following axioms which are applied to all illustrated retail businesses:

1. Interest rate of long-term debt represents i0=8 %, while the old debt is 8,000 Euro, share capital 22,000 Euro, short-term liabilities 4,000 Euro.
2. Capital requirements set by the management of company, in consideration of planned expansion, amounts to 20,000 Euro.
3. Required rate of return of group of managers adapts to the investor, company undertake an exponential growth of profits.

Net working capital is very low – it means that even permanently bonded portion of current assets is covered by short-term liabilities – liquidity.

Table 1 Variants of capital structures of the retail units

PARAMETER	RETAIL UNIT A	RETAIL UNIT B	RETAIL UNIT C
Deposit of investor	20,00 Euro	0 Euro	15,00 Euro
Required rate of return	25%	-	25%
New credit	0	20,00 Euro	5,00 Euro
Interest rate p.a.	-	30%	30%
Costs of primary debt(C_{d0}*)	6,48%	6,48%	6,48%
Costs of venture capital (C_{VC})	25%	0	25%
Costs of other equity (C_e)	25%	25%	25%
Costs of new debt (C_{d1}*)	0	24,30%	16,20%
$WACC_i$, while i = variant A, B, C	22,04%	21,76%	21,20%

* calculation is done by: C_d = i.(1 - d), while d means tax rate

Source: own processing according to [6]

Important role in assessing the optimality of a particular capital structure is the total average cost of capital (WACCi). Those could be defined as the weighted average cost of individual types of capital (Cdi) where the weights are the market shares of capital items (THdi) on the total capital of retail unit (TH) (Sivák – Mikócziová, 2006, p.50):

$$WACC_i = \frac{TH_{d0}}{TH} \times C_{d0} + \frac{TH_{d1}}{TH} \times C_{d1} + \frac{TH_{VC}}{TH} \times C_{VC} + \frac{TH_e}{TH} \times C_e \qquad (2.1.1)$$

Based on Table 1, we show these ranking for individual retail businesses A, B a C that WACCC < WACCB < WACCA. In order to check the objective factors that affect whether the investor decides for venture capital as a form of support to selected retail business, it is necessary to take into account the cost of venture capital (CVC). In can be understood as a proportion of the annual return on investment (Ds) on the difference between the market price of the share (Mp) and cost of acquisition of investments (CA) plus annual growth rate of revenue (g):

$$C_{VC} = \frac{D_S}{M_P - C_A} + g \qquad (2.1.2)$$

According to set assumptions, we could focus on other attribute of decision making – market value of the share of investor (Mp):

$$M_P = \frac{D_S}{C_{VC}} + \frac{g}{C_{VC}} + C_A \qquad (2.1.3)$$

However, focusing on market price shows some weaknesses affecting the understanding of the status of venture capital. The reason is failure to achieve a fair market valuation given the possible potential for success. Another important problem is the difficulty of determining the annual income from profit (DS) whereas the fact is distorting the pursuit of maximum retention of retained earnings as internal source. This fact justifies the consideration of the so-called cost of retained earnings (Dudáš 2007, p. 488).

4. DISCUSSIONS

According to Brealey and Myers, it is necessary to look on retained earnings as well as on obtaining an investor with a difference of abstraction from the actual acquisition cost (CA) (Brealey - Myers, 1984, p.398). By defining Ds over earnings per share (EPS), where the controller is the reinvestment rate (I), we come to the conclusion:

$$M_P = \frac{(1 - I) \times E_{PS}}{C_{UP}} + \frac{g}{C_{UP}} \qquad (2.1.4)$$

The issue of proper determination of growth rate (g) alludes to a fundamental mismatch between the parameters of model of the annual income from profit (DS) and earnings per share (EPS). Therefore follows that in case of the fixed part of the annual reinvested earnings, annual revenues from profit (DS) remain constant[2].

On the other hand, these generalized claims faced with a fundamental contradiction between the traditional partnership in business and systematic collaboration of client and venture capital investor. Interest of the client (in this case retail business) is to develop their business idea, innovate and provide products with ever increasing quality. On the contrary, investor interest - in addition to certain motifs – is to achieve consistently stable or superior revenue and its absolute effect will be reflected in "feedback" investment[3].

It is important to define other factors influencing the decision-making of retail manager for or against the use of

[2] This is evident from the calculation of earnings per share, for example in second year (E_{PS2}): $E_{ps2} = E_{ps} + rxIxE_{ps} = E_{ps}(1+Ixr)$

[3] in other words, leaving the investment

venture capital. Firstly, for venture capital is important to maximize the output share of the company (maxE) as the average annual growth in earnings per revenue (g). It can act against the interests of retail manager.

Secondly, the investor provides the necessary know-how, particularly in the areas of cash flow, financial and strategic management, thus contribute to increasing the stability and prosperity of the company. This can be rated as key non-financial advantage of venture capital for the development of retail units.

Thirdly, the investor may act as dampening subject for pure thoughts of retail business entity - which may lead to increasing opportunity cost of company (compared to other financing opportunity). Therefore, it is probably the most important factor acting to "award" the participation of venture capital, scarcity, or even unavailability of other forms of financing.

5. CONCLUSION

Capital structure, its optimization to maximize the value of the whole enterprise is one of the fundamental problems relating to the retail units. The complexity of the different views, their ambiguity and openness to other outputs encourages us to search for links between alternative methods of financing.

Venture capital represents high level of maturity of the business sector in financing investment needs, whether specific projects or through the business. In need of funding for projects, retail operators ranging o reorganize the capital structure which is a prerequisite for the analysis of possible models and their impact on the value of the company. The theoretical definition of variants of the capital structure offered by paper represents some tool for orientation in this issue.

Results of the analysis do not constitute a final impact of assessment of risk capital on optimality of capital structure of the retail units. It gives a financial view of this form of financing, especially in terms of potential of high growth of revenues and profits accrued from “feedback” investment. Also paper highlights the importance of non-financial impact of venture capital on the management and operation of retail units.

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