VENTURE FUNDING IN BELARUS

A REPORT BASED ON THE OUTCOMES OF A SURVEY UNDER THE “AIDVENTURE” PROJECT

MINSK 2017
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INTRODUCTION
Some Belarusian investment climate development challenges have also been considered in the course of preparation hereof. The report has relied upon the research of venture ecosystems in other countries throughout the region.

The results of the present study are not an exhaustive overview of all the challenges that startups, IT companies, business angels and venture investors in Belarus have to face. The study is an actual reflection of the views of Belarusian venture ecosystem’s entities.

Oftentimes, the opinions voiced by the venture ecosystem’s participants suggest that the current legislative framework does not meet the demands to the environment for venture funding development in the country. Such discrepancies affirm the need for closer contact between Belarusian Government and private sector to change such environment.

The report also features conclusions and recommendations by the team of a project to design state policy for venture funding development in Belarus. These recommendations address only the generic areas of activity to eliminate key issues in the way of venture funding development. The recommendations stem from legislation analysis and the project experts’ long-term experience in the development of the country’s startup and venture ecosystem.

The electronic version hereof is available at www.bel.biz website.
USAID

The U.S. Agency for International Development (USAID) supports the development of Belarusian private sector by improving the business environment, enhancing private SMEs' competencies and improving their access to finance. USAID is facilitating access to modern technology, innovative entrepreneurship and startups’ development. USAID supports the promotion of business interests, business environment improvement, the development of entrepreneurship support organizations, increased financial literacy, and improved access to finance. Since October 2016, USAID has been funding an ‘AID-Venture’ initiative for venture funding development in Belarus, which is intended for five years.

BELBIZ GROUP OF COMPANIES

Belbiz Group of Companies is the top hub for entrepreneurial and startup initiative in Belarus. Belbiz Group of Companies includes bel.biz, an website for business, and ‘Imaguru’ startup hub. ‘Imaguru’ startup hub is a major co-working area; a learning center for startups, investors and corporations; a platform for startup events. Belbiz hosts the Global Entrepreneurship Week in Belarus and Venture Day Minsk, the largest international startups conference.

“ALEINIkov AND PARTNERS” LAW FIRM

Aleinikov and Partners” Law Firm has been active in the Belarusian market since 2006. The company’s profile is the support of investment projects, M&A deals in IT, as well as facilitating dispute resolution. The company lawyers’ high professional standard is recognized by renowned international rankings for lawyers, such as Chambers Global, Chambers Europe, Legal 500, International Financial Law Review 1000. “Aleinikov and Partners” has been commended by the Belarusian Ministry of Justice twice as the best organization rendering legal services in the country (Ministry of Justice resolutions No. 99 dd. April 27, 2011; and No. 69 dd. May 3, 2013).
“Venture Funding in Belarus”: Study objectives

- current Belarusian venture funding market analysis and identification of the main opportunities for its stimulation;
- study of legal and institutional problems around venture funding development;
- identification of key administrative and regulatory barriers that the startup and venture ecosystems face in their activities;
- the development of practical recommendations for all stakeholders to ensure further effective development.

**COVERAGE**

310 entities within the Belarusian venture ecosystem took part in the survey.

**TIME FRAME**

The study was conducted in December 2016-February 2017.

**METHOD**

The survey and structured personal interviews featured 38 questions and extra sections on the following topics: current venture funding practices, venture ecosystem, legal aspects of venture funding, as well as necessary improvements for the development of venture funding in Belarus.

**SAMPLE**

The sample is representative of the venture ecosystem of Belarus.
Drag along is the right of a shareholder (participant) (usually of a majority/institutional investor) to force the other shareholders (participants) (as a rule, minority ones) to enter a deal to sell the latter’s stocks (equity shares) in the company on the same terms as the given shareholder (participant).

Tag along is the right of a shareholder (participant) (as a rule, of a minority one) to enter a deal under which company stock (equity shares) are sold by another shareholder (participant) (usually a majority one), on the same terms as such majority shareholder.

A business angel is an independent private investor (a natural person or a legal entity) who invests his/her capital into small innovative and high-tech companies (projects) during early stages of their development, and also normally provides advice as to the activities of such companies (projects). In exchange for such investments, business angels usually receive a certain share in the company’s equity (a share in the project).

Venture organization¹ (according to the Belarusian legislation) is a commercial organization established to invest into the creation and implementation of innovations, as well as to fund venture projects.

Venture funding is the type of financing in which institutional and individual investors provide funds to early-stage or small high-tech companies with long-term growth potential to enable the implementation by the latter of highly risky innovative projects. This type of funding comes with a high extent of risk to the investor and potentially high profitability. In exchange for such investments, investors are typically remunerated with profits or stocks (shares) in the company’s equity.

Venture fund is an investment fund investing into the equity of innovative companies at various stages of their growth. Venture funds effect high- or relatively high-risk investments in anticipation of extremely high profits. Normally, 70-80% of projects bring no returns, but the profit from the remaining 20-30% pays off all the losses.

¹ The definition is given under Art. 13 of the ‘Regulation On the Innovative Infrastructure Entities Establishment Procedure’ as approved by the Belarusian President’s Decree No. 1 dd. January 3, 2007.
Warranties are statements regarding factual circumstances or future promises made by one or both parties to the deal. Should either party breach such warranties, the other party to the deal receives the right to claim damages—but not to waive the contract.

A call option is a contract or a clause therein enabling (but not obliging) one party (option holder) to demand having a certain asset, e.g. stocks (shares), sold to it by another party to the contract at a predetermined price and within a predetermined period.

Convertible loan (note) is a loan granted to a company entitling the grantor to convert all or part of the loan amount into common or preferred stocks (shares) of a company at a certain conversion rate and within a certain period of time.

Liquidation preference in the case of 100% sale of stocks/shares—the procedure and conditions of preferential cash disbursement to certain investors and stockholders (participants) of the company when 100% of its equity/shares are sold.

Liquidation preference at company's dissolution is the procedure and conditions of preferential cash disbursement to certain investors and stockholders (participants) of the company in the case of its liquidation.

Liquidation preference at core assets sale—the procedure and conditions of preferential cash disbursement to certain investors and stockholders (participants) of the company in the case of its core assets sale.

Liquidation preference in the case of company’s reorganization—the procedure and conditions of preferential cash disbursement to investors and stockholders (participants) of the company in the case of its reorganization

Lockup period is the time frame during which the company’s leadership, managers and majority stockholders are prohibited to sell any of their stocks (equity shares) in the company.

Indemnity is the obligation of one contractual party to reimburse potential material losses, not arising out of the breach of its contractual obligations, incurred by the other party upon the onset of circumstances envisaged in their contract.
An **option program** for the management and key employees is a system of incentives for the leadership, managers and other staff enabling them to acquire a certain number of company’s stocks (equity shares) for the achieved progress and/or long track record with the company. Used as an incentive to maintain long-term employment relations with the company’s staff members.

A **put option** is a contract or a clause therein enabling (but not obliging) one party (option holder) to demand having a certain asset, e.g. stocks (shares), bought from it by another party to the contract at a predetermined price and within a predetermined period.

A **‘startup’** is a newly established and rapidly growing company engaged in the development or delivery of innovative products/services with scalable business models.
RESPONDENTS’ PROFILE
310 respondents from Belarus took part in the survey. The study sample is representative of the venture ecosystem, being based on information provided by key venture market entities within three target groups—investors, startups, and support organizations (Figure 1).

The investors group featured business angels and venture fund representatives, international organizations, companies with foreign capital and major IT companies currently investing in startups or intending to do so.

Most of investor companies are established businesses with a relatively long (7+ years) operation in the Belarusian market. ‘Age’ breakdown of investor companies is shown in Chart 1.

Over a third of all investor companies have foreign participation in their authorized fund (Chart 2).
STARTUPS

The group of startups featured representatives of young (under five years of operation) Belarus-based companies with an innovative development model and/or a scalable technological idea/product.

Most startups have been operating in IT for 1-3 years (Chart 3) and have two to three founders (Figure 2). Over a third of startups have been founded by women (Chart 4). Most companies have a prototype, and 40% of startups have launched it (Chart 6).

Chart 5 reflects the distribution of startups per their core activity. Most startups are engaged in other IT domains (54.7%), AI (12%), healthy lifestyle and healthcare technology (9%). A fairly small percentage of startups are engaged in manufacturing.

STARTUPS

The group of startups featured representatives of young (under five years of operation) Belarus-based companies with an innovative development model and/or a scalable technological idea/product.

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Chart 5 reflects the distribution of startups per their core activity. Most startups are engaged in other IT domains (54.7%), AI (12%), healthy lifestyle and healthcare technology (9%). A fairly small percentage of startups are engaged in manufacturing.
Chart 5. Startup industry

<table>
<thead>
<tr>
<th>Industry</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>AI</td>
<td>12,5%</td>
</tr>
<tr>
<td>FinTech</td>
<td>9,3%</td>
</tr>
<tr>
<td>VR</td>
<td>7,8%</td>
</tr>
<tr>
<td>AgriTech</td>
<td>6,3%</td>
</tr>
<tr>
<td>HealthTech</td>
<td>4,7%</td>
</tr>
<tr>
<td>Other tech domains</td>
<td>3,1%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1,6%</td>
</tr>
<tr>
<td>Other</td>
<td>54,7%</td>
</tr>
</tbody>
</table>

Chart 6. Startup’s product/service development stage

<table>
<thead>
<tr>
<th>Stage</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concept</td>
<td>40,3%</td>
</tr>
<tr>
<td>Business Plan</td>
<td>26,9%</td>
</tr>
<tr>
<td>Operational product prototype</td>
<td>16,4%</td>
</tr>
<tr>
<td>Launched on the market</td>
<td>16,4%</td>
</tr>
</tbody>
</table>

Figure 2. Number of founders in startups

- 1 founder: 12,5%
- 2 founders: 37,5%
- 3 founders: 26,5%
- 4 founders: 17,2%
- 5 founders: 6,3%
The group of support organizations comprised business associations, incubators, technoparks, coworking spaces, as well as public organizations facilitating the development of entrepreneurship and innovation in Belarus.

Same as investors, most companies in this sector have been around for 7+ years (Chart 7). Over a half of them are state-owned (Chart 8).

**Chart 7. ‘Age’ of support organizations**

- 1-3 years: 8.3%
- 3-6 years: 27.8%
- 7-10 years: 22.2%
- 10+ years: 41.7%
- Under 1 year: 8.3%

**Chart 8. State share in the support organizations’ authorized funds**

- None: 47.2%
- Yes: 52.8%
KEY STUDY OUTCOMES:
OVERVIEW
Labor resources are a positive factor for investing in Belarus.

75.7% of investors believe that labor resources are a positive factor for investing in Belarus (further details in “Venture Ecosystem through Investor’s Eyes” chapter).

Belarus is a growing market: local investors are prepared to invest in startups; startups are planning to attract venture funding.

Over 80% of national investors are prepared to invest into startups. 80% of startups plan to attract venture funding (further details in “Current Investment Practices” chapter).

Belarusian business is prepared to invest up to $100M/year in startups.

40% of investors are prepared for annual investment of $500k+. This enables estimation of the Belarusian investment market capacity at $100M per annum. This figure is rather comparable with the market volume in neighboring countries, such as Ukraine, Lithuania and Latvia (further details in “Current Investment Practices” chapter).

All ecosystem members noted the need for reforms geared toward its development.

54.6% of entities assess the investment climate as ‘unfavorable.’ Just over 8% of the venture ecosystem entities spoke positively of the reforms. 35% see no reforms (further details in “Venture Ecosystem through Investor’s Eyes” chapter).

Most deals are structured abroad.

Over half of the respondents (60.7%) use foreign law when structuring venture deals. The most popular jurisdiction among foreign ones is English law (60.7%). 21.4% of transactions are made ‘on the word of honor.’ According to the respondents, ensuring that the deals are structured in Belarus will take the following changes:

- decriminalization of liability in the economic domain;
- amendments to corporate law and venture funding legislation;
- benefits granted to venture companies

(for more information, see Chapter “Legal Aspects of venture funding”).
CURRENT INVESTMENT PRACTICES
46.4% of Belarusian investors have done five or more deals over the past three years. On top of this, the deals could have been carried out in Belarus and abroad. 21.4% of investors have done 3-4 deals. Only 7.1% of investors executed only one deal during this time frame (Chart 9). These indicators are suggestive of a fairly high activity on the part of Belarusian investors, given that the Belarusian venture ecosystem is only emerging. One can assume that all the deals were done by business angels (individuals or corporations), as no institutionalized venture funds have been present in Belarus until recently.

Professional business angels do not normally limit themselves to 1-2 investments so as to minimize risks. Business angels get much less than their investment when exiting most venture projects. 5-10% of deals can pay off tenfold or better. Accordingly, in order to balance the risks, business angels strive to have several companies in their investment portfolio at any given time. In developed ecosystems, business angels execute an average of 5 (UK1) to 10 (US2) deals per year. This can become their core professional activity or at least in part their lifestyle, as most business angels are former or active entrepreneurs or top managers in large companies.

1 Nation of Angels Report.
2 Angel Capital Association.
Extrapolation of these data upon the entire ecosystem leads to conclude that Belarusian investors invest in over 50 startups annually. This is an excellent indicator for an emerging market. In comparison, 66 deals with venture capital participation were done in Ukraine\(^3\) and 56 in Lithuania\(^4\) in 2015. Investors were offered to pick the factors of paramount importance with a significant impact upon their investment decision. The major ones include the team, return on investment, technological innovation (Figure 3).

**Figure 3. Key factors influencing investment decision**

<table>
<thead>
<tr>
<th>Factor</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>3.6%</td>
</tr>
<tr>
<td>Business idea</td>
<td>35.7%</td>
</tr>
<tr>
<td>Scalable business model</td>
<td>50%</td>
</tr>
<tr>
<td>International development prospects</td>
<td>50%</td>
</tr>
<tr>
<td>Technological innovation</td>
<td>53.6%</td>
</tr>
<tr>
<td>Team</td>
<td>64.3%</td>
</tr>
<tr>
<td>Expected return on investment</td>
<td>64.3%</td>
</tr>
</tbody>
</table>

37.3% of Belarusian startups attracted venture capital investment.

**Chart 10. Experience of attracting investments to finance the company’s growth**

- Yes: 37.3%
- None: 62.7%

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3 Ukrainian Venture Capital and Private Equity Overview 2015.
4 Lithuanian startup scene is green but soon to blossom by GoalEurope. June 2016.
Most startups (59.1%) closed rounds at seed stage. Detailed information is presented in Figure 4.

<table>
<thead>
<tr>
<th>Investment Objective</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding a startup for rapid growth in the market</td>
<td>4.5%</td>
</tr>
<tr>
<td>Funding a startup to sell it to a strategic investor and IPO</td>
<td>18.2%</td>
</tr>
<tr>
<td>Funding a startup to maintain early-stage growth and turning a profit</td>
<td>36.4%</td>
</tr>
<tr>
<td>Early-stage funding of a startup with no shaped team yet and product/service at concept level</td>
<td>59.1%</td>
</tr>
<tr>
<td>Early-stage funding of a startup with a shaped team in place and product/service at ‘operational prototype’ level</td>
<td></td>
</tr>
</tbody>
</table>

Seed investments happen at very early stages when the product is in the pipeline, possibly with a prototype available. Seed capital can be channeled to pay for preliminary product development activities, market research and putting a managerial team together. Initial funding comes with the highest risk as the investor sees no actual product and only has preliminary evaluations of the funding project's feasibility to go on. Fundraising options at this level include borrowings from friends, family, business angels, and crowdfunding.

In the US, professional venture companies’ investment into seed capital is normally under $1M. In our region this stage boasts an average deal amount of $100k-300k.

In Russia, seed stage deals in 2016 accounted for 25% (38 of 157) with a mean volume of $200k.1


In Belarus, 27.3% of startups raised $100k-300k, which can be deemed a classical seed stage (Chart 11). Another 13.6% of startups attracted $50k-100k, with 22.7% raising $10k-50k—these can be considered ‘pre-seed’.
Noteworthy is that seed valuation in Belarus is potentially underrated. Such conclusion can stem from the fact that startups themselves evaluated their pre-seed round as a seed one. This means that a seed-stage startup with a prototype or a product in development can raise pre-seed investment, usually under $100k.

As few as 5% of Belarusian startups have raised $1M+ as investment (Chart 11).

60% of startups raised business angels’ funds. As we can see, Belarus is in line with the global trend: the most active early-stage investors are business angels (Figure 5).
Over 62.7% of startups reported no fund-raising attempts despite the need in money (Chart 10). The lack of relevant knowledge and investment attraction experience were mentioned among the major reasons. This goes to demonstrate the shortage of educational programs for Belarusian startups, low activity of the government in the development of special initiatives/programs to foster innovative startup development in the country. The reasons preventing startups from seeking venture capital investment are displayed in Figure 6.

Figure 6. The reasons why startups sought no investment for their development

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>3.3%</td>
</tr>
<tr>
<td>No reasons</td>
<td>12.9%</td>
</tr>
<tr>
<td>No actual need in startup investment</td>
<td>20.8%</td>
</tr>
<tr>
<td>Reluctance to share company ownership with a third party</td>
<td>24.3%</td>
</tr>
<tr>
<td>Reluctance to release control over the company</td>
<td>27.7%</td>
</tr>
<tr>
<td>Preference for other sources of funding</td>
<td>30.3%</td>
</tr>
<tr>
<td>Lack of knowledge and experience</td>
<td>34.7%</td>
</tr>
</tbody>
</table>

Lack of awareness of startups; lack of experience in negotiations with investors; lack of knowledge about how and where to find an investor, how to negotiate and valuate the company; also confirmed by the following data. We asked startups to assess the issues faced by them when raising and receiving investment. The major issues voiced were: searching for a consultant, an investor; complexity of the process of obtaining investment; disagreement as to the company’s valuation process. This demonstrates the need in training for both investors and startups (Table 1).
Table 1. Issues faced by startups when attracting investment

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>SERIOUS</th>
<th>FAIRLY SERIOUS</th>
<th>FAIRLY INSIGNIFICANT</th>
<th>INSIGNIFICANT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Search for information</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Search for a consultant</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Search for an investor</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increasing demand for investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The complexity and workload associated with venture investment process</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consultancy fees, venture investment process cost, misc.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investors’ unwillingness to accept a minority (non-controlling) interest</td>
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</tr>
<tr>
<td>Significant disagreement with investors regarding the company’s valuation</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Significant differences with investors regarding business operation principles</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fear of not meeting the investor’s ROI expectations</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fear of not meeting investor’s other expectations</td>
<td></td>
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</tbody>
</table>
Accordingly, only 24.6% of startups evaluated investment access as ‘good’ (Chart 12).

Over a half of all deals have been structured abroad. 77.1% of the venture ecosystem members believe that over a half of all deals were have been structured abroad. 87.1% of investors, 78.5% of startups, and 66.7% of support organizations maintain this opinion (Chart 13).
Belarus is a growing market: local investors are prepared to invest in startups; startups are planning to attract venture funding.

Over 80% of domestic investors are prepared to invest in startups (Chart 14). Over 40% of investors plan to invest $500k+ into tech startups in the coming years. Business angels are rather active. 18.6% of investors are prepared to invest up to $100k (Chart 15).
40% of investors are prepared to invest $500k per annum. (Chart 15). This enables estimation of the Belarusian investment market capacity at $100M/year. This figure is rather comparable with the market volume in neighboring countries, such as Ukraine, Lithuania and Latvia.

So-called ‘super angels’ may emerge in Belarus, investing hundreds of thousands and millions of US dollars into innovative products. At the same time, given favorable institutional framework development, there is a potential for early- and following stages venture capital funds to emerge.

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For your reference: European business angels invest an average of €20k/year. Deal amounts range from €10k in Lithuania, €20-22k in the UK, Spain and Germany (European leaders for business angel investment) up to €66k in Finland and Estonia and €10k in Russia and Denmark.

1 Nation of Angels Report.

These plans coincide with the needs of Belarusian startups—79.5% intend to raise investors’ money. 22.7% of startups plan to attract over $500k in the next three years (Chart 16).
20.6% of startups need next-stage investment of $1M+ (Chart 17).

80% of startups are prepared to spend substantially more time on fund-raising vs. getting a loan (Figure 7).

**Chart 17. Startups’ potential investment appetite estimates**

![Pie chart showing investment appetite estimates]

- 33.8% for $10k-30k
- 19.1% for $30k-100k
- 16.2% for $100k-300k
- 5.9% for $300k-$1M
- 4.4% for $1M+
- No response

**Figure 7. In case investment is provided, startups (founders) are prepared:**

- to leave the company after several years: 36.2%
- to promise at least a 30% ROI: 40.2%
- to concede a share in the company: 41.9%
- to include investor in the board of Directors: 48.8%
- to accept company valuation based on the industry's comparative analysis and the company’s financial performance rather than on its future growth potential: 55%
- to spend significantly more time on fund-raising: 77.5%
Most attractive sectors for Belarusian venture investors include artificial intelligence (AI), Financial Technologies (FinTech), as well as healthcare and healthy lifestyle Technologies (Healthtech). Detailed information is represented in Figure 8.

This trend coincides with the international one. In 2016 in Europe most investment went into start-ups in FinTech, Health, Music, Fashion, and Travel\(^1\).

The majority of investors expect a 30%+ ROI (Chart 18).

\(^1\) European Tech Funding Report 2016 by TechEU.
A fund is deemed successful if it ensures a profitability of 20% for portfolio investments a year. At the same time, venture funds strive toward maximum payback from each deal (10x20x ROI). If a company is unable to yield at least a 5x-10x profit ratio, it is unlikely to substantially contribute to the fund’s income. Therefore, venture capitalists target such ratios from each deal they enter. Certainly, large profits from successful companies are a must, as a big share of startups fail.

Venture capital investment is by its nature a risky investment business. The so-called “2-6x(2:4)-2” arrangement is typical for venture investment, where out of 10 companies invested into...
- two fail (cease to exist already in the first year after first investment);
- two out of the next six become “neither alive nor dead”, i.e. their chances for success or failure are unclear;
- four ensure moderate (industry average) profitability;
- and finally, the last two are outstanding, yield very high (hundreds of percent) returns, and it is exactly them who provide decent payoff to a venture fund across its entire investment portfolio.
VENTURE ECOSYSTEM THROUGH INVESTORS’ EYES
75.7% of investors believe that labor resources are a positive factor for investing in Belarus. Detailed breakdown of other positive factors voiced by the investors is represented in Figure 9.

Figure 9. The most favorable factors for investing in the Republic of Belarus (as perceived by investors)

- Direct access to EAEU (Eurasian Economic Union) and CIS markets: 38.1%
- Potential is seen in low competition throughout the economy and in growth opportunities: 39.0%
- Labor resources—highly skilled, hardworking, inexpensive workforce: 75.7%
- Geographic location of Belarus: 23.1%
- Significant tax and other benefits for certain categories of entities: 18.1%
- Other: 5.7%
- Effective reforms aimed at enhancing the business environment: 2.7%
- Availability of sufficient investment protection guarantees for investors: 1.5%
- Effective system of public administration: 1.5%
- Effective innovation structure: 1.5%
- Effective judicial system: 1.5%
- Geographic location of Belarus: 23.1%
The opinions of all three respondent groups regarding the investment climate, its reforms and guarantees to investors coincide and generally suggest skepticism towards the investment climate. This attitude is especially pronounced among investors and startups. Being mindful of this study’s focus on venture ecosystem, we should also consider the fact that the latter also is an essential part of the investment environment. Venture funding development is impossible without significant shifts in (potential) investors’ attitude toward business and investment climate in Belarus.

For this reason we asked the respondents in all groups to assess the investment climate, its reforms, as well as guarantees to investors (Charts 19-21).

Only 8.6% of venture ecosystem members believe that a favorable investment climate has been established in Belarus. Over a half (54.6%) characterized the investment climate as ‘unfavorable.’

**Chart 19. Assessing Belarusian investment climate**

- 14.5% of respondents believe that favorable conditions for business management and development have been ensured, favorable investment climate has been created.
- 35.5% think that the current business environment and investment climate are generally okay, but tackling some of the existing difficulties consumes extra human and financial resources.
- 40.1% consider that the current business environment and investment climate are no good and require significant improvement.
- 8.6% see that existing conditions and investment climate affect business, hamper the development of business initiatives, and require major overhauling.
- 1.3% of respondents marked ‘other.’

12.9% of the venture ecosystem members assess the reforms positively. 20.6% see no reforms (Chart 20).
Chart 20. Assessing the nature of reforms underway in Belarus aimed at investment climate improvement

- **Positive**: Largely positive, but ongoing reforms do not enable active development of Belarusian companies
- **Largely Positive, but ongoing reforms do not enable active development of Belarusian companies**: 28.4%
- **Negative, but ongoing reforms have generally not been detrimental to Belarusian companies’ development**: 25.2%
- **Negative: our company is considering wrapping up or moving to a country with more favorable conditions**: 12.9%
- **I see no reforms**: 3.2%
- **Other**: 9.7%

And roughly equal (13.5%) portion of the ecosystem’s entities believe that investors enjoy sufficient guarantees (Chart 21).

Chart 21. Assessing investors’ rights protection in Belarus

- **Sufficient guarantees available in current legislation**: 4.5%
- **Sufficient guarantees exist only in some industries**: 13.5%
- **The level of guarantees is insufficient**: 21.3%
- **Legislation provides sufficient guarantees, but law enforcement practices leave much to be desired**: 21.3%
- **Other**: 39.3%
LEGAL ASPECTS OF VENTURE CAPITAL INVESTMENT
According to the majority of respondents, Belarus completely lacks any legislation on venture deals. Most respondents (54.1%) have indicated their complete unawareness of venture activity legislation in Belarus (Chart 22).

**Chart 22. Assessing Belarusian venture legislation**

- Positive: 6.3%
- Mostly positive: 6.3%
- Mostly negative: 8.1%
- Negative: 25.2%
- I am unaware of such legislation: 54.1%

**FYI**


The definition of a ‘venture organization’ is stipulated in Decree No. 1 (see Glossary, p. 10). Such definition facilitates neither registration of venture organizations as innovative infrastructure entities nor their entitlement to tax benefits.

In many countries with a developed venture funding market, governments actively promote innovative activity, inter alia through the development of venture funding legislation and
financial support rendered to venture capital entities. The experience of Israel, Singapore and the EU countries highlights the constructive role of a state-financed ‘fund of funds’ creation that contributes money to venture funds alongside other investors, including foreign ones. In the UK, the public venture fund also provides direct investment for innovative businesses.

However, current Belarusian legislation indicates no governmental activity in venture funding development.

Over a half of respondents (60.7%) use foreign law when structuring venture deals. English law is the top popular foreign jurisdiction (60.7%). That notwithstanding, respondents substantiating their choice of foreign jurisdiction noted that “if there had been an opportunity to follow their deals through relying on Belarusian law (from the investment protection standpoint), they would have been doing them under Belarusian legislation”, and also that “they do not trust Belarusian jurisdiction because of its unpredictability, obsolete and poorly enforceable laws.”

21.4% of deals are executed “on the word of honor” (Figure 10).
According to the respondents, many instruments used in international venture investment practice need to be settled at the level of Belarusian legislative framework (Figure 11). The investors indicated their preference toward such instruments as convertible loan (71.4%) and options (60.7%), as well as several others (Figure 11) when entering venture funding contracts in Belarus.

Current funding practices show national investors using convertible loans (64.3%), options (42.9%) and other tools for deal structuring abroad (Figure 11).

In line with global tendencies in venture funding regulation, Russian Federation’s commercial and corporate law, its Civil Code (hereinafter ‘CCRF’) have already implemented such instruments as indemnity/compensation of losses (CCRF’s Art. 406.1), representations (CCRF’s Art. 431.2), and options (CCRF’s Articles 429.2, 429.3).

Investors cited the complete lack of instruments common in international practice (convertible loans, options, indemnities, tag along, drag along etc.) for venture project structuring, and judicial practice as key bottlenecks hampering the implementation of venture projects and venture deals in Belarus.

Figure 12 outlines the barriers to venture deal execution in Belarus as identified by investors. The interviewed respondents highlighted several other factors complicating the implementation of venture projects and execution of venture deals, such as:

- excessive interference of supervisory authorities into economic entities’ activity;
- inability to implement venture projects and do venture deals in Belarus;
- lack of trust in the judicial system.

All ecosystem members noted the need for reforms geared toward its development.
Figure 11. In your opinion, which of the listed instruments need to be codified in Belarusian legislation?

- Other: 28.6%
- At company reorganization: 28.6%
- At company liquidation: 32.1%
- When selling off core assets: 32.1%
- Call option: 39.3%
- At sale of 100% of stocks/shares: 42.9%
- Put option: 42.9%
- Option program for management and key staff: 46.4%
- Lockup period for founders: 46.4%
- Indemnity: 50%
- Liquidation preference: 53.6%
- Warranties and representations: 57.1%
- Tag along: 57.1%
- Drag along: 60.7%
- Options: 71.4%
- Convertible loan: 71.4%
Figure 12. Factors complicating the implementation of venture projects and execution of venture deals in Belarus (as cited by investors)

- Insufficient number of startup support organizations: 10.7%
- Lack of competent lawyers: 10.7%
- Taxation system level: 21.4%
- Barriers stemming out of the governmental regulation of venture activity: 21.4%
- Small market size and other purely economic factors: 25%
- Formal barriers in foreign economic activity legislation that prevent cross-border commercialization of intellectual property rights from the territory of Belarus: 25%
- Insufficient number of investors: 32.1%
- Low level of property rights protection: 35.2%
- Low level of trust in the judicial system: 42.9%
- Insufficient number of interesting projects: 53.6%
- Venture deal structuring under the Belarusian legislation to guarantee investor's rights is largely unclear: 75%
- Legislative gap in terms of internationally common venture projects structuring instruments (convertible loans, options, indemnities, tag along, drag along etc.): 78.6%
- Lack of judicial practice on the matters related to the contractual use of internationally widespread instruments for venture project structuring: 78.6%
The majority of respondents would have preferred a foreign jurisdiction for venture deals. The list of top popular jurisdictions includes Israel, Estonia, Cyprus, the USA with developed venture ecosystems.

**Figure 13. Countries where you would move your business if given the chance**

- Latvia: 3.7%
- Poland: 5.7%
- Singapore: 11.4%
- Would have stayed in Belarus: 12.2%
- Other: 13%
- Russia: 13.4%
- Lithuania: 14.4%
- Israel: 27.8%
- Estonia: 30%
- Cyprus: 41.8%
- The USA: 45.8%

Key reasons in favor of a foreign jurisdiction, as voiced by the investors:
- difficulties in structuring venture investments relying upon Belarusian law (82.1%);
- developed corporate and tax legislation;
- more developed corporate legislation available in foreign jurisdictions (78.6%);
- a more convenient tax system available in foreign jurisdictions (46.4%).

Further reasons to choose a foreign jurisdiction are represented in Figure 14.
On top of that, respondents highlighted the factors appealing to them in foreign legislations, particularly:

- ability to structure deals in a flexible manner, to stipulate legally required conditions;
- developed corporate and tax legislation;
- advantageous taxation;
- developed judicial practice, no nationalization or confiscation (seizure of property);
- ability to conduct clear funding “rounds”.

**Figure 14. Investors’ reasoning behind choosing a foreign jurisdiction**

- Everybody does that: 10.7%
- Ability to repatriate the profits: 21.4%
- Access to finance: 35.7%
- All agreements between the parties will be legal and enforceable: 39.3%
- More convenient tax system: 46.4%
- This is required to attract a foreign investor: 46.6%
- Court rulings are predictable, the judicial system is effective and credible: 57.1%
- More developed corporate legislation, availability of effective mechanisms to ensure exit from venture projects: 78.6%
- Structuring venture investment under Belarusian law is unclear: 82.1%
REQUIRED IMPROVEMENTS
On top of that, respondents highlighted the factors appealing to them in foreign legislations, particularly:
- ability to conduct clear funding “rounds”.
- accepted in foreign jurisdictions into Belarusian legislation to facilitate venture funding development, as well as to amend current legislation in the following domains:
  - improved legislation on shareholder agreements and contracts to exercise the rights of LLC participants;
  - commercial law (implementation into the Belarusian legislation of such instruments as convertible loan, indemnity, warranties and representations);
  - non-compete and non-solicitation agreements;
  - tax legislation (developing the system of tax benefits and preferences, as well as other general proposals to boost venture funding

Basic rules of play should be prescribed for all the key stages in venture funding process (at this point, they are either non-existent or lack full consideration for the industry's specifics).”

The analysis of respondents’ answers indicates the need to codify the institutions commonly accepted in foreign jurisdictions into Belarusian legislation to facilitate venture funding development, as well as to amend current legislation in the following domains:
- state regulation of venture activity;
- corporate law (implementation into the Belarusian legislation of such instruments as put options, call options, option programs for the management and key staff; liquidation preference at 100% sale of stocks/shares; liquidation preference at company’s dissolution, sale of core assets, reorganization; tag along, drag along, lockup period for founders;
- improved legislation on shareholder agreements and contracts to exercise the rights of LLC participants;
measures of state support granted to venture activity entities):
  ▶ criminal law (decriminalization of illegal entrepreneurial activity—Art. 233 under the Criminal Code of the Republic of Belarus):
  ▶ commercialization and economic engagement of intellectual property assets created within state initiatives on the premises of various research institutes.

Under the Republic of Belarus’ 2016-2020 Socio-Economic Development Program approved by Presidential Decree No. 466 dd. December 15, 2016, a number of legislative acts is to be drafted and adopted to envisage new sources of funding, including the establishment of a collective investment institution and venture funding system development.

The most developed jurisdictions in terms of venture funding (the USA, China, the UK, Germany, Israel, Singapore, South Korea, Malaysia, Canada, India) are quite active and successful in their employment of various instruments in commercial and corporate law that attract potential investors.

Studying the Russian Federation's experience along with that of other foreign nations is deemed interesting for Belarus due to the similarity between legal systems. The analysis of current Russian venture funding legislation can clearly demonstrate the mechanisms to implement common law concepts into the civil law framework.

Alongside with that, the Russian legislation is yet to codify such most commonly used venture investment means as convertible loan. Also missing are such instruments as lockup period for founders, liquidation preference at company, dissolution, sale of key assets, and/or reorganization.

Practitioners believe that legislative provisions on options require considerable amendment. The Russian Federation is currently planning to develop a legislative framework to enable the conclusion of non-compete and non-solicitation agreement. The Belarusian legislation does not enable the execution of such agreements.
Among the principal disadvantages of Belarusian corporate law is inadequate legal regulation of shareholder agreements and agreements to implement the LLC participants’ rights. For example, comprehensive flexible provisions—fully compliant with international practices—in contracts on the exercise of LLC participants’ rights are not an option (for example, the company itself, its future participants and other persons cannot be parties to such agreements; the scope of provisions permitted therein is legally restricted, too), which seriously hinders their use in venture projects.

The implementation of the aforementioned instruments widely employed in international practice seems apparently relevant, also based on feedback from respondents during personal interviews. They pointed out that foreign jurisdictions are appealing for investment due to their more developed (compared to Belarus) corporate law and availability of well-known instruments used worldwide; these factors are instrumental in their investment decision-making. That said, the respondents also noted that “an investor will refuse to invest when common venture instruments are absent in the legislation.”

“Abolishing corporate legislation restrictions to enable structuring of a wide range of venture investments. Decriminalizing economic crimes, including illegal entrepreneurial activity.”
International experience suggests that one of the key incentives for venture investment development are tax benefits and preferences, as well as other state support measures.

The important role of tax benefits in shaping venture infrastructure is exemplified by Singapore where venture investment risks are shared through a tech investment support program that provides an opportunity to insure investors in startups against potential losses. A startup awarded special status is entitled to issue a certificate for its investors to invest over SGD 3M. Investors is possession of such certificates can deduct any investment-related losses from their taxable income during validity period of these securities.

In the UK, China and Canada, tax benefits to venture capital investors are provided as deductions from capital gains tax. Noteworthy is the fact that it was exactly corporate tax cut in Ireland that contributed to the strong economic growth of the nation’s economy, which was called “the leap of the Celtic Tiger” and attracted such international corporations as Apple Inc., Google Inc., Microsoft Corporation into the country.

61.8% of respondents believe that individuals wishing to engage in venture activity in Belarus should receive tax benefits (other benefits and preferences) (Chart 23). During the interview, the respondents noted the need for:

- tax legislation amendment (different taxation of profits resulting out of venture investment);
- the consideration of losses in tax accounting;
- the investment amount should not be taxed;
- “tax break” introduction;
- duty-free import of equipment and its prompt customs clearance.
Additionally, the majority of respondents named more convenient taxation systems in foreign jurisdictions one of principal reasons to choose a foreign jurisdiction when investing (46.4%). It was also pointed out that the taxation system and more developed tax legislation are among the appealing factors of foreign jurisdictions (Figure 14 on p. 47).

Studying foreign experience of tax incentives for venture business, as well as of other public support measures seen in the USA, China, the UK, Israel, Singapore, South Korea, Malaysia, Canada, Ireland, is rather relevant for our country.

Such research will enable the shaping of our own effective model for taxation and rendering other state support measures to venture activity entities in Belarus.

4 CRIMINAL LAW

Legislation on criminal and administrative liability is of paramount importance to investors. In this regard, laws and law enforcement must be prepared to propose a legal framework for business operation not-inferior to legal mechanisms of progressive foreign economies in terms of transparency, predictability and fairness.
The interviewees indicated the need to abolish criminal liability for illegal entrepreneurial activity stipulated in Art. 233 of the Belarusian Criminal Code, supplying such proposal with a comment, "its impact on the motivation to do business is devastating (business is a risk per se)."

"To ensure (actual) guarantee of private property rights. To abolish confiscation (seizure of property) as an administrative liability measure. To rescind criminal liability for economic violations and illegal entrepreneurial activity. To ensure consistency of investment policy."

A feasibility study for illegal entrepreneurial activity decriminalization in Belarus is deemed rather relevant, as the legislation of some foreign countries with developed venture funding industry (e.g. the USA) envisages no criminal liability for illegal entrepreneurial activity.

"To strengthen the mechanisms of ownership right protection. Abolish the unreasonable use of subsidiary liability. Waive criminal liability for illegal entrepreneurial activity."
The conducted research is highly important for all venture ecosystem entities, as it is the first experience of gaging key stakeholders’ opinions on venture funding market development in Belarus. The outcomes obtained have enabled the identification of current issues faced by market players and drawing up recommendations for the ecosystem’s further development, enhancing its informational integrity and openness.

Belarus does have a potential for venture funding development. It is demonstrated by investor activity over the past three years and the need in funding of a growing number of early-stage startups. Despite the underdeveloped ecosystem, Belarus is not lagging too far behind the countries in the region by a number of indicators (deals count, market capacity, investors’ potential, top popular sectors).

At the same time, most deals involving Belarusian startups and investors are structured abroad. The study has shed light upon the key factors contributing to such situation. One of the most important aspects impeding venture activity in our country is the lack of the legislative base compliant with best global practices that would have facilitated favorable conditions for venture industry development.

Moreover, an obstacle to growth is the lack of educational programs geared toward startups and investors, no state support initiatives for early-stage startups when the investors’ risks are the highest.

The study’s outcomes will help create a system of basic indicators for the Belarusian venture ecosystem and identify the most burning issues faced by high-risk startups and investors in Belarus. Repeated research can become a tool to monitor the effectiveness of legislative initiatives for venture funding development in Belarus.
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