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Firuz Dustov

Tashkent State University of Economics
PhD student

PROSPECTS FOR THE DEVELOPMENT OF VENTURE FINANCING IN UZBEKISTAN

Abstract: The paper examines the prospects for the development of venture financing in innovative activities. The author makes a comparative analysis of global trends, regional prospects of venture financing, foreign experience, the factors influencing venture financing in the Republic and the prospects for development. Based on the findings, developed scientific proposals and recommendations for improving venture financing in Uzbekistan.

Key words: innovation, venture, investment, startup, risk, venture capital, commercialization, business angels, venture investor, venture funds, innovation market, private sector, venture capital market.

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Introduction

One of the most important tasks of economic policy is the formation of an innovation-oriented economy.

Despite a number of positive steps taken in this direction, the development of innovative activities in Uzbekistan is insufficient. Currently, there are a number of problems hindering the development of innovation, one of the main of which is the lack of funding for innovation, the lack of multi-channel financing system and financing infrastructure, low use of market mechanisms for financing innovative projects and startups.

One such market mechanism is venture financing, although the first steps have been taken in this direction in Uzbekistan. the venture capital market remains in the formative stage.

In this regard, the purpose of this article is to form an author's conclusion on the factors and prospects for the development of venture financing in the Republic and to develop scientific proposals and recommendations for improving venture financing in Uzbekistan.

To achieve this goal, the study sets tasks such as global trends in venture financing, regional prospects, comparative analysis of foreign experience, study of factors influencing venture financing in the country,

development of scientific proposals and recommendations to improve venture financing in Uzbekistan.

Analysis of the relevant literature

The theoretical and methodological aspects of venture financing and venture capital have been extensively studied by foreign and local scholars, some of which we will focus on.

The term "innovative potential of the system" was coined by E. Rodgers, one of the founders of innovation, who understood the term as the ability to create, receive, implement innovations of any system, as well as get rid of obsolete, obsolete in a timely manner [1].

Kozlovskaya E.A, Rodionova Yu.V. defined the concept of commercialization of innovations, in which "the allocation of funds for innovation and management of this process, including the organization and coordination of public innovation activities, monitoring and evaluation of allocated funds, the transfer of completed and mastered results of innovation to production and reproduction of innovative products." [2]

From Uzbek scientists D.G' Gozibekov in his scientific monograph "Issues of investment financing" [3], studied venture financing as an unconventional

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method of investment financing - market mechanisms. However, it has not conducted in-depth research as an effective mechanism for financing innovative projects.

Professor N.G Karimov's monograph "Issues of introducing a market mechanism for financing investment activities in the context of economic integration" [4] explores venture financing as an alternative method of investment financing, focusing on the importance, advantages and development of this financing in Uzbekistan. He made his scientific and practical proposals on improving venture financing as a market mechanism for financing innovation and investment.

From local researchers Atamurodov Sh. A in his research, he states the following about funding innovation: "For each country on the world stage, it is typical to use only one specific financing model of high-tech invention and innovative technologies. The choice of the most effective model for a particular country should be based on the country's innovative system, infrastructure, scale and characteristics of the region's economy, as well as the situation on the world market, as well as the country's innovation resources and conditions such as the region's business potential, the level of market development and the human factor are taken into account"[5].

Another local researcher, Ruzieva D. I. in her research "...a start-up entrepreneur, researcher, inventor will need funds to independently implement their ideas and promising developments. At the same time, the venture fund will be the only investor willing to invest in new developments."[6]

From the above-mentioned researchers' research, the author compares the development trends of venture financing in recent years, factors influencing venture financing, the level of startup projects, the role of business angels in project financing, problems in venture financing and ways to develop them.

Research methodology

The methodology of this article consists of deduction, abstraction, classification, generalization, comparative, theoretical interpretation and analytical methods, and as a result of their use and bibliographic study developed recommendations on how to effectively use the mechanism of venture financing in the development of innovation in Uzbekistan.

Analysis and results

We begin the analytical part of our research by studying the recent work and current trends in the field of venture financing in the Central Asian region, and in particular in Uzbekistan.

The realities of the 2020 pandemic have changed the situation in venture capital markets around the world. The number of startups, as well as the amount of funding for them, has increased significantly, CB Insights International according to the data, the figure grew by 15 percent to \$ 259 billion. At the same time,

we can observe that the volume of funding in Asia increased by 28% compared to 2019, and during this period *HealthTech*, *DeepTech*, *geyminga*, we can observe that startups in the field of delivery and logistics are the most popular. In 2021, this growth trend continued, in particular, *Crunchbase* According to the data, the volume of venture capital investments in January 2021 reached \$ 39.9 billion, which is almost twice as much as in the same period in 2020. In the following months, the situation was repeated: in February alone, investors invested an average of \$ 1.7 billion in companies every day.

In the Central Asian region, too, such growth trends can be observed, for example, alone As of August 2020, more than \$ 2 million worth of venture investment transactions have been concluded on the platform of the Astana International Financial Center. At the same time, for the first time in the CIS, a convertible credit instrument based on the principles of English law was used.

Of course, it is gratifying that the regional venture capital market is developing and private funds are emerging, and ultimately there are interesting projects, and accordingly, investors see the potential in this regard. It is also important that many startup projects are being developed in the Central Asian region, and as a result, a market for startup projects is being formed and a competitive environment is emerging.

Also, the second trend in the market of startup projects is that the quality of startups is improving. At the same time, we mean, first of all, startups from Kyrgyzstan, Kazakhstan and Uzbekistan. positive, i.e. has a positive financial position and growth. Such projects may clearly require the attention of venture investors. One of the brightest examples of such projects is the Watermelon project, which is currently planning to enter the world market. Among such projects is the Edumarket platform, which specializes in various educational products for children in Uzbekistan.

In our opinion, the third trend in Central Asia is the entry of foreign players into our market, such as Sturgeon Capital, Salt Ventures, EDB Ventures, Quest Ventures and others. This makes the region interesting and attractive.

It is also important to note that in the countries of the Central Asian region, there is a dialogue between clubs, foundations, associations and incubators, and a trend called "regionalization" is emerging between them.

We continue our research by analyzing the issue of venture financing in the Republic of Uzbekistan it will be necessary to clarify an important issue first. Venture financing has been recognized as one of the most effective ways to finance innovative projects, and the theory has been put forward that the development of venture financing practices will stimulate the innovative development of the country's

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economy. This begs the question, does venture capital drive the growth of innovation, or conversely does the increase in innovation serve to increase the source of this type of funding by increasing the demand for venture capital?

There is no consensus on this in the scientific literature. We have seen in the literature review of our article that while some scholars have proven in their econometric analyzes that venture capital encourages increased innovation, another group of scholars has cited the “venture after innovation” theory based on econometric analysis.

In our opinion, there is an opportunity to increase the level of innovation through the development of venture practice in countries such as Uzbekistan, where venture practice is not yet developed. One thing is clear, however, that these two variables are inextricably linked, and the main purpose of this study is not to determine which variable causes which variable to develop. In this regard, research will be conducted with a comprehensive approach to this issue.

Uzbekistan is the largest economy in Central Asia, with an average economic growth of 5.5% over the past five years. Since 2017, reforms have been implemented in almost all sectors of the economy. In

particular, the liberalization of financial markets, especially currency liberalization, has led to significant growth in this sector.

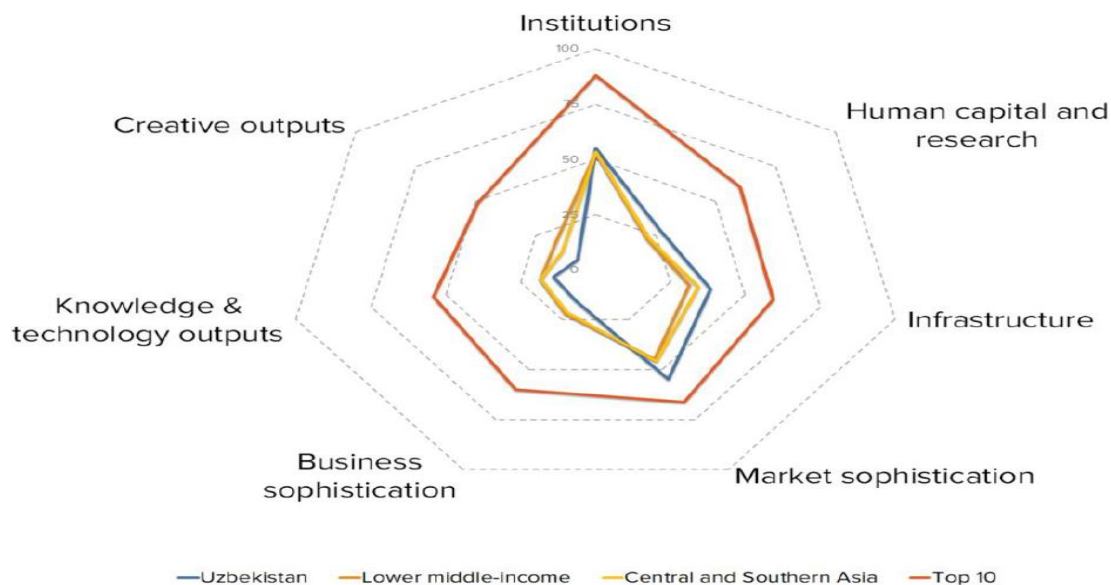
Along with important structural reforms to improve the living standards of the population, it was recognized that the country has the potential to develop through innovation, and the government has set high goals to be among the “most innovative economies (top 50)” by 2030.¹

However, an analysis of the country's achievements in the field of innovation in recent years shows that there is still much to be done in this area.

In particular, in the Global Innovation Index (Global Innovation Index)² In 2020, Uzbekistan ranked 93rd out of 131 countries with a score of 24.5 (maximum score 100), which is much lower than the average score of the leading countries (57.8).

The report, published by the rating agency, notes that Uzbekistan has produced less innovation in terms of investment. There is also no information on venture financing agreements that are considered important for this study. In our opinion, this situation has a negative impact on the decision of foreign investment companies and venture funds to enter the Uzbek market.

Image 1. Comparison of Uzbekistan with other low-income countries and Central and South Asian countries



Source: Global Innovation Index 2020

At the same time, as a result of the analysis of the specifics of the economy of the country, it was

¹Decree of the President of the Republic of Uzbekistan "On approval of the Strategy of innovative development of the Republic of Uzbekistan for 2019-2021". September 21, 2018 // Lex.uz

²The Global Innovation Index (GII) ranks world economies according to their innovation capabilities consisting of roughly 80 indicators, grouped into innovation inputs and outputs.

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identified that the development is hindering the development of innovative, innovative financing practices.

First, high share of the state in the economy, state enterprises produce the bulk of the country's GDP. These types of businesses usually do not invest in innovation. They are also slow to introduce innovative technologies into their activities, as a result of which the demand for innovative projects and investments in them remains low. This, in turn, requires accelerating the privatization process that has begun in the country and accelerating structural reforms.

Second, the dependence of the country's economy on raw materials. The mining industry plays an important role in the country, in particular, the mining industry accounts for about 40 percent of the gross value added of the industry. In addition, 40-50% of direct investments in recent years have been directed to the mining industry.

In our view, the dependence of the economy on raw materials does not provide additional incentives for innovative development.

Third, the high level of monopoly in the country and the weakness of the free competitive environment, as well as the breadth of the shadow economy. The protectionist support of some manufacturers in the country, the provision of exclusive state benefits leads to a decrease in the desire of enterprises to innovate.

In general, the concepts of "venture investment", "venture capital", "venture business" began to gain popularity in Uzbekistan in 2017 after the start of reforms under the "Strategy of Action".

Venture capital is still making its first steps today and lagging behind a number of developed countries.

The development of this sector began with the creation of a legal framework. On November 24, 2018, the Decree of the President of the Republic of Uzbekistan "On additional measures to improve the mechanisms of financing projects in the field of entrepreneurship and innovation" was signed. In accordance with this decree, in order to develop venture financing, a draft Regulation "On Investment and Management Companies" was developed and approved by the Cabinet of Ministers on May 17, 2019 No 414. As part of the implementation of the tasks provided for in these regulations, the state has established 1 (National Venture Fund "UzVC") and 2 private venture funds (MOST Ventures and SEMURG VC).

In accordance with the Resolution of the Cabinet of Ministers of the Republic of Uzbekistan dated November 3, 2020 No 684 "On measures to organize the activities of the National Venture Fund" UzVC "in order to support innovative ideas and startup ecosystems, accelerate the development of innovative infrastructure The initial authorized capital of the

Fund with a charter capital of 15 billion soums was formed at the expense of funds allocated from the budget of the Republic of Uzbekistan in 2020 to the Ministry of Innovation Development of the Republic of Uzbekistan.

Also, the Cabinet of Ministers of the Republic of Uzbekistan adopted a resolution on May 17, 2019 "On the activities of investment and management companies" and published a list of priority innovative, experimental and constructive startup projects recommended by the Ministry of Innovation Development for venture financing.

Today, UzVC National Venture Fund LLC has announced a tender for the transfer of the state share in the charter capital to trust management. Work is also underway to establish a joint venture fund with foreign partners.

The MOST Ventures private venture fund, which has been providing financial and non-financial support to technology entrepreneurs in Central Asia for several years, as well as implementing incubation and acceleration programs in the region, has also started operating in Uzbekistan. The fund focuses on IT startups aiming to create international business.

This year, the fund has allocated 2 mln. It is planned to invest in the amount of USD. Today, the foundation is accelerating the delivery of food to Girgiton and the startup TASS Vision.

SEMURG VC is also a private investment company, which includes a venture fund, aimed at creating and expanding technology startups in the CIS and Venture Builder markets. The Fund will provide \$ 5 million to startups operating in Uzbekistan over the next two years. It aimed to invest in the amount of USD.

At the same time, on May 28, 2021, the UzVC National Venture Fund and UZVCA Uzbekistan Venture Finance Association jointly held the first Central Asian Venture Forum in Uzbekistan on the future development of the venture financing and startup ecosystem in the region and international markets.

During the forum, a memorandum of understanding was signed between the National Venture Fund UzVC and JSC KazTech Ventures of Kazakhstan on the establishment of a joint venture fund.

Despite the results achieved, the financing of startup projects still remains a problem for startup owners. This is also reflected in the results of a survey conducted by Venture Funds Associations.

The survey was conducted among startup founders, and 89% of respondents said that capital is needed today for the development of their startup projects. Mentoring is also an important aspect for them.

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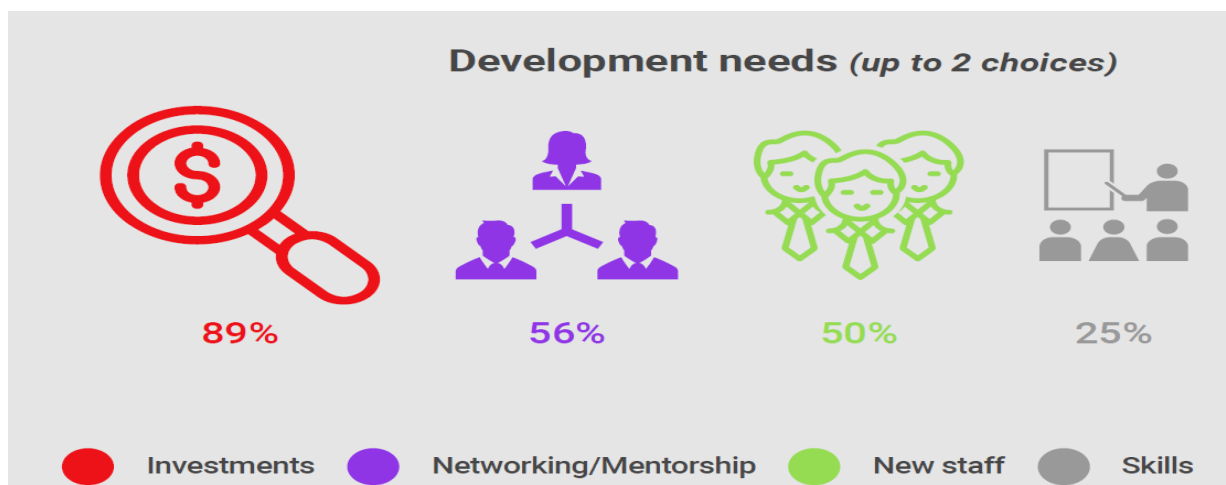


Image 2.

Also, when the founders of the startup were asked to comment on the problems facing the Uzbek market, the majority of respondents (63%) noted the lack of capital offered for development in the market.

At the same time, the indifference of large companies to innovative technologies (53%) and the lack of qualified specialists (47%) are also factors that, in their opinion, hinder development.

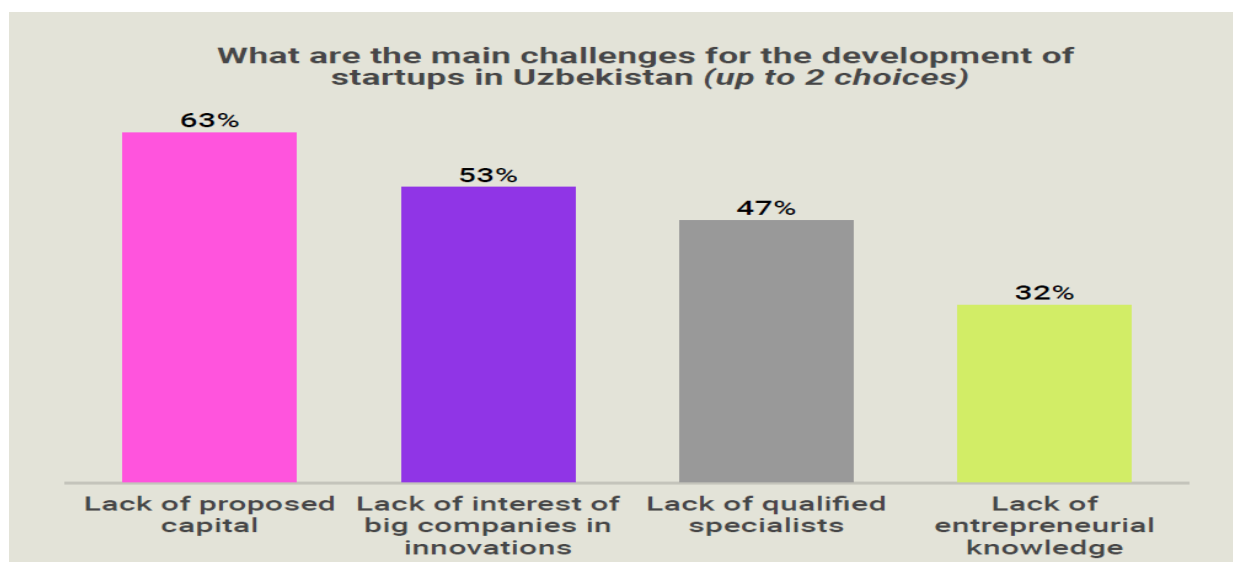


Image 3.

Asked how an investor helps you with non-capital investments, 60 percent of startups said that investors help out with no money, 25 percent help with project strategy and operations, and 15 percent introduce the right people.

This, in turn, is explained by the fact that the main sources of funding for startup projects are the funds of their family members and close acquaintances, as well as funds of business angels.

From the above answers, it is clear that today the sources of institutional funding, ie venture funds and corporate venture capital, are very important for the development of startup projects. In addition to financial investment, these resources provide the necessary knowledge and mentoring programs.

Despite this work, it should be noted that the venture capital market in Uzbekistan is in the process of formation, because in our opinion, on the one hand, the existing legal framework is not fully adapted to protect the interests of investors. On the other hand, the culture of investing and attracting investment in accordance with accepted international standards is just emerging..

Today, as the issue of green economy is becoming one of the most pressing issues in the world economy, it is very important to create conditions for the creation of a venture capital ecosystem.

Of course, in our opinion, the role of the state is important here. In addition to adapting venture funds to local legislation, it is necessary to encourage venture investors to invest, to give them a "shoulder"

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in case of loss of investment and to create a kind of "airbag". Unfortunately, such losses are inevitable.

If we say with a simple example, there is a mountain - it is a startup ecosystem. There are financial risks in our case to climb this. No one will go out there without security materials. The role of the state is important here, but at the same time it should not "lift" itself up to this mountain. After all, officials are not entrepreneurs and, by the way, the state often makes unsuccessful investments in startups.

In our case, the state needs to gather a group of investors, climbers. Climbing is an extreme sport and venture capital is an extreme form of financing. The state should offer helmets, ropes, uniforms for insurance, i.e. tax breaks, subsidies and so on. This is its key role in ecosystem development.

By the way, in no country has the venture capital industry developed without first aid from the state. In the United States, Israel, Southeast Asia and Europe, the state has been the main stimulus for the development of this industry. In the future, as the innovation market develops, the role of the state should be reduced and eventually minimized, so that only private technology entrepreneurs and private venture participants interact in the market.

We know that a venture ecosystem is an important and integral part of an innovative or digital economy. The level of development of this sector will determine what part of the country's GDP will be occupied by new technologies. In the United States, for example, the share of venture capital in GDP is less than 1%, but innovative products and services produced using venture capital account for more than 30% of GDP. The situation is similar in Israel: until 1994, the main share of the country's exports was orange exports. Venture Stimulates Investment Market WRITING "after the implementation of the state program on a large scale, private capital emerged and now the main share of exports is technology exports.

Venture investment is a new direction for the Central Asian region. This requires the creation of a new ecosystem. In addition, in order to attract global investors, it is necessary to have an expert assessment of jurisdictions and startups that meet international standards. To this end, Astana is an international financial center *Venture Rocket Eurasia (VRE)* created a platform. It is a platform for investment and management of startups, the purpose of which was to stimulate the development of the venture ecosystem in the Central Asian region. The main idea of this platform is to bring together technology startups, accredited, professional and institutional investors, as well as other participants in the ecosystem from around the world. For investors, this platform is an opportunity to collaborate with approved startups to support their startup portfolio, invest with partners, and access a global network of ecosystem participants.

It is currently a venture investment school in our region VRE began to work on the basis of which online training events for beginners were held. It not only taught the basics of venture financing, but also provided information on potential risks. Because of venture financing, money that is considered a very long-term investment will be "frozen" for 5-7 years, so to speak. And it's a very risky business because, according to statistics, 9 out of 10 startups "die". Therefore, people who invest need to understand what they are getting into.

The role of business or investment angels is very important in the development of venture finance. We know that the founder of venture capital is George Doriot, a professor at Harvard Business School. In 1946, Doriot founded the American Research and Development Corporation (ARDC) - actually one of the world's first venture capital companies. Under this project, it managed to attract an investment of \$ 3.5 million. Since then, venture capital funds have been a major source of funding for startups. However, it is known from world practice that some entrepreneurs, as well as so-called "angel investors" are looking for funds from investors. In fact, they are former owners of large and successful companies that support "young and brave" by funding their projects,

In our opinion, business angels are now people who are looking for a startup from morning till night, enriching their investment portfolio. That is, it is the people or companies that make this activity a profession. In that sense, we still have almost no business angels. We have stakeholders, but so far no one has made it public. The question arises here when an entrepreneur becomes a business angel?

We believe that entrepreneurs should look for ways to invest their capital in a business that can grow tenfold, encourage venture investors, constantly improve their knowledge and skills, as well as professional participants of the financial sector, top managers of corporations, as well as their knowledge and experience. and those who want to spend their money on corporate development may become business angels in the future.

Concluding our research in an optimistic spirit, we would like to say that Silicon Valley in the United States is currently a landmark for all startups around the world. Asked whether Silicon Valley could emerge in Central Asia or Uzbekistan, we still have many unresolved issues related to quality of life, elements of a market economy, and equal access to money and services. For example, 60-65% of the market in our region is now under state control in Uzbekistan, and even more so in Uzbekistan. To create Silicon Valley, it is necessary to invest in the country. Of course, all trends come from there. They are a leader in terms of investment, and if a person wants to conquer the world, they go there.

It is safe to say that investors in our region are now in the era of romance, corporate

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entrepreneurship. I think it ends quickly, people spend a certain amount of millions of dollars, they realize that it's all an illusion, they just can't take an innovative business. It's not that simple. And gradually companies will move on to what all the other companies in the world are doing: they are buying market leaders. Banks are one such strategist. That is, all trunk companies try to do that.

Conclusion

Based on our research, we were able to formulate the following conclusions.

Venture financing, in our opinion, is a high-risk investment on the one hand, an important tool for implementing innovative ideas on the other hand, an optimal link for the integration of science, technology and industry on the third, and finally the basis for economic development.

Although a number of measures have been taken in our region over the past five years to develop venture financing, we can fully say that this sector is in its infancy not only in Uzbekistan, but also in the Central Asian region.

The first steps taken to develop venture capital in Uzbekistan require the implementation of a number of legal, organizational and practical tasks in the future.

As a result of our research, we consider it appropriate to implement the following practical recommendations.

- Adaptation of venture funds to local legislation and encouragement of venture investors to invest and develop a mechanism for hedging investment risks and accelerate the implementation of digitization of the economy and all related tasks;

- take measures to ensure that jurisdictions and startups that meet international standards have an expert assessment;

- The creation of a fundamental and practical basis for the creation of a venture capital ecosystem and the development of regional history, in our opinion, the creation of a regional ecosystem is more promising than the creation of individual ecosystems in each Central Asian country;

- It is important to develop and implement a comprehensive mechanism for the formation of business angels in Uzbekistan and region.

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